FINAL : PAPER - 13

SYLLABUS - 2016

CORPORATE LAWS & COMPLIANCE

FINAL

STUDY NOTES

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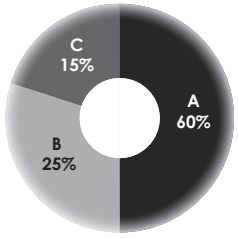
Syllabus - 2016

PAPER 13: CORPORATE LAWS & COMPLIANCE

Syllabus Structure

A	Companies Act	60%
B	Other Corporate Laws	25%
C	Corporate Governance	15%



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, and Corporate Governanace.

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.

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

Section A : Companies Act	
1. The Companies Act, 2013	**50%**
2. Insolvency and Bankrupcy Code, 2016	**10%**
Section B: Other Corporate Laws	**25%**
3. SEBI laws and Regulations	
4. The Competition Act, 2002 and its role in Corporate Governance	
5. Foreign Exchange Management Act, 1999 (Basic Understanding Only)	
6. Laws related to Banking Sector (Basic Understanding Only)	
7. Laws related to Insurance Sector (Basic Understanding Only)	
Section C: Corporate Governance	**15%**
8. Corporate Governance	
9. Social, Environmental and Economic Responsibilities of Business	

SECTION A : COMPANIES ACT 2013 [60 MARKS]

1. The Companies Act, 2013 – 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
(v) Conversion of LLPs into Private Limited Companies and vice versa

(b) Investment and Loans

(i) Procedure for inter-corporate loans, investments, giving off guarantee and security
(ii) Acceptance of deposits, renewal, repayment, default and remedies

(c) 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

(d) Accounts and Audit

(i) Maintenance of Books of Accounts
(ii) Statutory Auditor, Special Auditor and Cost Auditor - Appointment, resignation, removal, qualification, disqualification, rights, duties and liabilities
(iii) Companies Auditor Report Order (CARO) Rules

(e) Board of Directors & Managerial Personnel

(i) Directors and Managerial Personnel - Appointment, Reappointment, Resignation, Removal
(ii) Payment of remuneration to Directors and restrictions on the powers of Directors
(iii) Powers of Board of Directors and Restrictions on the powers of Directors
(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

(f) Board Meetings and Procedures

(i) Board Meetings, Minutes and Registers
(ii) Powers of the Boards
(iii) Corporate Governance & Audit Committee
(iv) Duties & Liabilities of Directors and
(v) Power related to political contributions

(g) Inspection, Inquiry and Investigation

(h) Compromises, arrangements and amalgamations

(i) Prevention of oppression and mis-management

(i) Majority Rule but Minority Protection
(ii) Prevention of Oppression and Mis-management

(j) Revival and Rehabilitation of Sick Industrial Companies

(k) Corporate Winding Up and Dissolution

(i) Kinds of Winding up - Powers of the Court and Official Liquidator

(l) Companies Incorporated outside India

(m) Offences and Penalties

(n) National Company Law Tribunal and Special Courts

2. Insolvency and Bankruptcy Code, 2016

(a) An introduction
(b) Corporate Insolvency Resolution Process
(c) Liquidation of a Corporate Person

SECTION B : Other Corporate Laws

3. SEBI Laws and Regulations

(a) The Securities Exchange Board of India Act, 1992 - Rules, Regulations and Guidelines issued there under Clause 49 and SEBI (Issue of Capital and Disclosures Reguations), 2009
(b) The Securities Contracts (Reguation) Act, 1956

4. The Competition Act, 2002

(a) Competition – Meaning, objectives, extent and applicability
(b) Competition Commission of India
(c) Areas affecting competition

5. Foreign Exchange Management Act, 1999 (Basic understanding only)

(a) Exports, Imports and Foreign Funds under Deferred Payment, ECB Route, Loans and Export Remittance and Import Remittance

6. Laws related to Banking Sector: (Basic understanding only)

(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

7. Laws related to Insurance Sector: (Basic understanding only)

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

SECTION C : Corporate Governance

8. Corporate Governance

(a) Overview-Issues and Concepts
(b) Corporate Governance Practices/Codes in India
(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) E-governance

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Study Note - 1

THE COMPANIES ACT, 2013

PART - A : COMPANIES FORMATION AND CONVERSION

This Study Note includes:

A : 1.1 Incorporation of private companies, public companies, company limited by guarantee and unlimited companies and their conversions/reconversion/re-registration

A : 1.2 Nidhi Companies, Mutual Benefit Funds and Producer Companies - concept, formation, membership, functioning, Dissolution

A : 1.3 Formation of Not-for-Profit making companies

A : 1.4 Procedure relating to Foreign Companies Carrying on Business in India

A : 1.5 Conversion of LLPs into Private Limited Companies and vice versa

A : 1.1 INCORPORATION OF PRIVATE COMPANIES, PUBLIC COMPANIES, COMPANY LIMITED BY GUARANTEE AND UNLIMITED COMPANIES AND THEIR CONVERSIONS/RECONVERSION/RE-REGISTRATION

1.1.1 Introduction

The Companies Act, 2013 consisting of 29 Chapters, 470 Sections and 7 Schedules as against 658 Sections under 13 Parts and 15 schedules in the Companies Act, 1956, was notified partially on 12th September 2013 (55 sections) and partially again on 26th March, 2014 (168 sections with effect from 1.4.2014). Part of the provisions related to National Company Law Tribunal have been notified with effect from 1st June, 2016. The provision relating to Class Action Suits also has been enforced with effect from 1st June, 2016. The jurisdiction in respect of merger and acquisitions and compromises and arrangements under Chapter XV (corresponding to earlier sections 391 – 394 in the previous Companies Act, 1956) still rests with the High Courts.

The Companies Act, 2013 (hereafter 'The Act') consolidates and amends the law relating to the companies in India and replaces the Companies Act, 1956 in phases, which is 56 years old. The new Act intends to improve corporate governance and to further strengthen regulations for the corporate sector with the introduction of key provisions as to Duties and Liabilities of Directors/Independent Directors, Auditor Rotation, Establishment of Serious Fraud Investigation Office (SFIO), Constitution of National Financial Reporting Authority (NFRA), Class Action Suit, Corporate Social Responsibility (CSR) etc.

The Companies Act, 2013 is administered by the Central Government through the Ministry of Corporate Affairs (MCA) and the Offices of Registrar of Companies, Official Liquidators, Public Trustee, Director of Inspection, National Company Law Tribunal (NCLT), National Company Law Appellate Tribunal (NCLAT), etc. The Registrar of Companies (ROC) controls the task of incorporation of new companies and the administration of running companies.

The Ministry of Corporate Affairs, was primarily concerned with administration of the Companies Act, 2013, other allied Acts and rules & regulations framed there under, mainly for regulating the functioning of the corporate sector in accordance with law. Further, the focus of the Ministry's working is not only limited to the Administration of Companies but has increasingly acquired an all inclusive role of addressing a vide sweep of functions like Corporate Governance Reforms and the Emerging Legal Framework.

1.1.2 Definition of company

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

A company may be an incorporated company or a Corporation, or an unincorporated company. An incorporated company is a single and legal (artificial) person distinct from the individuals constituting it, whereas an unincorporated company, such as a partnership, is a mere collection or aggregation of individuals. Therefore, unlike a partnership, a company is a corporate body and a legal person having status and personality distinct and separate from that of the members constituting it.

1.1.3 Characteristics/Advantages of company

1.1.3.1 Independent corporate existence

The outstanding feature of a company is its independent corporate existence. It is a distinct legal person existing independent of its members. By incorporation under the Act, the company is vested with a corporate personality which is distinct from the members who compose it.

A well-known illustration of this principle is the decision of the House of Lords in Salomon v. Salomon & Co. [(1898) AC 22].

1.1.3.2 Limited Liability

The privilege of limiting liability for business debts is one of the principal advantages of doing business under the corporate form of organization. Where the subscribers exercise the choice of registering the company with limited liability, the members' liability becomes limited or restricted to the nominal value of the shares taken by them or the amount guaranteed by them. No member is bound to contribute anything more than the nominal value of the shares held by him.

1.1.3.3 Perpetual succession

An incorporated company never dies. It is an entity with perpetual succession. Perpetual succession, means that the membership of a company may keep changing from time to time, but that does not affect the company's continuity. The death or insolvency of individual members does not, in any way affect the corporate existence of the company. [Gopalpur Tea Co. Ltd. v. Penhok Tea Co. Ltd. (1982) 52 Comp. Cas. 238 (Cal.)] "Members may come and go but the company can go on forever".

It continues to exist even if all its human members are dead. Even where during the war all the members of a private company, while in general meeting, were killed by a bomb, the company survived not even a hydrogen bomb could have destroyed it. [K'9 Meat Supplies (Guildford) Ltd., Re 1966 (3) All. ER 320.]

1.1.3.4 Separate property

A company, being a legal person, is capable of owning, enjoying and disposing of property in its own name. The company becomes the owner of its capital and assets. The shareholders are not the several or joint owners of the company's property. The company is the real person in which all its property is vested, and by which is controlled, managed and disposed of [Bacha F Guzdar v. C.I.T. AIR 1955 SC 74.]. The property is vested in the company as a body corporate, and no changes of individual membership affect the title. The property, however much, the shareholders may come and to remains vested in the company, and the company can convey, assign, mortgage, or otherwise deal with it irrespective of these mutations.

1.1.3.5 Transferable Shares

When joint stock companies were established the great object was that their shares should be capable of being easily transferred. Accordingly, the Companies Act, 2013 in Section 44 declares: 'The shares or debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company'. Thus incorporation enables a member to sell his shares in the open market and to get back his investment without having to withdraw the money from the company. This provides liquidity to the investor and stability to the company.

1.1.3.6 Common seal

Since the company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal acts as the official signature of the company. Prior to the Companies (Amendment) Act, 2015 the common seal is a seal used by a corporation as the symbol of its incorporation and also a statutory requirement for a company. As a departure from this concept, the Companies (Amendment) Act, 2015 has deleted the requirement of having Common Seal compulsorily.

After this amendment, in case a company does not have a common seal, the authorisation shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

1.1.4 Lifting of the 'Corporate Veil'

Before going into this question, one should first try to understand the meaning of the phrase 'lifting the veil'. It means looking behind the company as a legal person, i.e., disregarding the corporate entity and paying regard, instead, to the realities behind the legal facade. Where the Courts ignore the company and concern themselves directly with the members or managers, the corporate veil may be said to have been lifted. Only in appropriate circumstances, the Courts are willing to lift the corporate veil and that too, when questions of control are involved rather than merely a question of ownership.

The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

(a) In the law relating to trading with the enemy where the test of control is adopted.

(b) In certain matters concerning the law of taxes, duties and stamps particularly where question of the controlling interest is in issue.

(c) Where companies form other companies as their subsidiaries to act as their agent. The application of the doctrine may operate in favour of such companies depending upon the facts of a particular case. Suppose, a company acquires a partnership concern and registers it as a company, which becomes subsidiary of the acquiring company. In an action for compulsory acquisition of the business premises of the subsidiary, it was held that the parent company (which through itself and nominees held all the shares) was entitled to compensation, maintain action for the same [Smith, Stone and Knight Ltd. vs. Lord Mayor, etc., of Birmingham [1939] 4, All. 116].

(d) Where the courts find that there is avoidance of welfare legislation, it will be free to lift the corporate veil. (Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd; AIR 1986 SC 1).

(e) The Courts invariably lift the corporate veil or a disregard the corporate personality of a company to protect the public policy and prevent transactions contrary to public policy. [Connors v. Connors Ltd; (1939) S.C.R. 162].

(f) Under the law relating to exchange control. The courts pierce the corporate veil in quasi-criminal cases in order to look behind the legal person and punish the real persons who have violated the law.

(g) Where the use of an incorporated company is being made to avoid legal obligations, the Court may disregard the legal personality of the company and proceed on the assumption as if no company existed.

(h) In a latest judgment, the Hon'ble Supreme Court of India in the case of Estate Officer UT Chandigarh v. Esys Information Technologies Limited [2016] 136 SCL 513 held that lifting of corporate veil could be done in the case of transfer of shares of company which actually was sale of land which the original allottee (company) was prohibited to do so.

1.1.5 Classes of Companies

A company may be incorporated as a One Person Company (OPC) a new concept all together in the Companies Act, 2013, Private Company or a Public Company, depending upon the number of members joining it. Again it may either be an unlimited company, or may be limited by shares or by guarantee or by both. On the basis of control, companies can be classified as associate company, holding company and subsidiary company. Some other forms of classification of companies are: foreign company, Government Company, small company, dormant company, Nidhi Company and company formed for charitable objects.

Companies may be classified into various classes on the following basis:

1.1.5.1 On the Basis of Incorporation

(a) Statutory companies

These are the companies which are created by a special Act of the Legislature, e.g., the Reserve Bank of India, the State Bank of India, the Life Insurance Corporation, the Industrial Finance Corporation, the Unit trust of India and State Financial Corporations These are mostly concerned with public utilities, e.g. railways, tramways, gas and electricity companies and enterprises of national importance. The provisions of the Companies Act, 2013 do not apply to them unless the special act specifies such application. Banking Regulation Act, 1949 is a special legislation concerning banking companies.

(b) Registered companies

These are the companies which are formed and registered under the Companies Act, 2013, or were registered under any of the earlier Companies Acts.

1.1.5.2 On the basis of liability

(a) Company limited by shares

Section 2 (22) of the Companies Act, 2013, defines that when the liability of the members of a company is limited by its memorandum of association to the amount (if any) unpaid on the shares held by them, it is known as a company limited by shares. It thus implies that for meeting the debts of the company, the shareholder may be called upon to contribute only to the extent of the amount, which remains unpaid on his shareholdings. His separate property cannot be encompassed to meet the company's debt.

(b) Company limited by guarantee

Section 2 (21) of the Companies Act, 2013 defines it as the company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the member of a guarantee company is limited up to a stipulated sum mentioned in the memorandum. Members cannot be called upon to contribute beyond that stipulated sum.

(c) Unlimited company

Section 2 (92) of the Companies Act, 2013 defines unlimited company as a company not having any limit on the liability of its members. In such a company the liability of a member ceases when he ceases to be a member.

The liability of each member extends to the whole amount of the company's debts and liabilities but he will be entitled to claim contribution from other members.

1.1.5.3 On the basis of members

(a) One person company

(1) The Concept of One Person Company (OPC)

The concept of One Person Company (OPC) has now been introduced in India, through Section 2 (62) of Companies Act, 2013 thereby enabling Entrepreneur(s) carrying on the business in the Sole Proprietor form of business to enter into a Corporate Framework. Though this concept is new in India but it is already a part of many other countries like China, Australia, Pakistan and UK etc.

According to Section 2 (62) of the Companies Act, 2013 'One Person Company' means a company which has only one person as a member. A company formed under one person company may be either:

a) A company limited by shares, or

b) company limited by guarantee, or

c) An unlimited company.

One Person Company is a hybrid of Sole-Proprietor and Company form of business, and has been provided with concessional/relaxed requirements under the Act.

(2) Features of One Person Company (OPC)

(a) Only One Shareholder: Only a natural person, who is an Indian citizen and resident in India, shall be eligible to incorporate a One Person Company.

(b) Nominee for the Shareholder: The Shareholder shall nominate another person who shall become the shareholders in case of death/incapacity of the original shareholder. Such nominee shall give his/her consent and such consent for being appointed as the Nominee for the sole Shareholder. Only a natural person, who is an Indian citizen and resident in India, shall be a nominee for the sole member of a One Person Company.

(c) Director: Must have a minimum of One Director, the Sole Shareholder can himself be the Sole Director. The Company may have a maximum number of 15 directors.

(b) Private Company [Section 2 (68)]

According to Section 2 (68) of Companies Act, 2013 a 'private company' means a company having a minimum paid-up share capital as may be prescribed, and which by its articles:

(1) restricts the right to transfer its shares.

(2) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member;

Provided further that:

(a) persons who are in the employment of the company, and

(b) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members, and

(3) prohibits any invitation to the public to subscribe for any securities of the company.

The Companies (Amendment) Act, 2015 has omitted 'of one lakh rupees or such higher paid-up share capital' from the definition of Private Company w.e.f. 25.05.2015. The impact of this amendment is that today one can have a company of paid up capital of mere ` Two (with each subscriber giving a rupee as subscription) for a private company and ` Seven for a public company.

(c) Public company [Section 2 (71)]

According to Section 2 (71) of Companies Act, 2013 a 'public company' means a company which:

(1) is not a private company and

(2) has a minimum paid-up share capital, as may be prescribed:

(3) Seven or more members are required to form the company.

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

The Companies (Amendment) Act, 2015 has omitted "of five lakh rupees or such higher paid-up capital," from the definition of Public Company w.e.f. 25.05.2015.

(d) Small Company [Section 2 (85)]

According to Section 2 (85) of Companies Act, 2013 a ''small company'' means a company, other than a public company:

(1) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees. Or

(2) turnover of which as per its profit and loss account for the immediate preceding financial year. does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Provided that nothing in this clause shall apply to:

a) a holding company or a subsidiary company.

b) a company registered under Section 8, or

c) a company or body corporate governed by any special Act.

Some of the advantages enjoyed by the small companies are:

a) holding of two board meetings instead of four – one each in the first and second half years and the gap between the two meeting should not be more than 90 days. [section 173(5)]

b) Not required to give cash flow statements with the financial statements [section 2(40)]

1.1.5.4 On the basis of control

Holding company and Subsidiary company

'Holding' and 'Subsidiary' Companies are relative terms. A company is a holding company of another if the other is its subsidiary.

According to Section 2 (46) of the Companies Act, 2013 'holding company', in relation to one or more other companies, means a body corporate of which such companies are subsidiary companies.

According to Section 2 (87) of the Companies Act, 2013 'subsidiary company' or 'subsidiary', in relation to any other body corporate (that is to say the holding company), means a body corporate in which the holding company :

a) controls the composition of the Board of Directors, Or

b) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of

subsidiaries beyond such numbers as may be prescribed.

1.1.5.5 On the basis of Listing in the recognised Stock Exchange

(a) Listed company (also widely held)

According to Section 2 (52) of the Companies Act, 2013, a 'listed company' means a company which has any of its securities listed on any recognised stock exchange. Whereas the word securities as per the Section 2 (81) of the Companies Act, 2013 has been assigned the same meaning as defined in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956.

(b) Unlisted company

Unlisted Company means company other than listed company.

1.1.5.6 Others

(a) Government Company

According to Section 2 (45) of the Companies Act, 2013, a 'Government company' means any company in which not less than fifty one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

(b) Foreign Company

According to Section 2 (42) of the Companies Act, 2013, 'foreign company' means any company or body corporate incorporated outside India which:

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode. And

(b) conducts any business activity in India in any other manner.

(c) Associate Company

According to Section 2 (6) of the Companies Act, 2013, 'associate company' in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

As per the Explanation given under the Section, the clause, 'significant influence' means control of at least twenty per cent of total share capital, or of business decisions under an agreement.

(d) Dormant company

Where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.

'Significant accounting transaction' means any transaction other than:

(a) payment of fees by a company to the Registrar.

(b) payments made by it to fulfil the requirements of this Act or any other law.

(c) allotment of shares to fulfil the requirements of this Act, and

(d) payments for maintenance of its office and records.

(e) Nidhi Companies

Company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift (cost cutting) and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefits and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies. [Section 406 of the Companies Act, 2013]

(f) Public financial institutions

According to Section 2 (72) of the Companies Act, 2013 the following institutions are to be regarded as public financial institutions:

(1) The Life Insurance Corporation of India established under the Life Insurance Corporation Act, 1956.

(2) The Infrastructure Development Finance Company Limited,

(3) Specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.

(4) Institutions notified by the Central Government under Section 4A (2) of the Companies Act, 1956 so repealed under Section 465 of this Act.

(5) Such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

Provided that no institution shall be so notified unless:

a) it has been established or constituted by or under any Central or State Act. Or

b) not less than fifty-one per cent of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.

(g) **Joint Venture Company:** The term "joint venture" has also been defined to mean "joint arrangement where the parties who have joint control of the arrangements have rights to the net assets or the arrangement.

1.1.6 Conversion of Public Company into a Private Company or vice versa

(a) Conversion of public company into private company

A public company can be converted into a private company by passing a special resolution, after altering its articles so as to include therein the restrictions contained in Section 2(68) of the Act. A special resolution passed to convert a public company into a private company is binding on dissenting shareholders provided it is bona fide, is in the interest of the company as a whole, and is consistent with the objects in the Memorandum of Association [Bal Ramba vs. Master Silk Mills AIR 1955 N.U.R. Saurashtra 927]. Under Section 14 (1), any alteration made in the articles to convert a public company into a private company shall take effect only with the approval of the Tribunal which shall make such order as it may deems fit.

(b) Conversion of private company into public company

Similarly where a private company alters its articles by passing special resolution in such a manner that they no longer includes the restrictions and limitations which are required to be included in the articles of a private company, then such company shall cease to be a private company from the date of such alteration.

(c) Filing with the registrar

Every alteration of the articles and a copy of the order of the Tribunal approving the alteration of articles in respect of conversion of public company into private company or private company into

public company shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same.

Any alteration of the articles registered as above shall, subject to the provisions of this Act, be valid as if it were originally in the articles.

1.1.7 When Companies must be registered

According to Section 464 of the Companies Act, 2013, no association or partnership consisting of more than such number of persons (i.e., not exceeding 50 as per Rule 10 of Companies (Miscellaneous) Rules, 2014) shall be, formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force:

Above stated provision shall not apply to:

(a) Hindu undivided family carrying on any business. Or

(b) an association or partnership, if it is formed by professionals who are governed by special Acts.

Every member of an association or partnership carrying on business in contravention of above law, shall be punishable with fine which may extend to one lakh rupees and shall also be personally liable for all liabilities incurred in such business.

Where an association is formed, which has membership in excess of the number aforementioned, will be an illegal association. Such a body will have no legal existence and it cannot be wound up under the Act, or even as an unregistered company. Neither a member of it would be able to sue it, nor would it be able to sue the member. Nevertheless, a member who has paid any money to the association would be able to recover it from the director or agents or the association before the money so paid has been applied to an illegal purpose [Greeberg vs. Cooperstein [1965] Ch. 657 followed in Ram Das vs. Kunut Dhari AIR 1925]. Every person who is, or continues to be a member of an association in the circumstance described above, is personally culpable for all liabilities incurred in such business and every member is, in addition punishable for any person or persons to trade or carry on business under any name or title of which 'limited' is the last word, without being fully incorporated.

1.1.8 Incorporation of Company

(a) Formation of company

Persons who form the company are known as promoters. It is they, who conceive the idea of forming the company. They take all necessary steps for its registration.

Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company.

(1) Public Company: In the case of a public company with or without limited liability any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration.

(2) Private Company: In exactly the same way, 2 or more persons can form a private company.

(3) One person company (OPC): One person, where the company to be formed is to be One Person Company.

If number of members reduce below above stipulation and the company carries on business for more than six months, every member severally shall be liable to pay debts of the company.

(b) Procedural aspects of incorporation of company

Section 7 of the Companies Act, 2013 provides for the procedure to be followed for incorporation of a company.

(1) Filing of the documents and information with the registrar: For the registration of the company following documents and information are required to be filed with the registrar within whose jurisdiction the registered office of the company is proposed to be situated:

a) the memorandum and articles of the company duly signed by all the subscribers to the memorandum.

b) a declaration by person who is engaged in the formation of the company (an advocate, a chartered accountant, cost accountant or company secretary in practice), and by a person named in the articles (director, manager or secretary of the company), that all the requirements of this Act and the rules made there under in respect of registration and matters precedent or incidental thereto have been complied with.

c) a declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles stating that:

1) he is not convicted of any offence in connection with the promotion, formation or management of any company, or

2) he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the last five years,

3) and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief.

d) the address for correspondence till its registered office is established for which 30 days time is alloted after incorporation.

e) the particulars (names, including surnames or family names, residential address, nationality) of every subscriber to the memorandum along with proof of identity, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.

f) the particulars (names, including surnames or family names, the Director Identification Number, residential address, nationality) of the persons mentioned in the articles as the first directors of the company and such other particulars including proof of identity as may be prescribed, and

g) the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

Particulars provided in this provision shall be of the individual subscriber and not of the professional engaged in the incorporation of the company [The Companies (Incorporation) Rules, 2014].

(2) Issue of certificate of incorporation on registration: The Registrar on the basis of documents and information filed, shall register all the documents and information in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

(3) Allotment of corporate identity number (CIN): On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

(4) Maintenance of copies of all documents and information: The company shall maintain and preserve at its registered office copies of all documents and information as originally filed, till its dissolution under this Act.

(5) Furnishing of false or incorrect information or suppression of material fact: If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be liable for action under Section 447.

(6) Company incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact: where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration under this Section shall each be liable for action under Section 447.

(7) Order of the Tribunal: where a company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants:

(a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors, or

(b) direct that liability of the members shall be unlimited. or

(c) direct removal of the name of the company from the register of companies, or

(d) pass an order for the winding up of the company, or

(e) pass such other orders as it may deem fit.

Provided that before making any order:

1) the company shall be given a reasonable opportunity of being heard in the matter, and

2) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

(8) Formation of OPC

a) The memorandum of OPC shall indicate the name of the other person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.

b) The other person whose name is given in the memorandum shall give his prior written consent in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation.

c) Such other person may be given the right to withdraw his consent

d) The member of OPC may at any time change the name of such other person by giving notice to the company and the company shall intimate the same to the Registrar

e) Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.

f) Only a natural person who is an Indian citizen and resident in India (person who has stayed in India for a period of not less than 182 days during the immediately preceding one calendar year):

1) shall be eligible to incorporate a OPC.

2)shall be a nominee for the sole member of a OPC.

g) No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.

h) No minor shall become member or nominee of the OPC or can hold share with beneficial interest.

i) Such Company cannot be incorporated or converted into a company under Section 8 of the Act. Though it may be converted to private or public companies in certain cases. The procedure of conversion is given in the Rules 6 & 7 of the Companies (Incorporation) Rules, 2014.

j) Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporate.

k) OPC cannot convert voluntarily into any kind of company unless two years have expired from the date of incorporation, except where the paid up share capital is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.

l) If One Person Company or any officer of such company contravenes the provisions, they shall be punishable with fine which may extend to ten thousand rupees and with a further fine which may extend to one thousand rupees for every day after the first during which such contravention continues.

(c) Effect of registration

According to Section 9 of the Companies Act, 2013, from the date of incorporation (mentioned in the certificate of incorporation), the subscribers to the memorandum and all other persons, who may from time to time become members of the company, shall be a body corporate by the name contained in the memorandum. Such a registered Company shall be capable of exercising all the functions of an incorporated company under this Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name.

From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from the incorporators and there comes into existence a binding contract between the company and its members as evidenced by the Memorandum and Articles of Association [Hari Nagar Sugar Mills Ltd. vs. S.S. Jhunjhunwala AIR 1961 SC 1669]. It has perpetual existence until it is dissolved by liquidation or struck out of the register. A shareholder who buys shares, does not buy any interest in the property of the company but in certain cases a writ petition will be maintainable by a company or its shareholders.

A legal personality emerges from the moment of registration of a company and from that moment the persons subscribing to the Memorandum of Association and other persons joining as members are regarded as a body corporate or a corporation in aggregate and the legal person begins to function as an entity. A company on registration acquires a separate existence and the law recognises it as a legal person separate and distinct from its members [State Trading Corporation of India vs. Commercial Tax Officer AIR 1963 SC 1811].

It may be noted that under the provisions of the Act, a company may purchase shares of another company and thus become a controlling company. However, merely because a company purchases all shares of another company it will not serve as a means of putting an end to the corporate character of another company and each company is a separate juristic entity [Spencer & Co. Ltd. Madras vs. CWT Madras (1969) 39 Comp. Case 212].

(d) Certificate as Conclusive Evidence

According to Section 35 of the 1956 Act, a Certificate of Incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of the Acts have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under the Act. The Certificate of Incorporation is conclusive evidence that everything is in order as regards registration and that the company has come in to existence from the earliest moment of the day of incorporation stated therein with rights & liabilities of a natural person, competent to enter into contracts [Jubilee Cotton Mills Ltd.

v. Lewis (1924) A.C. 958.]. The validity of the registration cannot be questioned after the issue of the certificate.

It is for the purpose of incorporation that the certificate was made conclusive by the legislature and the certificate cannot legalise the illegal object contained in the Memorandum. Where the object of the company is unlawful, it has been held that the certificate of registration is not conclusive for this purpose [Performing Right Society Ltd. v. London Theatre of Varieties (1992) 2 KB 433].

Even if the two signatures to a Memorandum were written by one person, or were forged, the certificate would be conclusive that the company was duly incorporated. So too, if the signatories were all minors, the certificate would still be conclusive [Hammod v. Prentice Bros (1920) 1 Ch. 201 and Bowman v. Secular Society Ltd. 1917 AC 406,438].

Section 35 of the 1956 Act has not been incorporated bodily in the 2013 Act and the same shall be watched with interest as to how the Courts would interpret the absence of such a provision.

(e) Effect of Memorandum and Articles

As per Section 10 of the Companies Act, 2013, where the memorandum and articles when registered, shall bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member, and an agreement to observe all the provisions of the memorandum and of the articles. All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.

As a result, a number of legal relationships are formed between different parties and the company which are described below:

(1) Between the members and company: The memorandum and articles constitute a contract between the members and the company. In consequence, the members are bound to the company under a statutory covenant.

Views differ on the questions as to whether and how far the memorandum and articles bind the company to the members. One view is that it is bound just as its members are. Another view is that the company is not wholly bound. But it seems that courts, instead of conforming to either of these views, have elected to take a via media. It is not true to say that the company is wholly bound so that any member can enforce any articles against it. But it is bound to the extent that any member can sue it so as to prevent any breach of the article which is likely to affect his right as a member of the company [Hickman vs. Kent Sheepbreeder's Association [1985] 1 Ch. 881]. Thus an individual member can file a suit against the company to enforce his individual rights, e.g., right to contest election for directorship of the company, right to get back his shares wrongfully forfeited, right to receive a share certificate, share warrants to bearer or notice of general meetings etc. [Pender vs. Lushington (1817) 7 Ch. D. 70; Nagaffa vs. Madras Race Club, AIR 1951 Mad. 83; C.L. Joseph vs. Los AIR 1965 (Ker.) 68]. The member suing in such cases 'sues not in the rights of a member but in his own right to protect from invasion of his own individual right as a member' [Per Jenkis L.J. in Edwards vs. Halliwell [1950] 2 All ER 1964 at p. 1067].

(2) Between member inter se: In the case of Wood vs. Odessa Water Works Co. [1989] 42 Ch. D. 363, Sterling J. Observed: The articles of Association constitute a contract not merely between the shareholders and the company but between each individual shareholder and every other.

(3) Between the company and the outsiders: The memorandum and the articles do not constitute a contract between the company and outsiders. Neither the company nor the members are bound by the articles to outsiders, since these constitute a contract between members, inter se, and the outsider is not a party to the articles although he may be named therein.

Nonetheless, an outsider is entitled to assume that in respect of contract entered into with him all the formalities required to be carried out under the articles or memorandum have been duly complied with [Royal British Bank vs. Turquand (1956) 6 E.B. 327].

(f) Commencement of business, etc.

Prior to the Companies (Amendment) Act, 2015, Section 11 of the Companies Act, 2013 seeks to provide that a company having a share capital shall not commence any business or exercise any borrowing powers only after fulfilment of certain conditions. However, the Companies (Amendment) Act, 2015 has done away with this requirement.

(g) Registered office of a company

Section 12 of the Companies Act, 2013 seeks to provide for the registered office of the company for the communication and serving of necessary documents, notices letters etc. The domicile and the nationality of a company are determined by the place of its registered office. This is also important for determining the jurisdiction of the court.

(1) Registered office: From the 15th day of its incorporation and at all times thereafter a company shall have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it.

(2) Verification of registered office: The Company shall furnish to the Registrar verification of its registered office within a period of thirty days of its incorporation. The form to be filed in INC-22.

(3) Labelling of company: Every company shall:

a) paint or affix its name, and the address of its registered office, and keep the same painted or affixed, on the outside of every office or place in which its business is carried on, in a conspicuous position, in legible letters, and if the characters employed are not those of the language/s in general use in that locality, then also in the characters of that language/s.

b) have its name engraved in legible characters on its seal (the Companies (Amendment) Act, 2015 has deleted the requirement of having Common Seal compulsorily).

c) get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications, and

d) have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed.

(4) Name change by the company: Where a company has changed its name/s during the last two years, it shall paint or affix or print, along with its name, the former name or names so changed during the last two years.

(5) In case of OPC: The words ''One Person Company'' shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

(6) Notice of change to registrar: Notice of every change of the situation of the registered office, verified in the manner prescribed, after the date of incorporation of the company, shall be given to the Registrar within 15 days of the change, who shall record the same. This is applicable to change in the registered address of the company within the local limits of the village, town or city and remaining within the jurisdiction of the same Registrar of Companies.

(7) Change by passing of special resolution: The registered office of the company shall be changed only by passing of special resolution by a company:

a) in the case of an existing company, outside the local limits of any city, town or village where such office is situated at the commencement of this Act or where it may be situated later by virtue of a special resolution passed by the company, and

b) in the case of any other company, outside the local limits of any city, town or village where such

office is first situated or where it may be situated later by virtue of a special resolution passed by the company.

(8) Change of registered office outside the jurisdiction of registrar: Where a company changes the place of its registered office from the jurisdiction of one Registrar to the jurisdiction of another Registrar within the same State, there such change is to confirmed by the Regional Director on an application made by the company.

(9) Communication and filing of confirmation: The confirmation of change of registered office from jurisdiction of one registrar to another registrar within the same state, shall be:

a) communicated within 30 days from the date of receipt of application by the Regional Director to the company, and

b) the company shall file the confirmation with the Registrar within a period of 60 days of the date of confirmation who shall register the same, and

The Registrar of Companies of the new jurisdiction shall certify the registration within a period of thirty days from the date of filing of such confirmation. As of now, Tamil Nadu and Maharashtra are the two states where there are two Registrars of Companies are operating. The jurisdictions of the respective Registrars of Companies are notified.

(10) Certificate, a conclusive evidence of compliance of requirements of this Act: The certificate shall be conclusive evidence that all the requirements of this Act with respect to change of registered office have been complied with and the change shall take effect from the date of the certificate.

(11) In case of default: If any default is made in complying with the requirements of this Section, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees.

(h) Act to override memorandum, articles, etc.

According to Section 6 of the Companies Act, 2013, the provisions of this Act shall have overriding effect on provisions contained in memorandum or articles or in an agreement or in resolution passed by the company in the general meeting or by its board of directors, whether they are registered, executed or passed before or after the commencement of this Act.

Any provision contained in any of the above mentioned document, shall be void, to the extent to which it is inconsistent to the provisions of this Act.

1.1.9 Memorandum of Association

The Memorandum of Association of company is in fact its charter. It defines its constitution and the scope of the powers of the company with which it has been established under the Act.

A memorandum is a public document under Section 399 of the Companies Act, 2013. Consequently, every person entering into a contract with the company is presumed to have the knowledge of the conditions contained therein.

Section 4 of the Companies Act, 2013 seeks to provide for the requirements with respect to memorandum of a company.

(a) Content of the memorandum

The memorandum of a company shall state:

(1) the name of the company with the last word 'Limited' in the case of a public limited company, or the last words 'Private Limited' in the case of a private limited company.

(2) the State in which the registered office of the company is to be situated.

(3) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof. If any company has changed its activities which are not reflected in its name, it shall change its name in line with its activities within a period of six months from the change of activities after complying with all the provisions as applicable to change of name.

(4) the liability of members of the company, whether limited or unlimited, and also state:

a) in the case of a company limited by shares, that the liability of its members is limited to the amount unpaid, if any, on the shares held by them. And

b) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute:

1) To the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be, and

2) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves.

(5) in the case of a company having a share capital:

a) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share, and

b) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name.

(6) in the case of OPC, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

(b) Applying for the name of the company

The name stated in the memorandum shall not:

(a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law. or

(b) be such that its use by the company:

(1) will constitute an offence under any law for the time being in force, or

(2) is undesirable in the opinion of the Central Government.

(3) Registration of name of the company: Without effecting the above provisions, a company shall not be registered with a name which contains:

a) any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force, or

b) such word or expression, as may be prescribed, unless the previous approval of the Central Government has been obtained for the use of any such word or expression.

(4) Requirement for the reservation of the name of the company:

a) A person may make an application, for reservation of name through web service to the Registrar, Central Registration Centre, which may either be approved or regected for -

1) the name of the proposed company. or

2) the name to which the company proposes to change its name.

b) The name shall be registered for 20 days from the date of approval incase of new company and sixty days in case of existing company.

c) Where after reservation of name it is found that name was applied by furnishing wrong or incorrect information, then:

1) if the company has not been incorporated, the reserved name shall be cancelled and the person making application shall be liable to a penalty extending to one lakh rupees.

2) if the company has been incorporated, the Registrar may, after giving the company an opportunity of being heard:

a. either direct the company to change its name within a period of three months, after passing an ordinary resolution.

b. take action for striking off the name of the company from the register of companies, or

c. make a petition for winding up of the company.

(5) Forms and schedule related to memorandum: The memorandum of a company shall be in respective forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to such company.

(6) Any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, shall not give any person a right to participate in the divisible profits of the company otherwise than as a member. If the contrary is done, it shall be void.

Doctrine of ultra vires: The meaning of the term 'ultra vires' is simply 'beyond (their) powers'. This pre supposes that the powers are in their nature limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid. It is only when the law has called into existence a person for a particular purpose or has recognised its existence, such as in the case of a limited company that the power is limited to the authority delegated expressly or by implication and to the objects for which it was created. In the case of such a creation, the ordinary law applicable to an individual is somewhat reversed, whatever is not permitted expressly or by implication, by the constituting instrument, is prohibited not by any express prohibition of the legislature, but by the doctrine of ultra vires.

The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a 'public document', it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company.

An act which is ultra vires the company being void, cannot be ratified by the shareholders of the company. Sometimes, act which is ultra vires can be regularised by ratifying it subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it. If it is ultra vires the articles of the company, the company can alter the articles, if the act is within the power of the company but is done irregularly, shareholder can validate it.

1.1.10 Alteration of the Memorandum

(a) Procedure of alteration of memorandum

Section 13 of the Companies Act, 2013 provides the provisions that deal with the alteration of the memorandum. The provision says that:

(1) Alteration by special resolution: Company may alter the provisions of its memorandum with the approval of the members by a special resolution.

(2) Name change of the company: Any change in the name of a company shall be effected only with the approval of the Central Government in writing:

However, no such approval shall be necessary where the change in the name of the company is only the deletion there from, or addition thereto, of the word 'Private', on the conversion of any one class of companies to another class.

The change of name shall not be allowed to a company which has defaulted in filing its annual returns or financial statements or any document due for filing with the Registrar or which has defaulted in repayment of matured deposits or debentures or interest on deposits or debentures.

(3) Entry in register of companies: On any change in the name of a company, the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation with the new name and the change in the name shall be complete and effective only on the issue of such a certificate.

(4) Change in the registered office: The alteration of the memorandum relating to the place of the registered office from one State to another shall not have any effect unless it is approved by the Central Government on an application in such form and manner as may be prescribed.

(5) Dispose of the application of change of place of the registered office: The Central Government shall dispose of the application of change of place of the registered office within a period of sixty days. Before passing of order, Central Government may satisfy itself that:

a) the alteration has the consent of the creditors, debenture-holders and other persons concerned with the company, or

b) the sufficient provision has been made by the company either for the due discharge of all its debts and obligations, or

c) adequate security has been provided for such discharge.

(6) Filing with Registrar: A company shall, in relation to any alteration of its memorandum, file with the Registrar:

a) the special resolution passed by the company under Sub-Section (1).

b) the approval of the Central Government under Sub-Section (2), if the alteration involves any change in the name of the company.

(7) Filing of the certified copy of the order with the registrar of the states: Where an alteration of the memorandum results in the transfer of the registered office of a company from one State to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the Registrar of each of the States within such time and in such manner as may be prescribed, who shall register the same.

(8) Issue of fresh certificate of incorporation: The Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration.

(9) Change in the object of the company: A company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution through postal ballot is passed by the company and:

a) the details, in respect of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating therein the justification for such change.

b) the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

(10) Registrar to certify the registration on the alteration of the objects: The Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution.

(11) Alteration to be registered: No alteration made under this Section shall have any effect until it has been registered in accordance with the provisions of this Section.

(12) Only member have a right to participate in the divisible profits of the company: Any alteration of the memorandum, in the case of a company limited by guarantee and not having a share capital, intending to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

(b) Rectification of name of memorandum

(1) Central government to issue direction

According to Section 16 of the Companies Act, 2013, the Central Government is empowered to give direction to the company to rectify its name (Where the name is identical with or too nearly resembles the name by which a company in existence had been previously registered, or the name is identical with or too nearly resembling to a registered trade mark) within a period of 3 months or 6 months, as the case may be, from the issue of such direction by passing an ordinary resolution.

(2) Notice of change to the registrar

Where a company changes its name or obtains a new name, it shall within a period of 15 days from the date of such change, give notice of the change to the Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and the memorandum.

(3) Default in compliance with the direction

If a company makes default in complying with any direction:

Liable person	Penalty/punishment
Company	Fine of 1,000 rupees for every day during which the default continues
Every Officer who is in default	Fine varying from 5,000 rupees to 1 lakh rupees.

1.1.11 Articles of Association

The articles of association of a company are its rules and regulations, which are framed to manage its internal affairs. Just as the memorandum contains the fundamental conditions upon which along the company is allowed to be incorporated, so also the articles are the internal regulations of the company [Guiness vs. Land Corporation of Ireland 22 Ch. D. 349, 381].

The articles of association are in fact the bye-laws of the company according to which director and other officers are required to perform their functions as regards the management of the company, its accounts and audit. It is important therefore that the auditor should study them and, while doing so he should note the provisions therein in respect of relevant matters. Section 5 of the Companies Act, 2013 seeks to provide the contents and model of articles of association as follows:

(a) Regulations for management: The articles of a company shall contain the regulations for management of the company.

(b) Inclusion of matters: The articles shall also contain such matters, as are prescribed under the rules. However, a company may also include such additional matters in its articles as may be considered necessary for its management.

(c) Contain provisions for entrenchment: The articles may contain provisions for entrenchment (to protect something) to the effect that specified provisions of the articles may be altered only if conditions or procedures as that are more restrictive than those applicable in the case of a special resolution, are met or complied with.

(d) Manner of inclusion of the entrenchment provision: The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.

(e) Notice to the registrar of the entrenchment provision: Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.

(f) Forms of articles: The articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company.

(g) Model articles: A company may adopt all or any of the regulations contained in the model articles applicable to such company.

(h) Company registered after the commencement of this Act: In case of any company, which is registered after the commencement of this Act, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

(i) Section not apply on company registered under any previous company law: Nothing in this Section shall apply to the articles of a company registered under any previous company law, unless amended under this Act.

1.1.12 Alteration of Articles

Section 14 of the Companies Act, 2013 vests companies with power to alter or add to its articles. The law with respect to alteration of articles is as follows:

(a) Alteration by special resolution: Subject to the provisions of this Act and the conditions contained in its memorandum, if any, a company may, by a special resolution alter its articles.

(b) Alteration to include conversion of companies: Alteration of articles include alterations having the effect of conversion of:

(1) a private company into a public company, or

(2) a public company into a private company:

Even where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of

a private company under this Act, then such company shall, as from the date of such alteration, cease to be a private company:

However any such alteration having the effect of conversion of a public company into a private company, then such conversion shall not take effect except with the approval of the Tribunal and make such order as it may deem fit.

(c) Filing of alteration with the registrar: Every alteration of the articles and a copy of the order of the Tribunal approving the alteration, shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same.

(d) Any alteration made shall be valid: Any alteration of the articles registered as above shall, subject to the provisions of this Act, be valid as if it were originally contained in the articles.

(e) Alteration noted in every copy: Every alteration made in articles of a company shall be noted in every copy of the articles, as the case may be. If a company makes any default in complying with the stated provisions, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every copy of the articles issued without such alteration.[Section 15]

1.1.13 Copies of memorandum, articles, etc., to be given to members

According to Section 17 every company on being so requested by a member, shall send copies of the following documents within seven days of the request on the payment of fees:

(a) the memorandum.

(b) the articles, and

(c) every agreement and every resolution referred in Section 117 (Resolutions and agreements to be filed), if and in so far as they have not been embodied in the memorandum or articles.

In case of default, the company and every officer who is in default shall be liable for each default, to a penalty of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

1.1.14 Doctrines of constructive notice and indoor management

In consequences of the registration of the memorandum and articles of association of the company with the Registrar of Companies, a person dealing with the company is deemed to have constructive notice of their contents. This is because these documents are construed as 'public document' under Section 399 of the Companies Act, 2013. Accordingly if a person deals with a company in a manner incompatible with the provisions of the aforesaid documents or enters into transaction, which is ultra vires to these documents, he must do so at his peril. If someone supplies goods to a company in which it cannot deal according to its objects clause, he will not be able to recover the price from the company. Suppose the articles provide that a bill of exchange must be signed by two directors, if the bill is actually signed by one director only the holder thereof cannot claim payment thereon. However, the doctrine of constructive notice is not a positive one but a negative one like that of estoppel of which it forms parts. It operates only against the person who has been dealing with the company but not against the company itself. Consequently he is prevented from alleging that he did not know that the constitution of the company rendered a particular act or a particular delegation of authority ultra vires. Thus, the doctrine is a 'cloud' for the strangers. The doctrine of indoor management has been recognized in the case of Royal British Bank v. Turquand (1856) 6 E&B 327 All ER Rep (435), While an ordinary person dealing with a company is bound to assume that the requisite compliance or delegation of powers to the person dealing on behalf of the company has been made, he need not probe beyond what is ostensible and evident from the actions.

Case law relating to doctrine of constructive notice

1. Knowledge of irregularity: Where a person dealing with a company has actual or constructive notice of

the irregularity as regards internal management, he cannot claim the benefit under the rule of indoor management. [T.R. PRATT (Bombay) Ltd. v. E.D. Sassoon & Co. Ltd. AIR 1936 Bom 62].

2. Negligence: Where a person dealing with a company could discover the irregularity if he had made proper inquiries, he cannot claim the benefit of the rule of indoor management. The protection of the rule is also not available where the circumstances surrounding the contract- are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry [Anand Bihari Lel v. Dinshaw & Co and Under-Wood v. Bank of Liver Pool; A.I.R. (1942) Oudh 417].

3. Act void abinitio and forgery: Where the acts done in the name of a company are void abinitio, the doctrine of indoor management does not apply. The doctrine applies only to irregularities that otherwise might affect a genuine transaction. It does not apply to a forgery. A Company can never he held liable for forgeries committed by its officers. [Ruben v. Great Fingall Consolidated Co (1906) A.C. 439].

4. Acts outside the scope of apparent authority: If an officer of a company enters into a contract with a third party and if the act of the officer is beyond the scope of his authority, the company is not bound. [Kreditbank Cassel v. Schenkers Ltd (1927) 1 KB 826].

1.1.15 Doctrine of Indoor Management

The aforesaid doctrine of constructive notice does in no sense mean that outsiders are deemed to have notice of the internal affairs of the company. For instance, if an act is authorised by the articles or memorandum, an outsider is entitled to assume that all the detailed formalities for doing that act have been observed. For example, the directors of the Royal British Bank Ltd. (R.B.B) gave a bond to Turquand (T). The articles empowered the directors to issue such bonds under the authority of a proper resolution. In fact, no such resolution was passed. Notwithstanding that, it was held that T could sue on the bonds on the ground that he was entitled to assume that the resolution had been duly passed [The Royal British Bank vs. Turquand (1956) 6E & B 327.] This is the doctrine of indoor management, which is the only limitation to the doctrine of constructive notice discussed above.

Exceptions to Doctrine of Indoor Management: The aforementioned rule of Indoor Management is important to persons dealing with a company through its directors or other persons. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority. So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required. The above mentioned doctrine of Indoor Management has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

(a) The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity [Moris vs. Kenssen (1946) A.C. 459. Devi Ditta Mal vs. The Standard Bank of India (1972) I.C. 568]. Thus director of a company cannot normally claim the benefit of the rule in the Turquand Case where he is also acting for the company in the transaction.

(b) The doctrine in no way, rewards those who behave negligently. Where the person dealing with the company is put upon an inquiry.

(c) When an instrument purporting to be executed on behalf of the company is a forgery. The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity and void ab initio [Ruben vs. Great Fingal Consolidated (1966) A.C. 439: Official Liquidator vs. Commr. of Police (1969) I Comp. L.J. (Mad.)].

1.1.16 Conversion of companies already registered

According to Section 18 of the Companies Act, 2013, a company may convert itself in some other class of company by altering its memorandum and articles of association. Following is the law with respect to the conversion of the companies already registered.

(a) By alteration of memorandum and articles: A company of any class registered under this Act may convert itself as a company of other class under this Act by alteration of memorandum and articles

of the company in accordance with the provisions of this Chapter.

(b) File an application to the Registrar: Wherever such conversion of companies is required to be done, the company shall file an application to the Registrar, who shall after satisfying himself that the provisions applicable for registration of companies have been complied with, close the former registration of the company.

(c) Issue a certificate of incorporation: After registering the required documents, issue a certificate of incorporation in the same manner as its first registration.

(d) No effect on the debts, liabilities etc. incurred before conversion: The registration of a company under this Section shall not affect any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the company before conversion and such debts, liabilities, obligations and contracts may be enforced in the manner as if such registration had not been done.

A : 1.2 NIDHI COMPANIES, MUTUAL BENEFIT FUNDS AND PRODUCER COMPANIES - CONCEPT, FORMATION, MEMBERSHIP, FUNCTIONING, DISSOLUTION

1.2.1 Nidhi Companies

Nidhis are popular in the Southern part of the country and in fact the Government has recognized the importance of nidhi companies as an instrument of savings of communities coming together for mutual help and making available products like loans and cash credit at the location of the member and make such credit also available on easy attempts.

(a) Power to Modify Act in its Application to Nidhis [Section 406]

Definitions

a) As per Section 406 of the Companies Act, 2013, 'Nidhi' means a company which has been incorporated as a Nidhi with the object of:

1) cultivating the habit of thrift and savings amongst its members

2) receiving deposits from, and lending to, its members only, for their mutual benefit, and

3) which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.

b) The Central Government may, by notification, direct that any of the provisions of this Act shall not apply, or shall apply with such exceptions, modifications and adaptations as may be specified in that notification, to any Nidhi or Nidhis of any class or description as may be specified in that notification. In exercise of the power under this section read with section 462, the Central Government has exempted various provisions of the Act for the Nidhi Companies vide notification no. 2/11/2014-CL.V dated the 5th June, 2015.

(b) The Nidhi Rules, 2014, shall apply in relation to the following:

(1) Application

It applies to:

a) every company which had been declared as a Nidhi or Mutual Benefit Society under Sub-Section (1) of Section 620A of the Companies Act, 1956.

b) every company functioning on the lines of a Nidhi company or Mutual Benefit Society but has either not applied for or has applied for and is awaiting notification to be a Nidhi or Mutual Benefit Society under Sub-Section (1) of Section 620A of the Companies Act, 1956. And

c) every company incorporated as a Nidhi pursuant to the provisions of Section 406 of the Companies Act, 2013.

(2) Important definitions

Vide Notification No.G.S.R.258 (E) dated 31.03.2014 MCA has notified 'Nidhi Rules, 2014'. According to these Rules:

1) 'Doubtful Asset' means a borrowal account which has remained a Non-performing asset for more than two years but less than three years.

2) 'Loss Asset' means a borrowal account which has remained a Non-performing asset for more than three years or where in the opinion of the Board, a shortfall in the recovery of the loan account is expected because the documents executed may become invalid if subjected to legal process or for any other reason.

3) 'Net Owned Funds' means the aggregate of paid up equity share capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet.

Provided that the amount representing the proceeds of issue of preference shares shall not be included for calculating Net Owned Funds.

4) 'Non-Performing Asset' means a borrowal account in respect of which interest income or instalment of loan towards re payment of principal amount has remained unrealised for twelve months.

5) 'Standard Asset' means the asset in respect of which no default in re-payment of principal or payment of interest has occurred or is perceived and which has neither shown signs of any problem relating to re-payment of principal sum or interest nor does it carry more than normal risk attached to the business.

6) 'Sub-Standard Asset' means a borrowal account which is a Non-performing asset. Provided that reschedulement or renegotiation or rephasement of the loan installment or interest payment shall not change the classification of an asset unless the borrowal account has satisfactorily performed for at least twelve months after such reschedulement or renegotiation or rephasement.

1.2.1.1 Incorporation and Incidental Matters

(1) Requirements for incorporation

(a) A Nidhi to be incorporated under the Act shall be a public company and shall have a minimum paid up equity share capital of five lakh rupees.

(b) On and after the commencement of the Act, no Nidhi shall issue preference shares.

(c) If preference shares had been issued by a Nidhi before the commencement of this Act, such preference shares shall be redeemed in accordance with the terms of issue of such shares.

(d) Except as provided under the proviso to sub-rule (e) to rule 6, no Nidhi shall have any object in its Memorandum of Association other than the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit.

(e) Every Company incorporated as a 'Nidhi' shall have the last words 'Nidhi Limited' as part of its name.

(2) Requirements for Minimum Number of Members, Net Owned Fund etc.

(a) Every Nidhi shall, within a period of one year from the commencement of these rules, ensure that it has:

(1) Not less than two hundred members.

(2) Net Owned Funds of ten lakh rupees or more.

(3) Un-encumbered term deposits of not less than ten per cent of the outstanding deposits as specified in rule 14 and

(4) Ratio of Net Owned Funds to deposits of not more than 1:20.

(a) Within ninety days from the close of the first financial year after its incorporation and where applicable, the second financial year, Nidhi shall file a return of statutory compliances with the Registrar duly certified by a company secretary in practice or a chartered accountant in practice or a cost accountant in practice.

(b) If a Nidhi is not complying with clauses (a) or (d) of sub-rule (1) above, it shall within thirty days from the close of the first financial year, apply to the Regional Director for extension of time and the Regional Director may consider the application and pass orders within thirty days of receipt of the application.

(c) If the failure to comply with sub-rule (1) of this rule extends beyond the second financial year, Nidhi shall not accept any further deposits from the commencement of the second financial year till it complies with the provisions contained in sub-rule (1), besides being liable for penal consequences as provided in the Act.

(3) General Restrictions or Prohibitions

No Nidhi shall:

(a) carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any body corporate.

(b) issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever.

(c) open any current account with its members.

(d) acquire another company by purchase of securities or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management, unless it has passed a special resolution in its general meeting and also obtained the previous approval of the Regional Director having jurisdiction over such Nidhi.

(e) carry on any business other than the business of borrowing or lending in its own name. Provided that Nidhis which have adhered to all the provisions of these rules may provide locker facilities on rent to its members subject to the rental income from such facilities not exceeding twenty per cent of the gross income of the Nidhi at any point of time during a financial year.

(f) accept deposits from or lend to any person, other than its members.

(g) pledge any of the assets lodged by its members as security.

(h) take deposits from or lend money to anybody corporate.

(i) enter into any partnership arrangement in its borrowing or lending activities.

(j) issue or cause to be issued any advertisement in any form for soliciting deposit.

(k) pay any brokerage or incentive for mobilising deposits from members or for deployment of funds or for granting loans.

(4) Share Capital and Allotment

(a) Every Nidhi shall issue equity shares of the nominal value of not less than ten rupees each.

(b) No service charge shall be levied for issue of shares.

(c) Every Nidhi shall allot to each deposit holder at least a minimum of ten equity shares or shares equivalent to one hundred rupees.

(5) Membership

(a) A Nidhi shall not admit a body corporate or trust as a member.

(b) Except as otherwise permitted under these rules, every Nidhi shall ensure that its membership is not reduced to less than two hundred members at any time.

(c) A minor shall not be admitted as a member of Nidhi.

(6) Net Owned Funds

Every Nidhi shall maintain Net Owned Funds (excluding the proceeds of any preference share capital) of not less than ten lakh rupees or such higher amount as the Central Government may specify from time to time.

(7) Branches

A Nidhi may open branches, only if it has earned net profits after tax continuously during the preceding three financial years.

1.2.1.2 Acceptance of Deposits by Nidhis

(a) A Nidhis shall not accept deposits exceeding twenty times of its Net Owned Funds (NOF) as per its last audited financial statements.

(b) The ratio specified in sub-rule (2) shall also apply to incremental deposits.

(1) The application form shall also contain the following statements, namely:

a) in case of Non-payment of the deposit or part thereof as per the terms and conditions of such deposit, the depositor may approach the Registrar of companies having jurisdiction over Nidhi.

b) in case of any deficiency of Nidhi in servicing its depositors, the depositor may approach the National Consumers Disputes Redressal Forum, the State Consumers Disputes Redressal Forum or District Consumers Disputes Redressal Forum, as the case may be, for redressal of his relief.

c) a declaration by the Board of Directors to the effect that the financial position of Nidhi as disclosed and the representations made in the application form are true and correct and that Nidhi has complied with all the applicable rules.

d) a statement to the effect that the Central Government does not undertake any responsibility for the financial soundness of Nidhi or for the correctness of any of the statement or the representations made or opinions expressed by Nidhi.

e) the deposits accepted by Nidhi are not insured and the repayment of deposits is not guaranteed by either the Central Government or the Reserve Bank of India, and

f) a verification clause by the depositor stating that he had read and understood the financial and other particulars furnished and representations made by Nidhi in his application form and after careful consideration he is making the deposit with Nidhi at his own risk and volition.

(1) Every Nidhi shall obtain proper introduction of new depositors before opening their accounts or accepting their deposits and keep on its record the evidence on which it has relied upon for the purpose of such introduction.

(2) For the purposes of introduction of depositors, a Nidhi shall obtain documentary evidence of the depositor in the form of proof of identity and address.

(1) Deposits

(a) The fixed deposits shall be accepted for a minimum period of six months and a maximum period of sixty months.

(b) Recurring deposits shall be accepted for a minimum period of twelve months and a maximum period of sixty months.

(c) In case of recurring deposits relating to mortgage loans, the maximum period of recurring deposits shall correspond to the repayment period of such loans granted by Nidhi.

(d) The maximum balance in a savings deposit account at any given time qualifying for interest shall not exceed one lakh rupees at any point of time and the rate of interest shall not exceed two per cent above the rate of interest payable on savings bank account by nationalised banks.

(e) A Nidhi may offer interest on fixed and recurring deposits at a rate not exceeding the maximum rate of interest prescribed by the Reserve Bank of India which the Non-Banking Financial Companies can pay on their public deposits.

(f) A fixed deposit account or a recurring deposit account shall be foreclosed by the depositor subject to the conditions specified under the Act:

(2) Un-Encumbered Term Deposits

Every Nidhi shall invest and continue to keep invested, in unencumbered term deposits with a Scheduled commercial bank (other than a co-operative bank or a regional rural bank), or post office deposits in its own name an amount which shall not be less than ten per cent of the deposits outstanding at the close of business on the last working day of the second preceding month.

(3) Loans

(a) A Nidhi shall provide loans only to its members.

(b) The loans given by a Nidhi to a member shall be subject to the limits specified under the Act.

(c) For the purposes of sub-rule (2), the amount of deposits shall be calculated on the basis of the last audited annual financial statements.

(d) A Nidhi shall give loans to its members only against the securities specified:

1.2.1.3 Rate of Interest

The rate of interest to be charged on any loan given by a Nidhi shall not exceed seven and half per cent above the highest rate of interest offered on deposits by Nidhi and shall be calculated on reducing balance method.

Provided that Nidhi shall charge the same rate of interest on the borrowers in respect of the same class of loans and the rates of interest of all classes of loans shall be prominently displayed on the notice board at

the registered office and each branch office of Nidhi.

1.2.1.4 Dividend

A Nidhi shall not declare dividend exceeding twenty five per cent or such higher amount as may be specifically approved by the Regional Director for reasons to be recorded in writing and further subject to the following conditions, namely:

(a) an equal amount is transferred to General Reserve.

(b) there has been no default in repayment of matured deposits and interest, and

(c) it has complied with all the rules as applicable to Nidhis.

1.2.1.5 Auditor

(1) No Nidhi shall appoint or re-appoint an individual as auditor for more than one term of five consecutive years.

(2) No Nidhi shall appoint or re-appoint an audit firm as auditor for more than two terms of five consecutive years.

1.2.1.6 Filing of Half Yearly Return

Every company covered under rule 2 shall file half yearly return with the Registrar in Form NDH-3 along with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 within thirty days from the conclusion of each half year duly certified by a company secretary in practice or chartered accountant in practice or cost accountant in practice.

1.2.1.7 Auditor's Certificate

The Auditor of the company shall furnish a certificate every year to the effect that the company has complied with all the provisions contained in the rules and such certificate shall be annexed to the audit report and in case of non-compliance, he shall specifically state the rules which have not been complied with.

1.2.1.8 Penalty for Non-Compliance

If a company falling under rule 2 contravenes any of the provisions of the rules prescribed herein, 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 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.

1.2.2 PRODUCER COMPANIES

The Companies (Amendment) Act, 2002 has introduced provisions relating to Producer Companies vide Sections 581A to 581ZT under Part-IXA of the Companies Act, 1956. Section 465 of the Companies Act, 2013, deals with the provisions relating to repeal of certain enactments and savings. However, Section 465 (1) of the Companies Act, 2013 has retained the provisions relating to Producer Companies and clarifies that these provisions shall continue to be in force in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies.

In view of the explicit provisions contained in the Companies Act, 2013, the Producer Companies are continued to be governed by the Companies Act, 1956 (Section 581A to 581ZT) for the time being. Thus, under this topic 'Producer Companies', wherever the word 'Act' is used, it refers to the Companies Act, 1956.

It must be understood that the concept of Producer companies has not taken off despite there being enough potential in view of some of the irritants like restricted tenure of directors of maximum five years. People who have for long been associated with co-operative and other such movements in India have found that the tenure of five years is too short and would force people out of the producer companies.

The tenure should be suitably enhanced. The Government has done well to retain the old provisions of Companies Act, 1956, but should give a try to remove the irritants so that the movement takes off.

1.2.2.1 Objects and Formation of A Producer Company

Producer Company means a body corporate having objects or activities specified in Section 581B and registered as a Producer Company under the Companies Act, 1956.

Every Producer Company should deal basically with the produce of its active member for carrying out any of its objects. The objects of the Producer Company, as per Section 581B, may be relating to all or any of the following matters, namely:

(a) production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the members or import of goods or services for their benefit.

(b) processing including preserving, drying, distilling, brewing, vinting, canning and packaging of produce of its member.

(c) manufacture, sale or supply of machinery, equipment or consumables mainly to its members.

(d) providing education on the mutual assistance principles to its members and others.

(e) rendering technical services, consultancy services, training, research and development and all other activities for the promotion of the interests of its members.

(f) generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communication relatable to primary produce.

(g) insurance of 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 to in clauses (a) to (i) or other activities which may promote the principles of mutuality and mutual assistance amongst the members in any other manner.

(k) financing of procurement, processing, marketing or other activities specified in clauses (a) to (j) which include extending of credit facilities or any other financial services to its members.

(1) Formation and Registration: The formalities relating to registration of a Producer Company are similar as applicable for all companies. However, for registration of a Producer Company, the requirements of Part-IXA should also be complied with. [Section 581C].

The Producer Company should also be required to submit (a) memorandum and (b) its articles duly signed by the subscribers to the memorandum, to the Registrar of the State in which the registered office of the company is to situate [Section 581G(1)].

(2) Effect of incorporation of Producer Company (Section 581K): Every shareholder of the inter-state co-operative society immediately before the date of registration of Producer Company shall be deemed to be registered on and from that date as a shareholder of the Producer Company to the extent of the face value of the shares held by such shareholder.

(3) Membership and voting rights of members (Section 581D): A person, who has any business interest which is not in conflict with business of the Producer Company, shall become a member. On the other hand, a member, who acquires any business interest which is in conflict with the business of the Producer Company, shall cease to be a member and be removed as a member in accordance with articles of the Producer Company. The articles of any Producer Company may

provide for the conditions, subject to which a member may continue to retain his membership, and the manner in which voting rights shall be exercised by the members.

(4) Benefits to member (Section 581E): The member of the Producer Company may get benefited in the following ways:

a) Every member of Producer Company, subject to provisions made in the articles, shall initially receive only such value for the produce or products pooled and supplied, as the Board of Producer Company may determine, and the withheld price may be disbursed later 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 to such extent and in such manner and subject to such conditions as may be decided by the Board.

b) Every member shall, on the share capital contributed, receive only a limited return. However, every such member may be allotted bonus shares in accordance with the provisions contained in Section 581ZJ.

c) The surplus if any, remaining after making provision for payment of limited return and reserves referred to in Section 581ZI, may also be disbursed as patronage bonus, amongst the members, in proportion to their participation in the business of the Producer Company, either in cash or by way of allotment of equity shares, or both, as may be decided by the members at the general meeting.

1.2.2.2 Memorandum of Producer Company (Section 581F)

The memorandum of association of every Producer Company should contain the following:

(a) the name of the company with 'Producer Company Limited' as the last words of the name of such Company.

(b) the State in which the registered office of the Producer Company is to situate.

(c) the main objects of the Producer Company shall be one or more of the objects specified in Section 581B.

(d) the names and addresses of the persons who have subscribed to the memorandum.

(e) the amount of share capital with which the Producer Company is to be registered and division thereof into shares of a fixed amount.

(f) the names, addresses and occupations of the subscribers being producers, who shall act as the first directors in accordance with Sub-Section (2) of Section 58IJ.

(g) that the liability of its member is limited.

(h) opposite to the subscriber's name the number of shares each subscriber takes:

(i) in case the objects of the Producer Company are not confined to one State, the States to whose territories the objects extend.

1.2.2.3 Articles of Association (Section 581G)

(a) The articles should contain the following provisions, namely:

(1) the qualifications for member, the conditions for continuance or cancellation of member and the terms, conditions and procedure for transfer of shares.

(2) the manner of ascertaining the patronage and voting right based on patronage.

(3) subject to the provisions contained in Sub-Section (1) of Section 581N, 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.

(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.

(6) the manner of disbursement of patronage bonus in cash or by issue of equity shares, or both.

(7) the contribution to be shared and related matters referred to in Sub-Section (2) of Section 581ZI.

(8) the matters relating to issue of bonus shares out of general reserves as set out in Section 581ZJ.

(9) the basis and manner of allotment of equity shares of the Producer Company in lieu of the whole or part of the 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 authorisation for division, amalgamation, merger, creation of subsidiaries and the entering into joint ventures and other matters connected therewith.

(15) laying of the memorandum and articles of the Producer Company before a special general meeting to be held within ninety days of its registration.

(16) any other provision, which the member may, by special resolution recommend to be included in articles.

(b) The articles should also contain the following mutual assistance principles, namely:

(1) 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 member.

(2) each member shall save as otherwise provided in this Part, have only a single vote irrespective of the share holding.

(3) 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 this Part and the Board shall be accountable to the members.

(4) save as provided in this Part, there shall be limited return on share capital.

(5) 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.

(6) provision shall be made for the education of member, employees and others, on principles of mutuality and techniques of mutual assistance.

(7) the Producer Company shall actively co-operate with other producer companies at local, national or international level so as to best serve the interest of their members and the communities it purports to serve.

1.2.2.4 Management

(a) **Number of directors (Section 581O)**

Every Producer Company shall have at least 5 directors and not more than 15 directors.

The proviso to the Section states that in the case of the Inter-State Co-operative Society incorporated as a Producer Company, such company may have more than 15 directors for a period of one year from the date of its incorporation as a Producer Company.

1.2.2.5 General Meetings

(a) **Matters to be transacted at general meeting (Section 581S)**

The Board of directors of a Producer Company shall exercise the following powers on behalf of the company, and it shall do so only by means of resolutions passed at the annual general meeting of its members, namely:

(1) approval of budget and adoption of annual accounts of the Producer Company.

(2) approval of patronage bonus.

(3) issue of bonus shares.

(4) declaration of limited return and decision on the distribution of patronage.

(5) specify the conditions and limits of loans that may be given by the Board to any director, and

(6) approval of any transaction of the nature as is to be reserved in the articles for approval by the members.

(b) **Quorum (Section 581Y)**

Unless the articles require a larger number, one-fourth of the total membership shall constitute the quorum at a general meeting.

(c) **Voting Rights (Section 581Z)**

Subject to Sections 581D, (1) & (3), 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.

A : 1.3 FORMATION OF NOT-FOR-PROFIT MAKING COMPANIES (SECTION 8)

Introduction

A Not-for-Profit organization also known as a non-business entity is an organization, the purpose of which is something other than making a profit. A Not-for-Profit organization is often dedicated to furthering a particular

social cause or advocating for a particular point of view. In economic terms, a Not-for-Profit organization uses its surplus revenues to further achieve its purpose or mission, rather than distributing its surplus income to the organization's shareholders (or equivalents) as profit or dividends.

Registration

Where it is proved to the satisfaction of the Central Government that a person or an association of persons proposed to be registered under this Act as a limited company:

(a) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object.

(b) intends to apply its profits, if any, or other income in promoting its objects, and

(c) intends to prohibit the payment of any dividend to its members, the Central Government may, by licence issued in such manner as may be prescribed, and on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company under this Section without the addition to its name of the word 'Limited', or as the case may be, the words 'Private Limited' , and thereupon the Registrar shall, on application, in the prescribed form, register such person or association of persons as a company under this Section.

(1) The company registered under this Section shall enjoy all the privileges and be subject to all the obligations of limited companies.

(2) A firm may be a member of the company registered under this Section.

(3) A company registered under this Section shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

(4) A company registered under this Section may convert itself into company of any other kind only after complying with such conditions as may be prescribed.

(5) Where it is proved to the satisfaction of the Central Government that a limited company registered under this Act or under any previous company law has been formed with any of the objects specified in clause (a) of Sub-Section (1) and with the restrictions and prohibitions as mentioned respectively in clauses (b) and (c) of that Sub-Section, it may, by license, allow the company to be registered under this Section subject to such conditions as the Central Government deems fit and to change its name by omitting the word 'Limited', or as the case may be, the words 'Private Limited' from its name and thereupon the Registrar shall, on application, in the prescribed form, register such company under this Section and all the provisions of this Section shall apply to that company.

(6) The Central Government may, by order, revoke the licence granted to a company registered under this Section if the company contravenes any of the requirements of this Section or any of the conditions subject to which a licence is issued or the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest, and without prejudice to any other action against the company under this Act, direct the company to convert its status and change its name to add the word 'Limited' or the words 'Private Limited', as the case may be, to its name and thereupon the Registrar shall, without prejudice to any action that may be taken under Sub-Section (7), on application, in the prescribed form, register the company accordingly.

Provided that no such order shall be made unless the company is given a reasonable opportunity of being heard.

Provided further that a copy of every such order shall be given to the Registrar.

(7) Where a licence is revoked under Sub-Section (6), the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act

or amalgamated with another company registered under this Section.

The Companies Act, 2013 Provided that no such order shall be made unless the company is given a reasonable opportunity of being heard.

(8) Where a licence is revoked under Sub-Section (6) and where the Central Government is satisfied that it is essential in the public interest that the company registered under this Section should be amalgamated with another company registered under this Section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

(9) If on the winding up or dissolution of a company registered under this Section, there remains, after the satisfaction of its debts and liabilities, any asset, they may be transferred to another company registered under this Section and having similar objects, subject to such conditions as the Tribunal may impose, or may be sold and proceeds thereof credited to the Rehabilitation and Insolvency Fund formed under Section 269 of the Companies Act, 2013.

(10) A company registered under this Section shall amalgamate only with another company registered under this Section and having similar objects. Certificate of incorporaton under this section shall mention permanant account number.

(11) If a company makes any default in complying with any of the requirements laidown in this Section, the company shall, without prejudice to any other action under the provisions of this Section, be punishable with fine which shall not be less than ten lakh rupees but which may extend to one crore rupees and the directors and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty five lakh rupees, or with both.

Provided that when it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under Section 447.

1.3.1 License Under Section 8 for Existing Companies

A limited company registered under this Act or under any previous company law, with any of the objects specified in clause (a) of Sub-Section (1) of Section 8 and the restrictions and prohibitions as mentioned respectively in clause (b) and (c) of that Sub-Section, and which is desirous of being registered under Section 8, without the addition to its name of the word 'Limited' or as the case may be, the words 'Private Limited', shall make an application in Form No.INC.12 along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014 to the Registrar for a licence under Sub-Section (5) of Section 8.

The licence shall be in Form No.INC.16 or Form No.INC.17, as the case may be, and the Registrar shall have power to include in the licence such other conditions as may be deemed necessary by him.

The Registrar may direct the company to insert in its memorandum, or in its articles, or partly in one and partly in the other, such conditions of the license as may be specified by the Registrar in this behalf.

1.3.2 Submission of Documents

The application shall be accompanied by the following documents, namely:

(a) the memorandum and articles of association of the company.

(b) the declaration as given in Form No.INC.14 by an Advocate, a Chartered accountant, Cost Accountant or Company Secretary in Practice, that the memorandum and articles of association have been drawn up in conformity with the provisions of Section 8 and rules made there under and that all the requirements of the Act and the rules made there under relating to registration of the company under Section 8 and matters incidental or supplemental thereto have been complied with.

(c) For each of the two financial years immediately preceding the date of the application, or when the company has functioned only for one financial year, for such year:

(1) the financial statements,

(2) the Board's reports, and (c) the Audit reports, relating to existing companies

(d) a statement showing in detail the assets (with the values thereof), and the liabilities of the company, as on the date of the application or within thirty days preceding that date.

(e) an estimate of the future annual income and expenditure of the company for next three years, specifying the sources of the income and the objects of the expenditure.

(f) the certified copy of the resolutions passed in general/ board meetings approving registration of the company under Section 8, and

(g) a declaration by each of the persons making the application in Form No.INC.15.

A : 1.4 PROCEDURE RELATING TO FOREIGN COMPANIES CARRYING ON BUSINESS IN INDIA

According to Section 2 (42) 'foreign company' means any company or body corporate incorporated outside India which

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode, and

(b) conducts any business activity in India in any other manner.

The Companies Act, 2013 provides detailed provisions for compliance by the foreign companies carrying on business in India. These provisions are discussed below:

1.4.1 Inspection, inquiry or investigation[Section 228]

The provisions as to inspection, inquiry or investigation under Chapter XIV of the Act shall apply 'mutatis mutandis' to foreign companies.

1.4.2 Merger into a company registered under this Act or vice versa [Section 234(2)]

Subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.

Explanation: For the purposes of sub-section (2), the expression "foreign company" means any company or body corporate incorporated outside India whether having a place of business in India or not.

1.4.3 Winding up as an unregistered company [Section 376]

Where a body corporate incorporated outside India which has been carrying on business in India, ceases to carry on business in India, it may be wound up as an unregistered company under this Part, notwithstanding that the body corporate has been dissolved or otherwise ceased to exist as such under or by virtue of the laws of the country under which it was incorporated.

1.4.4 Foreign Company shall be deemed to be an Indian Company for this purpose [Section 379]

Where not less than fifty per cent of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by one or more citizens of India or by one or more companies or bodies corporate incorporated in India, or by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with the provisions of Chapter XXII of the Act and such other provisions of the Act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India.

1.4.5 Registration with the Registrar of Companies [Section 380(1)]

(a) Every foreign company shall, within thirty days of the establishment of its place of business in India, deliver to the Registrar for registration:

(1) a certified copy of the charter, statutes 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 the English language, a certified translation thereof in the English language.

(2) the full address of the registered or principal office of the company.

(3) a list of the directors and secretary of the company containing such particulars as may be prescribed.

(4) the name and address or the names and addresses 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.

(5) the full address of the office of the company in India which is deemed to be its principal place of business in India.

(6) particulars of opening and closing of a place of business in India on earlier occasion or occasions.

(7) declaration that none of the directors of the company or the authorized representative in India has ever been convicted or debarred from formation of companies and management in India or abroad, and

(8) any other information as may be prescribed.

(b) Every foreign company existing at the commencement of this Act shall, if it has not delivered to the Registrar before such commencement, the documents and particulars specified in sub-section (1) of section 592 of the Companies Act, 1956, continue to be subject to the obligation to deliver those documents and particulars in accordance with that Act.

(c) Where any alteration is made or occurs in the documents delivered to the Registrar under this section, the foreign company shall, within thirty days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration in the prescribed form.

1.4.6 Balance sheet and profit and loss account [Section 381(1)]

(a) Every foreign company shall, in every calendar year:

(1) 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 as may be prescribed, and

(2) deliver a copy of those documents to the Registrar:

Provided that the Central Government may, by notification, 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 that notification.

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

(c) Every foreign company shall send to the Registrar along with the documents required to be delivered to him under sub-section (1), 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.

1.4.7 Display of Name of the Company [Section 382]

(a) Every foreign company shall

(b) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situate.

(c) 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, billheads and letter paper, and in all notices, and other official publications of the company, and

(d) if the liability of the members of the company is limited, cause notice of that fact:

(1) to be stated in every such prospectus issued and in all business letters, bill-heads, letter paper, notices, advertisements and other official publications of the company, in legible English characters; and

(2) to be conspicuously exhibited 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 language or one of the languages in general use in the locality in which the office or place is situate.

1.4.8 Service of documents [Section 383]

Any process, notice, or other document required to be served on a foreign company shall be deemed to be sufficiently served, if addressed to any person whose name and address have been delivered to the Registrar under Section 380 and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode.

(a) The provisions of section 71 shall apply mutatis mutandis to a foreign company [Section 384(1)].

(b) The provisions of section 92 shall, subject to such exceptions, modifications and adaptations as may be made therein by rules made under this Act, apply to a foreign company as they apply to a company incorporated in India.

(c) The provisions of section 128 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 to in that section, with respect to monies received and spent, sales and purchases made, and assets and liabilities, in the course of or in relation to its business in India.

(d) The provisions of Chapter VI shall apply mutatis mutandis to charges on properties which are created or acquired by any foreign company.

(e) The provisions of Chapter XIV shall apply mutatis mutandis to the Indian business of a foreign company as they apply to a company incorporated in India.

1.4.9 Expressions [Section 386]

For the purposes of the foregoing provisions of this Chapter:

(a) the expression "certified" means certified in the prescribed manner to be a true copy or a correct translation.

(b) the expression "director", in relation to a foreign company, includes any person in accordance with whose directions or instructions the Board of Directors of the company is accustomed to act, and

(c) the expression "place of business" includes a share transfer or registration office.

1.4.10 Issue of prospectus and Indian Depository Receipts [Section 391(1)]

The provisions of sections 34 to 36 (both inclusive) shall apply to:

(1) the issue of a prospectus by a company incorporated outside India under section 389 as they apply to prospectus issued by an Indian company;

(2) the issue of Indian Depository Receipts by a foreign company.

The provisions of Chapter XX shall apply 'mutatis mutandis' for closure of the place of business of a foreign company in India as if it were a company incorporated in India.

1.4.11 Penalty for contravention [Section 392]

Without prejudice to the provisions of section 391, if a foreign company contravenes the provisions of this Chapter, the foreign company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and in the case of a continuing offence, with an additional fine which may extend to fifty thousand rupees for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees, or with both

1.4.12 Applicability of all references under the Act [Section 405(5)]

Where a foreign company carries on business in India, all references to a company in this section shall be deemed to include references to the foreign company in relation, and only in relation, to such business.

A : 1.5 CONVERSION OF LLPS INTO PRIVATE LIMITED COMPANIES AND VICE VERSA

The LLP Act contains enabling provisions pursuant to which a firm (set up under Indian Partnership Act, 1932) and private company or unlisted public company (incorporated under Companies Act) would be able to convert themselves into LLPs. Provisions of clause 58 and Schedule II to Schedule IV to the Companies Act, 2013 provide the following procedure in this regard.

1.5.1 Conversion of LLP in to Company and vice versa

The LLP Act, 2008 does not provide any facility for conversion of a LLP into a private limited company.

As per Section 366 of the Companies Act, 2013 the 'company' includes any partnership firm, limited liability partnership, cooperative society, society or any other business entity formed under any other law for the time being in force which applied for registration of companies.

However, the Companies Act, 2013, provides for registration of LLP as a Company. The Government of India have framed the Companies (Authorised to Register) Rules, 2014 and the LLP could be converted into a Public or Private company in accordance with those rules. Such LLPs should have seven or more partners on the date of conversion.

The Act further states that, on conversion of a firm/private company/ unlisted public company into LLP, any approval, permit or license issued to the firm/private company/unlisted company under any other Act shall, subject to the provisions of such other Act under which such approval, permit or license was issued, be transferred in the name of converted entity viz., LLP. Since Stamp Duty is the subject reserved for the States, the LLP Act does not contain any provision for treatment of stamp duty issues. The stamp duty payable will depend upon the relevant Stamp Act prescribed by the State Government/ Union Territory.

Self-Assessment Questions

1. Explain the brief facts and principles of Salomon vs. Salomon & Co. Ltd. Case
2. Write Short Notes on the following :
   (a) Memorandum of Association (MOA)
   (b) Articles of Association
3. Explain the "Doctrine of lifting the corporate veil". How far does this doctrine ensure protection to third parties?
4. How the Company is registered? Discuss about the conclusiveness of certificate of Incorporation
5. Write short notes on:
   (a) Perpetual succession
   (b) Transferability of shares
   (c) Limited liability
   (d) Corporate personality
   (e) One man company.
6. Explain the provision relating to NIDHIS under Section 406 of the Companies Act, 2013.
7. Write Short notes on the following
   (a) Not-for-profit making company
   (b) Company limited by guarantee
   (c) One Person Company (OPC)
8. Explain the procedure relating to Foreign Companies carrying on business in India.
9. Explain the procedure for conversion of LLPs into Private or Public Limited Companies.
10. Write Short notes on the following :
    (a) Doctrine of 'ultra vires'
    (b) Doctrine of 'Indoor Management'

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Study Note - 1

THE COMPANIES ACT, 2013

PART - B : INVESTMENT AND LOANS

This Study Note includes:

B : 1.1 Procedure for inter-corporate loans, investments, giving off guarantee and security

B : 1.2 Acceptance of deposits, renewal, repayment, default and remedies

Chapter V and Chapter XII of the Companies Act, 2013 contain the provisions as to Acceptance of Deposits by the Companies and Inter-corporate Loans and Investments etc.,

B : 1.1 PROCEDURE FOR INTER-CORPORATE LOANS, INVESTMENTS, GIVING OFF GUARANTEE AND SECURITY

The word 'Investments' in common parlance would include any property or right in which money or capital is invested. However, in the present context the term 'Investments' is used in a limited sense to mean the investment of money in shares, stock, debentures, or other securities.

The power to invest the funds of the company is the prerogative of the Board of Directors. This power is derived by the Board under Section 179 of the Companies Act, 2013. However, the Act contains provisions for restrictions on investments that a company can make and loans it can provide. Moreover, giving corporate guarantee or security is also as good as giving a loan, because the person to whom guarantee or security is given can decide to enforce the guarantee or security in certain conditions and in such a situation, the company will have to pay the amount.

Thus apart from loan and investments, restrictions are also placed on the guarantees which the company can give or security it can provide for a loan. Provisions in respect of giving of loans, making investments, giving guarantee or providing securities have been considerably modified under Section 186 of the Companies Act, 2013.

1.1.1 Loan and investment by company (Section 186)

Section 186 of the Act provides Loan and Investment by a Company.

(a) Without prejudice to the provisions contained in this Act, a company shall unless otherwise prescribed, make investment through not more than two layers of investment companies:

Provided that the provisions of this Sub-Section shall not affect:

(1) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country.

(2) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

(3) where loan or guarantee is given or security is provided by a company to its wholly owned subsidiary or joint venture company or acquisition is made by holding company by subscription or otherwise of the securities of wholly owned subsidiary company.

(b) No company shall directly or indirectly:

(1) give any loan to any person or other body corporate.

(2) give any guarantee or provide security in connection with a loan to any other body corporate or person, and

(3) 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, free reserves and securities premium account and debit or credit balance of profit or loss account or one hundred per cent of its free reserves and securities premium account, whichever is more.

(c) Where the giving of any loan or guarantee or providing any security or the acquisition under Sub-Section (2) exceeds the limits specified in that Sub-Section, prior approval by means of a special resolution passed at a general meeting shall be necessary.

(d) The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security.

(e) No investment shall be made or loan or guarantee or security given 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 concerned 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 amount 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 as specified in Sub-Section (2) and 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.

(f) No company, which is registered under Section 12 of the Securities and Exchange Board of India Act, 1992 and covered under such class or classes of companies as may be prescribed, shall take inter-corporate loan or deposits exceeding the prescribed limit and such company shall furnish in its financial statement the details of the loan or deposits.

(g) No loan shall be given under this Section at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

(h) No company which is in default in the repayment of any deposits accepted before or after the commencement of this Act or in payment of interest thereon, shall give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting.

(i) Every company giving loan or giving a guarantee or providing security or making an acquisition under this Section shall keep a register which shall contain such particulars and shall be maintained in such manner as may be prescribed.

(j) The register referred to in Sub-Section (9) shall be kept at the registered office of the company and:

(1) shall be open to inspection at such office, and

(2) extracts may be taken there from by any member, and copies thereof may be furnished to any member of the company on payment of such fees as may be prescribed.

(k) Nothing contained in this Section, except Sub-Section (1) shall apply:

(1) to a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or a company engaged in the business of financing of industrial establishment or of providing infrastructural facilities.

(2) to any investment: (i) made by an investment company(ii)subscription to right issue (iii) by NBFC (iv) made by a company whose principal business is the acquisition of securities. (v) of shares allotted in pursuance of clause (a) of Sub-Section (1) of Section 62.

(l) The Central Government may make rules for the purposes of this Section.

(m) If a company contravenes the provisions of this Section, the company shall be punishable with fine which shall not be less than twenty five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty five thousand rupees but which may extend to one lakh rupees.

1.1.2 Investments of company to be held in its own name [Section 187]

(a) All investments made or held by a company in any property, security or other asset shall be made and held by it in its own name:

Provided that the company may hold any shares in its subsidiary company in the name of any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.

(b) Nothing in this Section shall be deemed to prevent a company:

(1) from depositing with a bank, being the bankers of the company, any shares or securities for the collection of any dividend or interest payable thereon. or Investments of company to be held in its own name.

(2) 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:

Provided that if within a period of six months from the date on 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 re-transferred 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

(3) from depositing with, or transferring to, any person any shares or securities, by way of security for the repayment of any loan advanced to the company or the performance of any obligation undertaken by it.

(4) from holding investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

(c) Where in pursuance of clause (d) of Sub-Section (2), any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall maintain a register which shall contain such particulars as may be prescribed and such register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

(d) If a company contravenes the provisions of this Section, the company shall be punishable with fine which shall not be less than twenty five thousand rupees but which may extend to twenty five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

B : 1.2 ACCEPTANCE OF DEPOSITS, RENEWAL, REPAYMENT, DEFAULT AND REMEDIES

'Deposit' includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India [Section 2 (31) of the Companies Act, 2013].

Provisions as to acceptance of deposits by companies have been considerably modified and made more stringent from Sections 73 to 76 under Chapter V of the Companies Act, 2013.

1.2.1 Prohibition on Acceptance of Deposits from Public [Section 73]

(a) On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter.

Provided that nothing in this Sub-Section shall apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

(b) A company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to the fulfilment of the following conditions, namely:

(1) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed.

(2) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular.

(3) depositing on or before 30th April each year such sum which shall not be less than twenty per cent of the amount of its deposits maturing during a financial year, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account.

(4) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits, and where the default has occured, the company made good the default and five years have elapsed since then.

(5) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company.

Provided that in case where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as 'unsecured deposits' and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

(c) Every deposit accepted by a company under Sub-Section (2) shall be repaid with interest in accordance with the terms and conditions of the agreement referred to in that Sub-Section.

(d) Where a company fails to repay the deposit or part thereof or any interest thereon under Sub-Section (3) the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

(e) The deposit repayment reserve account referred to in clause (c) of Sub-Section (2) shall not be used by the company for any purpose other than repayment of deposits.

1.2.2 Terms and Conditions of Acceptance of Deposits by Companies

(a) On and from the commencement of these rules:

(1) no company referred to in Sub-Section (2) of Section 73 and no eligible company shall accept or renew any deposit, whether secured or unsecured, which is repayable on demand or upon receiving a notice within a period of less than six months or more than thirty six months from the date of acceptance or renewal of such deposit.

Provided that a company may, for the purpose of meeting any of its short-term requirements of funds, accept or renew such deposits for repayment earlier than six months from the date of deposit or renewal, as the case may be, subject to the condition that:

a) such deposits shall not exceed ten per cent of the aggregate of the paid up share capital and free reserves of the company, and

b) such deposits are repayable not earlier than three months from the date of such deposits or renewal thereof.

(2) Where depositors so desire, deposits may be accepted in joint names not exceeding three, with or without any of the clauses, namely, 'Jointly', 'Either or Survivor', 'First named or Survivor', 'Anyone or Survivor'.

(b) No company referred to in Sub-Section (2) of Section 73 shall accept or renew any deposit from its members, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal of such deposits exceeds thirty five per cent, of the aggregate of the paid-up share capital reserves and security premium of the company.

(c) No eligible company shall accept or renew:

a) any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members exceeds ten per cent, of the aggregate of the paid-up share capital and free reserves of the company.

b) any other deposit, if the amount of such deposit together with the amount of such other deposits, other than the deposit referred to in clause (a), outstanding on the date of acceptance or renewal exceeds twenty-five per cent, of aggregate of the paid-up share capital free reserves and security premium of the company.

(d) No Government company eligible to accept deposits under Section 76 shall accept or renew any deposit, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal exceeds thirty five per cent, of the aggregate of its paid up share capital free reserves and security premium of the company.

(e) No company referred to in Sub-Section (2) of Section 73 or any eligible company shall invite or accept or renew any deposit in any form, carrying a rate of interest or pay brokerage thereon at a rate exceeding the maximum rate of interest or brokerage prescribed by the Reserve Bank of India for acceptance of deposits by non-banking financial companies.

(f) The company shall not reserve to itself either directly or indirectly a right to alter, to the prejudice or disadvantage of the depositor, any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract after circular or circular in the form of advertisement is issued and deposits are accepted.

1.2.3 Manner and Extent of Deposit Insurance

(a) Every company referred to in Sub-Section (2) of Section 73 and every other eligible company inviting deposits shall enter into a contract for providing deposit insurance at least thirty days before the issue of circular or advertisement or at least thirty days before the date of renewal, as the case may be.

Provided that the companies may accept the deposits without deposit insurance contract till the 31st March, 2018 of till date availability of deposit insure product, whichever is earlier.

(b) The deposit insurance contract shall specifically provide that in case the company defaults in repayment of principal amount and interest thereon, the depositor shall be entitled to the repayment of principal amount of deposits and the interest thereon by the insurer up to the aggregate monetary ceiling as specified in the contract.

Provided that in the case of any deposit and interest not exceeding twenty thousand rupees, the deposit insurance contract shall provide for payment of the full amount of the deposit and interest and in the case of any deposit and the interest thereon in excess of twenty thousand rupees, the deposit insurance contract shall provide for payment of an amount not less than twenty thousand rupees for each depositor.

(c) The amount of insurance premium paid on the insurance of such deposits shall be borne by the company itself and shall not be recovered from the depositors by deducting the same from the principal amount or interest payable thereon.

(d) If any default is made by the company in complying with the terms and conditions of the deposit insurance contract which makes the insurance cover ineffective, the company shall either rectify the default immediately or enter into a fresh contract within thirty days and in case of noncompliance, the amount of deposits covered under the deposit insurance contract and interest payable thereon shall be repaid within the next fifteen days and if such a company does not repay the amount of deposits within said fifteen days it shall pay fifteen per cent, interest per annum for the period of delay and shall be treated as having defaulted and shall be liable to be punished in accordance with the provisions of the Act.

1.2.4 Creation of Security

(a) For the purposes of providing security, every company referred to in sub Section (2) of Section 73 and every eligible company inviting secured deposits shall provide for security by way of a charge on its assets as referred to in Schedule III of the Act excluding intangible assets of the company for the due repayment of the amount of deposit and interest thereon for an amount which shall not be less than the amount remaining unsecured by the deposit insurance.

Provided that in the case of deposits which are secured by the charge on the assets referred to in Schedule III of the Act excluding intangible assets, the amount of such deposits and the interest payable thereon shall not exceed the market value of such assets as assessed by a registered valuer.

(b) The security (not being in the nature of a pledge) for deposits as specified in sub-rule (1) shall be created in favour of a trustee for the depositors on:

(1) specific movable property of the company, or

(2) specific immovable property of the company wherever situated, or any interest therein.

1.2.5 Appointment of Trustee for Depositors

(a) No company referred to in Sub-Section (2) of Section 73 or any eligible company shall issue a circular or advertisement inviting secured deposits unless the company has appointed one or more trustees for depositors for creating security for the deposits:

Provided that a written consent shall be obtained from the trustee for depositors before their appointment and a statement shall appear in the circular or circular in the form of advertisement with reasonable prominence to the effect that the trustees for depositors have given their consent to the company to be so appointed.

(b) The company shall execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement.

(c) No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the depositors, if the proposed trustee:

(1) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company.

(2) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company.

(3) has any material pecuniary relationship with the company.

(4) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon.

(5) is related to any person specified in clause (a) above.

(d) No trustee for depositors shall be removed from office after the issue of circular or advertisement and before the expiry of his term except with the consent of all the directors present at a meeting of the board.

Provided that in case the company is required to have independent directors, at least one independent director shall be present in such meeting of the Board.

1.2.6 Duties of Trustees

It shall be the duty of every trustee for depositors to:

(a) ensure that the assets of the company on which charge is created together with the amount of deposit insurance are sufficient to cover the repayment of the principal amount of secured deposits outstanding and interest accrued thereon.

(b) satisfy himself that the circular or advertisement inviting deposits does not contain any information which is inconsistent with the terms of the deposit scheme or with the trust deed and is in compliance with the rules and provisions of the Act.

(c) ensure that the company does not commit any breach of covenants and provisions of the trust deed.

(d) take such reasonable steps as may be necessary to procure a remedy for any breach of covenants of the trust deed or the terms of invitation of deposits.

(e) take steps to call a meeting of the holders of depositors as and when such meeting is required to be held.

(f) supervise the implementation of the conditions regarding creation of security for deposits and the terms of deposit insurance.

(g) do such acts as arc necessary in the event the security becomes enforceable.

(h) carry out such acts as are necessary for the protection of the interest of depositors and to resolve their grievances.

1.2.7 Meeting of Depositors

The trustee for depositors shall call a meeting of all the depositors on:

(a) requisition in writing signed by at least one-tenth of the depositors in value for the time being outstanding.

(b) the happening of any event, which constitutes a default or which, in the opinion of the trustee for depositors, affects the interest of the depositors.

1.2.8 Repayment of Deposits, etc., Accepted before Commencement of this Act [Section 74]

(a) Where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains un paid on such commencement or becomes due at any time thereafter, the company shall:

(1) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law, and

(2) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier:

(b) The Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.

(c) If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in Sub-Section (1) or such further time as may be allowed by the Tribunal under Sub-Section (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.

1.2.9 Maintenance of Liquid Assets and Creation of Deposit Repayment Reserve Account

Every company referred to in Sub-Section (2) of Section 73 and every eligible company shall on or before the 30th day of April of each year deposit the sum as specified in clause (c) of the said Sub-Section with any scheduled bank and the amount so deposited shall not be utilised for any purpose other than for the repayment of deposits.

Provided that the amount remaining deposited shall not at any time fall below fifteen per cent, of the amount of deposits maturing, until the end of the current financial year and the next financial year.

1.2.10 Registers of Deposits

(a) Every company accepting deposits shall maintain at its registered office one or more separate registers for deposits accepted or renewed, in which there shall be entered separately in the case of each depositor the following particulars, namely:

(1) name, address and PAN of the depositor/s.

(2) particulars of guardian, in case of a minor.

(3) particulars of the nominee.

(4) deposit receipt number.

(5) date and the amount of each deposit.

(6) duration of the deposit and the date on which each deposit is repayable.

(7) rate of interest or such deposits to be payable to the depositor.

(8) due date for payment of interest.

(9) mandate and instructions for payment of interest and for non-deduction of tax at source, if any.

(10) date or dates on which the payment of interest shall be made.

(11) details of deposit insurance including extent of deposit insurance.

(12) particulars of security or charge created for repayment of deposits.

(13) any other relevant particulars.

(b) The entries specified in sub-rule (1) shall be made within seven days from the date of issuance of the receipt duly authenticated by a director or secretary of the company or by any other officer authorised by the Board for this purpose.

(c) The register referred to in sub-rule (1) shall be preserved in good order for a period of not less than eight years from the financial year in which the latest entry is made in the register.

1.2.11 Damages for Fraud [Section 75]

(a) Where a company fails to repay the deposit or part thereof or any interest thereon referred to in Section 74 within the time specified in Sub-Section (1) of that Section or such further time as may be allowed by the Tribunal under Sub-Section (2) of that Section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in Sub-Section (3) of that Section and liability under Section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

(b) Any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

1.2.12 Acceptance of Deposits from Public by Certain Companies [Section 76]

(a) Notwithstanding anything contained in Section 73, a public company, having such net worth or turnover as may be prescribed, may accept deposits from persons other than its members subject to compliance with the requirements provided in Sub-Section (2) of Section 73 and subject to such rules as the Central Government may, in consultation with the Reserve Bank of India, prescribe.

Provided that such a company shall be required to obtain the rating (including its net worth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety and the rating shall be obtained for every year during the tenure of deposits.

Provided further that every company accepting secured deposits from the public shall within thirty days of such acceptance, create a charge on its assets of an amount not less than the amount of deposits accepted in favour of the deposit holders in accordance with such rules as may be prescribed.

(b) The provisions of this Chapter shall, mutatis mutandis, apply to the acceptance of deposits from public under this Section.

1.2.13 Punishment for contravention of Section 73 or Section 76 [Section 76A]

Where a company accepts or invites or allows or cause any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under Section 73 or Section 76

or rules made thereunder or if a company fails to repay the deposit or part thereof or any interest due thereon within the time specified under Section 73 or Section 76 or rules made thereunder or such further time as may be allowed by the Tribunal under Section 73:

(a) The company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees or twice the amount of deposit whichever is lower.

(b) Every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years and fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees.

Provided that if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under Section 447.

Self Assessment Questions

1. Discuss the law relating to inter-corporate loans and investments.

2. Which companies are exempt from the provisions with regard to inter-company investments/loans?

3. What particulars are required to be entered in the Register of Loans and Investments?

4. Explain the provisions has to prohibition on Acceptance of Deposits from the Public Under Section 73 of the Companies Act, 2013

5. Explain the provisions in respect of Acceptance of Deposits by the Companies under Chapter V of the Companies Act, 2013.

6. Write short notes on :

(i) Deposit Repayment Reserve Account

(ii) Return of deposits.

(iii) Registrar of Deposits

(iv) Deposit Insurance

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Study Note - 1

THE COMPANIES ACT, 2013

PART - C : DIVIDENDS

This Study Note includes:

C : 1.1 Profits and ascertainment of divisible profits

C : 1.2 Declaration and payment of dividend

C : 1.3 Unpaid and unclaimed dividend - Treatment and transfer to Investor Education and Protection Fund

Chapter VIII of the Companies Act, 2013 deals with the Payment and Declaration of Dividend.

C : 1.1 PROFITS AND ASCERTAINMENT OF DIVISIBLE PROFITS

Maximisation of shareholders wealth is one of the objectives of any business. Dividend in literal terms means the profit of a company which is not retained in the business and is distributed among the shareholders in proportion to the amount paid up on the shares held by them.

'Divisible profits' means the profits which the law allows the company to distribute to the shareholders by way of dividend. According to Palmer's Company Law, the terms 'divisible profits' and 'profits in the legal sense' are synonymous. The profits of a business mean the net proceeds of the concern after deducting the necessary outgoings without which those proceeds could not be earned. [Bharat Insurance Co. Ltd. v. CIT (1931) 1 Com Cases 192, 196 (Lah)].

C : 1.2 DECLARATION AND PAYMENT OF DIVIDEND

1.2.1 Meaning of Dividend

The term 'dividend' has been defined under Section 2(35) of the Companies Act, 2013. The term "Dividend" includes any interim dividend. It is an inclusive and not an exhaustive definition. According to the generally accepted definition, "dividend" means the profit of a company, which is not retained in the business and is distributed among the shareholders in proportion to the amount paid-up on the shares held by them.

Dividends are usually payable for a financial year after the final accounts are ready and the amount of distributable profits is available.

Dividend for a financial year of the company (which is called 'final dividend') are payable only if it is declared by the company at its annual general meeting on the recommendation of the Board of directors. Sometimes dividends are also paid by the Board of directors between two annual general meetings without declaring them at an annual general meeting (which is called 'interim dividend').

The companies having licence under Section 8 of the Act [Formation of companies with charitable objects etc.,] are prohibited by their constitution from paying any dividend to its members. They apply the profits in promoting the objects of the company.

1.2.2 Declaration of Dividend [Section 123]

According to Section 123 (1) of the Act dividend can be paid by a company:

(a) out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), or

(b) 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 that sub-section and remaining undistributed, or out of both, or

(c) out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government:

Provided that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company:

Provided further that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the free reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf:

Provided also that no dividend shall be declared or paid by a company from its reserves other than free reserves.

The above proviso shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments. [Inserted vide Notification dated 5th June, 2015]

Further stipulations under the rules:

(a) For declaration of dividend out of accumulated profits, the Ministry of Corporate Affairs has provided Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014. Thereby, when there is inadequacy or absence of profits in any year, a company may declare dividend out of free reserves. However, the following conditions shall be fulfilled before declaring dividend out of reserves:

(1) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the 3 years immediately preceding that year: However, this rule will not apply if a company has not declared any dividend in each of the three preceding financial year.

(2) The total amount to be drawn from such accumulated profits shall not exceed one tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement. Therefore, the total amount that can be drawn from the accumulated profits is Less than or equal to 1/10th of the Paid up share capital and free reserves.

The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

(3) The balance of reserves after such withdrawal shall not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.

[Note: "No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year or years are set off against profit of the company of the current year, inserted by the Companies (Declaration and Payment of Dividend) Amendment Rules, 2014" has been deleted vide Notification no. GSR 441(E) dated 29th May 2015.]

1.2.3 Depositing of amount of dividend

In terms of section 123(4), the amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

This sub- section shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any state government or Governments or by the Central Government and one or more State Governments.

1.2.4 Interim Dividend

According to section 2(35), 'dividend' includes any interim dividend. According to section 123(3), the Board of Directors of a company may declare interim dividend during any financial year or at any time durint the period from closure of financial year till AGM out of the surplus in the profit and loss account or out of profits of the financial year for which such interim dividend is sought to be declared or out of profit generated in Financial Year till the quarter preceding the date of declaration of dividend.

However, in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

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.

1.2.5 Payment of dividend [123(5]

According to Section 123 (5) of the Act:

(a) Dividends are payable in cash. Dividends that are payable to the shareholder in cash may be paid by cheque or warrant or in any electronic mode.

(b) Dividend shall be payable only to the registered shareholder of the share or to his order or to his banker.

(c) Nothing in sub-section 5 of section 123, shall prohibit the capitalization 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.

1.2.6 Punishment for failure to distribute dividends (Section 127)

Section 127 of the Companies Act, 2013 came into force on 12th September, 2013 which provides for punishment for failure to distribute dividend on time. According to this section:

(a) Where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within thirty days from the date of declaration to any shareholder entitled to the payment of the dividend, every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years.

(b) He shall also be liable for a fine which shall not be less than ` 1,000 rupees for every day during which such default continues.

(c) The company shall also be liable to pay simple interest at the rate of 18% p.a. during the period for which such default continues.

(d) However, the following are the exceptions under which no offence shall be deemed to have been committed:

(1) where the dividend could not be paid by reason of the operation of any law.

(2) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him.

(3) where there is a dispute regarding the right to receive the dividend.

(4) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder, or

(5) where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.

This section shall apply to the Nidhis company, subject to that where the dividend payable to a member is one hundred rupees or less, it shall be sufficient compliance of the provisions of the section, if the declaration of the dividend is announced in the local language in one local newspaper of wide circulation and announcement of the said declaration is also displayed on the notice board of the Nidhis for at least three months [Vide Notification no. 465(E) dated 5th June 2015].

1.2.7 Revocation of declared dividend:

Ordinarily, a dividend once declared at Annual General Meeting, 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.

If a dividend is declared and the amount is paid or credited to the shareholders as dividend, the character of the credit or payment as dividend cannot be altered by a subsequent resolution. [Kishanchand Chellaram v CIT (1962) 32 Comp Cas 1046,1050 (SC)].

C : 1.3 UNPAID AND UNCLAIMED DIVIDEND - TREATMENT AND TRANSFER TO INVESTOR EDUCATION AND PROTECTION FUND

(a) Investor Education and Protection Fund (IEPF) has been set-up under Section 205C of the Companies Act, 1956 by way of the Companies (Amendment) Act, 1999. As per the Act, the following amounts which have remained unclaimed and unpaid for a period of seven years from the date they became due for payment shall be credited to the IEPF:

(1) Unpaid dividend accounts of the companies.

(2) The application moneys received and due for refund.

(3) Matured deposits.

(4) The interest accrued in the amounts referred to in clauses (1) to (3).

(5) Matured debentures.

(6) Grants and donations by the Central Govt., State Govt., companies or any other institutions.

(7) The interest or other income received out of the investments made from the Fund.

The Fund has been established with a view to support the activities relating to investor education, awareness and protection.

The Act provides for setting up of a Committee for taking decisions regarding spending moneys out of the Fund for carrying out the objects.

For the purpose of administration of IEPF, the Investor Education and Protection Fund (awareness

and protection of investors) Rules were notified which contain provisions relating to constitution and functions of the Committee, activities relating to investors' education, awareness and protection to be undertaken with the recommendation of the Committee, conditions for utilisation of Funds by the Committee, proforma for applications for registration of associations, institutions or organisations and also for seeking financial assistance under IEPF, etc.

Now, Section 125 of the Companies Act, 2013 provides detailed provisions as to establishment of Fund. Under Section 125(1) of the Act, The Central Government shall establish a Fund to be called the Investor Education and Protection Fund (herein referred to as the Fund).

(b) As per Sub Section (2) of the Act, there shall be credited to the Fund:

(1) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund.

(2) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund.

(3) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub-section (5) of section 124.

(4) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act.

(5) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956.

(6) the interest or other income received out of investments made from the Fund.

(7) the amount received under sub-section (4) of section 38.

(8) the application money received by companies for allotment of any securities and due for refund.

(9) matured deposits with companies other than banking companies.

(10) matured debentures with companies.

(11) interest accrued on the amounts referred to in clauses (8) to (10).

(12) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years.

(13) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years, and

(14) such other amount as may be prescribed.

(c) According to Sub-Section 3, the fund shall be utilised for:

(1) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon.

(2) promotion of investors' education, awareness and protection.

(3) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement.

(4) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 of the Act by members, debenture-holders or depositors as may be sanctioned by the Tribunal, and

(5) any other purpose incidental thereto, in accordance with such rules as may be prescribed:

(d) The following procedure should be followed by the company while transferring unpaid or unclaimed dividend from unpaid dividend account to IEPF:

(1) Section 124(5) of the Act, 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 is required to be transferred by the company along with interest accrued, if any, thereon to the Investor Education and Protection Fund (IEPF) established under Section 125.

(2) The amount shall be remitted into the specified branches of State Bank of India or any other nationalized bank along with challan (in triplicate) within a period of 90 days of such amount becoming due to be credited to the IEPF. The Bank will return two copies duly stamped to the Company as token of having received the amount and the company shall file one such copy of challan to the authority.

(3) The company shall send a statement of amount credited to Investor Education and Protection Fund in Form DIV 5 to the authority which administer the fund and the authority shall issue a receipt to the company as evidence of such transfer.

(4) On receipt of this statement, the authority shall enter the details of such receipts in a register maintained by it in respect of each company every year and reconcile the amount.

(5) The company shall keep a record consisting of names, last known addresses of the persons entitled to receive the same, the amount to which each person is entitled, folio number/ client ID, certificate number, beneficiary details etc. of the persons in respect of whom amount has been remain unpaid or unclaimed for 7 years and transferred to IEPF. Such record shall be maintained for a period of 8 years from the date of such transfer to IEPF and authority shall have the powers to inspect such records.

(e) Any person claiming to be entitled to the amount referred in sub-section (2) may apply to the authority constituted under Sub-Section (5) for the payment of the money claimed.

(f) The Central Government shall constitute, by notification, an authority for administration of the Fund consisting of a Chairperson and such other members, not exceeding seven and a chief executive officer, as the Central Government may appoint.

(g) The manner of administration of the Fund, appointment of chairperson, members and chief executive officer, holding of meetings of the authority shall be in accordance with such rules as may be prescribed.

(h) The Central Government may provide to the authority such offices, officers, employees and other resources in accordance with such rules as may be prescribed.

Self Assessment Questions

(1) Dividend must be paid only out of profits and after providing for depreciation as provided under section 125 of Companies Act, 2013. Explain.

(2) Explain the law relating to declaration and payment of final dividend.

(3) State the legal provisions relating to disposal of unpaid and unclaimed dividend.

(4) Both interim and final dividend when declared become debt and are payable within 30 days of declaration.

(5) Under Section 2(35) of the Companies Act, 2013, 'dividend' includes any interim dividend. Explain.

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Study Note - 1

THE COMPANIES ACT, 2013

PART - D : ACCOUNTS AND AUDIT

This Study Note includes:

D : 1.1 Maintenance of Books of Accounts

D : 1.2 Statutory Auditor, Special Auditor and Cost Auditor - Appointment, resignation, removal, qualification, disqualification, rights, duties and liabilities

D : 1.3 Companies Auditor Report Order (CARO) Rules, 2016

Chapter IX and Chapter X of the Companies Act, 2013 contain the provisions as to Accounts of Companies (Section 128 to Section 138); and Audit and Auditors (Section 139 to Section 148) respectively.

D : 1.1 MAINTENANCE OF BOOKS OF ACCOUNTS (SECTION 128)

According to Section 2(13) of the Companies Act, 2013, "Books of Account" includes records maintained in respect of:

(i) All sums of money received and expended by a company and matters in relation to which receipts and expenditure take place;

(ii) All sales and purchases of goods and services by the company ;

(iii) The assets and liabilities of the company; and

The items of costs as may be prescribed under Section 148 in the case of a company which belongs to any class of companies specified under that section

Section 128 of the Companies Act, 2013 provides for Books of account, etc., to be kept by the company. This provision came into force from 1st April, 2014. This Section provides:

1.1.1 Maintenance of books of accounts [Section 128 (1)]

(a) Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any.

(b) The company shall be in a position to explain the transactions effected both at the registered office and its branches.

(c) Such books of Account shall be kept on accrual basis and according to the double entry system of accounting.

1.1.2 Place of maintenance of books of account [Section 128 (1)]

(a) The books of account and other relevant papers are required to be kept at the registered office of the company.

(b) The company may also keep all or any of the books of account at any other place in India as the Board of directors may decide. In such a case, the company shall file with the Registrar of Companies, a notice in writing giving the full address of that other place within 7 days of the Board's decision.

1.1.3 Electronic form of Books of account [Section 128 (1)]

(a) Rule 3 of the Companies (Accounts) Rules, 2014 provides that the company may keep its books of account or other relevant papers in electronic mode.

(b) The books of account and other relevant books and papers maintained in electronic mode shall:

(1) remain accessible in India so as to be usable for subsequent reference.

(2) be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.

(3) The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches.

(4) The information in the electronic record of the document shall be capable of being displayed in a legible form.

(5) There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law.

(6) The back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis.

(c) The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement:

(1) the name of the service provider.

(2) the internet protocol address of service provider.

(3) the location of the service provider (wherever applicable).

(4) where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider .

1.1.4 Proper books of account in relation to a branch of the company [Section 128(2)]

Where company has a branch office in India or outside India, proper books of account relating to the transactions effected at the branch office may be kept at that branch office.

Provided, proper summarised returns periodically must be sent by the branch office to the company at its registered office or the other place as decided by the Board of directors.

1.1.5 Persons who can inspect [Section 128 (3) and (4)]

(a) The books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours.

(b) In the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as prescribed under the Rule 4 of the Companies (Accounts) Rules, 2014 which provides that:

(1) The summarised returns of the books of account of the company kept and maintained outside

India shall be sent to the registered office at quarterly intervals, which shall be kept and maintained at the registered office of the company and kept open to directors for inspection.

(2) Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought, the period for which such information is sought.

(3) The company shall produce such financial information to the director within 15 days of the date of receipt of the written request.

(4) The financial information required under Sub-rules (2) and (3) above shall be sought for by the director himself and not by or through his power of attorney holder or agent or representative.

(c) The inspection in respect of any subsidiary of the company shall be done only by the person authorised in this behalf by a resolution of the Board of Directors.

(d) The officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.

1.1.6 Period of Maintenance [Section 128 (5)]

(a) The books of account of every company together with the vouchers relevant to any entry in such books of account shall be kept in good order by the company for a minimum period of 8 financial years immediately preceding a financial year.

(b) Where the company had been in existence for a period of less than 8 years, it shall maintain the books of account in respect of all such preceding years in good order.

(c) Where an investigation has been ordered in respect of the company, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.

1.1.7 Persons responsible for Maintenance & Penalty [Section 128 (6)]

(a) The following persons are responsible for the maintenance of proper books of account:

(1) The managing director, the whole-time director in charge of finance, the Chief Financial Officer, or

(2) any other person of a company charged by the Board.

(b) If any of the persons mentioned above contravenes provisions of this Section, they shall be punishable with:

(1) Imprisonment for a term which may extend to 1 year, Or

(2) Fine which shall not be less than ` 50,000 but which may extend to ` 5 lakh, or

(3) Both with imprisonment and fine.

1.1.8 Financial Statement [Section 129]

(a) As per the definition of Financial Statement under Section 2(40), 'financial statement' in relation to the company includes:-

1) A balance sheet as at the end of the financial year

2) A profit & loss account, or in case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

3) Cash Flow Statement for the financial year;

4) A statement of changes in equity, if applicable; and

5) Any explanatory note annexed to or forming part of any document referred above.

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include Cash Flow Statement.

(b) Section 129(1) provides that the financial statements shall:

(1) give a true and fair view of the state of affairs of the company or companies,

(2) comply with the accounting standards notified under Section 133 and,

(3) shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.

(4) However, the items contained in such financial statements shall be in accordance with the accounting standards.

(c) The above provisions relating to form and content of financial statement shall not apply to following companies:

(1) Insurance Companies, or

(2) Banking companies, or

(3) Company engaged in the generation or supply of electricity, or

(4) Any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

(d) If the following disclosures are not made, the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company:

(1) In case of Insurance Company, matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999.

(2) In case of Banking Company, matters which are not required to be disclosed by the Banking Regulation Act, 1949.

(3) In case of Company engaged in the generation or supply of electricity, matters which are not required to be disclosed by the Electricity Act, 2003.

(4) In case of company governed by any other law, matters which are not required to be disclosed by that law.

(e) Here, any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under this Act.

1.1.9 Laying of financial statements at Annual General Meeting [Section 129(2)]

At every annual general meeting of a company, the Board of directors of the company shall lay before such meeting the financial statements for the financial year.

1.1.10 Consolidated Financial Statements [Section 129(3) & (4)]

(a) Where a company has one or more subsidiaries, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

(b) The Consolidated financial statements shall also be laid before the annual general meeting of the company along with the laying of its own financial statement.

(c) The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in Form AOC-1.

(d) For the purposes of consolidated financial statements, subsidiary shall include associate company.

(e) According to Rule 6 of the Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act. (Proviso to Rule 6)

'Provided further that nothing in this rule shall apply in respect of preparation of consolidated financial statements by a company if it meets the following conditions:-

(i) It is a wholly owned subsidiary, or is a partially owned subsidiary of another company and all its other members, including those who are not otherwise entitled to vote, having been intimated in writing and for which proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;

(ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and

(iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with applicable Accounting Standards.'

Nothing contained in this rule shall, subject to any other law or regulation, apply for the financial year commencing from the 1st day of April, 2014 and ending on the 31st March, 2015, in case of a company which does not have a subsidiary or subsidiaries but has one or more associate companies or joint ventures or both, for the consolidation of financial statement in respect of associate companies or joint ventures or both, as the case may be.

Provided also that nothing in this rule shall apply in respect of consolidation of financial statement by a company having subsidiary or subsidiaries incorporated outside India only for the financial year commencing on or after 1st April, 2014.

(f) The provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to the consolidated financial statements [Section 129(4)].

1.1.11 Deviations from Accounting Standards [Section 129 (5)]

If the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements the following namely:

(a) the deviation from the accounting standards.

(b) the reasons for such deviation and

(c) the financial effects, if any, arising out of such deviation.

1.1.12 Exemptions [Section 129 (6)]

(a) The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this Section or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest.

(b) Any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

This notification shall be applicable in respect of financial statement prepared in respect of the financial years ending on or after the 31st March, 2016.

1.1.13 Contravention [Section 129 (7)]

If a company contravenes the provisions of this Section, the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this Section and in the absence of any of the officers mentioned above, all the directors shall be punishable with

(a) Imprisonment for a term which may extend to 1 year, or

(b) Fine which shall not be less than ₹ 50,000 but which may extend to ₹ 5 lakhs, or

(c) Both with imprisonment and fine.

1.1.14 Central Government to prescribe Accounting Standards (Section 133)

Section 133 of the Companies Act, 2013 deals with the power of the Central Government to prescribe the accounting standards. Accounting Standards means the standards of accounting or any addendum thereto as recommended by the Institute of Chartered Accountants of India (ICAI) constituted under Section 3 of the Chartered Accountants Act, 1949, as may be prescribed by the Central Government in consultation with and after examination of the recommendations made by the National Financial Reporting Authority constituted under Section 132 of the Companies Act, 2013.

In respect of accounting standards, the role of National Financial Reporting Authority is limited to advise the Central Government on the accounting standards recommended by ICAI for adoption by companies.

Financial Reporting Authority, the existing Accounting Standards notified under the Companies Act, 1956 shall continue to apply.

1.1.15 Financial Statement, Board's report, etc (Section 134)

Section 134 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for financial statement, Board's report, etc. According to this Section:

(a) **Authentication of Financial statements [Sections 134 (1), (2) & (7)]**

(1) The financial statements, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board at least by the following:

a) The chairperson of the company where he is authorised by the Board, or

b) By two directors out of which one shall be managing director and other the Chief Executive Officer, if he is a director in the company,

c) The Chief Financial Officer, wherever he is appointed, and

d) The company secretary of the company, wherever he is appointed.

(2) In the case of a One Person Company, the financial statement shall be signed by only one director, for submission to the auditor for his report thereon.

(3) The auditors' report shall be attached to every financial statement [Section 134(2)].

(4) A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of

a) Any notes annexed to or forming part of such financial statement.

b) The auditor' report. and

c) The Board's report. [Section 134(7)]

(b) **Board's report [Sections 134 (3) & (4)]**

(1) According to Companies (Accounts) Rules, 2014, the Board's Report shall be prepared based on the stand alone financial statements of the company and vide notification G.S.R. 742(E) dated 27th July, 2016, Board report shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report.

(2) There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include:

a) The extract of the annual return as provided under Sub-Section (3) of Section 92 in Form MGT-9; to be placed in website and webaddress to be mentioned in Board Report.

b) number of meetings of the Board;

c) Directors' Responsibility Statement;

d) Details in respect of frauds reported by auditors under Section 143 (12) other than those which are reportable to the Central Government. [inserted by the Companies [Amendment) Act, 2015 notified on 29th May, 2015]

e) a statement on declaration given by independent directors under Sub-Section (6) of Section 149.

f) in case of a company covered under Sub-Section (1) of Section 178, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under Sub-Section (3) of Section 178.

However, it is provided vide notification no. G.S.R. 463 (E) dated 5th June, 2015, this clause shall not apply to Government Company.

g) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made:

1) by the auditor in his report. and

2) by the company secretary in practice in his secretarial audit report.

h) particulars of loans, guarantees or investments under Section 186.

i) particulars of contracts or arrangements with related parties referred to in Sub- Section (1) of Section 188 in Form AOC-2.

j) the state of the company's affairs.

k) the amounts, if any, which it proposes to carry to any reserves.

l) the amount, if any, which it recommends should be paid by way of dividend.

m) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report.

n) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as prescribed under the Rule 8(3) of the Companies (Accounts) Rules, 2014 which provides for.

o) A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company.

p) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year alongwith the webaddress where the policy is hosted.

q) Every listed company and every other public company having a paid up share capital of ` 25 crore or more calculated at the end of the preceding financial year shall include (as prescribed under the Companies (Accounts) Rules, 2014), in the report by its Board of directors, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.

r) Such other matters as contain as prescribed under the Companies (Accounts) Rules, 2014. According to which the report of the Board shall also contain:

   1) the financial summary or highlights.

   2) the change in the nature of business, if any.

   3) the details of directors or key managerial personnel who were appointed or have resigned during the year.

   4) the names of companies which have become or ceased to be its subsidiaries, joint ventures or associate companies during the year.

   5) the details relating to deposits like:

      a. accepted during the year.

      b. remained unpaid or unclaimed as at the end of the year.

      c. whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved:

         1. at the beginning of the year.

         2. maximum during the year.

         3. at the end of the year.

   6) the details of deposits which are not in compliance with the requirements of Chapter V of the Act.

7) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future.

8) the details in respect of adequacy of internal financial controls with reference to the Financial Statements.

(c) **Board's Report in case of OPC [Section 134 (4)]**

In case of a One Person Company, the report of the Board of Directors to be attached to the financial statement under this Section shall, mean a report containing explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.

(d) **Directors' Responsibility Statement [Section 134 (5)**

The Directors' Responsibility Statement referred to in 134 (3) (c) shall state that:

(a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures.

(b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period.

(c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

(d) the directors had prepared the annual accounts on a going concern basis, and

(e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Here, the term "internal financial controls" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

(f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

(e) **Signing of Board's Report [Section 134(6)]**

The Board's report and any annexures thereto shall be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.

(f) **Contravention [Section 134(8)]**

(a) If a company contravenes any provisions of this Section, the company shall be punishable with fine which shall not be less than ₹ 50,000 but which may extend to ₹ 25 lacs.

(b) Every officer of the company who is in default shall be punishable with:

(1) Imprisonment for a term which may extend to 3 years. or

(2) fine which shall not be less than ₹ 50,000 but which may extend to ₹ 5 lacs, or

(3) Both with imprisonment and fine

1.1.16 Corporate Social Responsibility (Section 135)

Corporate Social Responsibility ('CSR') was introduced in the Companies Act, 2013. It requires that every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The Board's report shall disclose the composition of the Corporate Social Responsibility Committee where independent director is not required, any two or more director shall be in committee.

The Corporate Social Responsibility Committee shall formulate and recommend to the Board a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII of the Companies Act, 2013, it shall recommend the amount of expenditure to be incurred on the activities referred to above and monitor the Corporate Social Responsibility Policy of the company from time-to-time.

The Board of every company shall after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve of the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed and ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:

(a) Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility.

(b) Provided further that if the company fails to spend such amount, the Board shall, in its report made specify the reasons for not spending the amount.

Average net profit shall be calculated in accordance with the provisions of Section 198 of the Companies Act, 2013.

In this context, the ICAI has issued a guidance note on accounting for expenditure on corporate social responsibility (CSR) activities. It provides guidance on the recognition, measurement, presentation and disclosure of expenditure on activities relating to CSR activities.

1.1.17 Right of member to copies of Audited Financial Statement (Section 136)

According Section 136 of the Companies Act, 2013:

(a) A copy of the financial statements, which are to be laid before a company in its general meeting, shall be sent to the following:

(1) every member of the company,

(2) to every trustee for the debenture holder of any debentures issued by the company, and

(3) to all persons other than such member or trustee, being the person so entitled.

(b) Consolidated financial statements, if any, auditors' report and every other document required by law to be annexed or attached to the financial statements shall be annexed with financial statements.

(c) These financial statements shall be sent in not less than 21 days before the date of the meeting. May be sent less than 21 days before if shareholders with 95% voting agree.

(d) In the case of a listed company:

(1) The above provisions shall be deemed to be complied with, if the copies of the documents are made available for inspection at its registered office during working hours for a period of 21 days before the date of the meeting.

(2) Along with it a statement containing the salient features of such documents in the Form AOC-3 or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company.

(3) The statement is to be sent not less than 21 days before the date of the meeting unless the shareholders ask for full financial statements.

Vide Circular No. 11/2015 dated 21st July, 2015, it is clarified that a company holding a general meeting after giving a shorter notice as provided under Section 101 of the Act may also circulate financial statements (to be laid/considered in the same general meeting) at such shorter notice.

Vide Notification No. G.S.R. 466(E) dated 5th June, 2015, in respect of Section 8 companies, for the word "twenty one days" , the words "fourteen days" shall be substituted.

(e) A company shall also allow every member or trustee of the debenture holder to inspect the audited Financial Statement at its registered office during business hours.

(f) In case of all listed companies and such public companies which have a net worth of more than one crore rupees and turnover of more than ten crore rupees, the financial statements may be sent:

(1) by electronic mode to such members whose shareholding is in dematerialized format and whose email Ids are registered with Depository for communication purposes.

(2) where Shareholding is held otherwise than by dematerialized format, to such members who have positively consented in writing for receiving by electronic mode, and

(3) by dispatch of physical copies through any recognised mode of delivery as specified under Section 20 of the Act, in all other cases.

(g) A listed company shall also place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website, which is maintained by or on behalf of the company.

(h) Every company having a subsidiary or subsidiaries shall:

(1) place separate audited accounts in respect of each of its subsidiary on its website, if any.

(2) provide a copy of separate audited financial statements in respect of each of its subsidiary, to any shareholder of the company who asks for it.

(i) listed company having subsidiary which is required to be consolidated under the law of the country shall place such account on its website (Indian holding company). Further if such subsidiary is not supposed to get audited, such unaudited accounts shall be placed in website of Indian holding company. If the accounts are prepared in one language, other than English, the English translated version is to be placed in holding company website.

1.1.18 Contravention

(a) If any default is made in complying with the provisions of this Section, the company shall be liable to a penalty of ₹ 25,000.

(b) Every officer of the company who is in default shall be liable to a penalty of ₹ 5,000.

1.1.19 Copy of financial statements to be filed with Registrar (Section 137 of the Companies Act, 2013)

Section 137 of the Companies Act, 2013 provides for copy of financial statements to be filed with Registrar. According to this Section:

(a) Filing of financial statements [Section 137 (1)]

A copy of the financial statements, including consolidated financial statement, if any, along with all the documents which are required to be or attached to such financial statements under this Act, duly adopted at the annual general meeting of the company, shall be filed with the Registrar within 30 days of the date of annual general meeting in such manner, with such fees or additional fees as may be prescribed within the time specified under Section 403.

(b) If Financial Statements are not adopted [First proviso to Section 137 (1)]

(a) Where the financial statements are not adopted at annual general meeting or adjourned annual general meeting, such unadopted financial statements along with the required documents shall be filed with the Registrar within 30 days of the date of annual general meeting.

(b) The Registrar shall take them in his records as provisional till the financial statements are filed with him after their adoption in the adjourned annual general meeting for that purpose.

(c) If the financial statements are adopted in the adjourned annual general meeting, then they shall be filed with the Registrar within 30 days of the date of such adjourned annual general meeting with such fees or such additional fees as may be prescribed within the time specified under Section 403 (i.e. within 270 days from the date by which it should have been filed with additional fees).

(c) Filing by One Person Company [Third proviso to Section 137 (1)]

A One Person Company shall file a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, within 180 days from the closure of the financial year.

(d) Company having subsidiaries outside India [Fourth proviso to Section 137 (1)]

A company shall, along with its financial statements to be filed with the Registrar, attach the accounts of its subsidiary or subsidiaries which have been incorporated outside India and which have not established their place of business in India.

It has also been clarified vide General Circular No. 11/2015 dated 21st July 2015 that in case of foreign company which is not required to get its accounts audited as per the legal requirements prevalent in the country of its incorporation and which does not get such accounts audited, the holding or parent Indian may place or file such unaudited accounts to comply with requirements of Section 136 (1) and 137 (1) as applicable. Further, the format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.

(e) Annual General meeting not held [Section 137 (2)]

Where the annual general meeting of a company for any year has not been held, the financial statements along with the documents required to be attached, duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty days of the last date before which the annual general meeting should have been held and in such manner, with such fees or additional fees as may be prescribed within the time specified, under Section 403.

(f) Penalty [Section 137 (3)]

If any of the provisions of this Section are contravened:

(a) The company shall be punishable with fine of ₹ 1,000 for every day during which the failure continues but which shall not be more than ₹ 10 Lacs, and

(b) The managing director and the Chief Financial Officer of the company, if any, and, in the absence of the managing director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of this Section, and, in the absence of any such director, all the directors of the company, shall be punishable with:

(1) Imprisonment for a term which may extend to 6 months, or

(2) Fine which shall not be less than ₹1 lac but which may extend to ₹5 Lacs, or

(3) Both with imprisonment and fine.

1.1.20 Internal Audit (Section 138)

There was no provision under the Companies Act, 1956 for Internal Audit. Section 138 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for it. According to Section 138 of the Companies Act, 2013 and the Companies (Accounts) Rules, 2014:

(a) Companies required to appoint Internal Auditor

(1) The following class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate [As amended vide notification no. G.S.R. 742(E) dated 27th July, 2016], namely:

a) every listed company.

b) every unlisted public company having:

1) paid up share capital of ₹ 50 crore or more during the preceding financial year, or

2) turnover of ₹ 200 crore or more during the preceding financial year, or

3) outstanding loans or borrowings from banks or public financial institutions exceeding ₹100 crores or more at any point of time during the preceding financial year, or

4) outstanding deposits of ₹ 25 crore or more at any point of time during the preceding financial year, and

c) every private company having:

1) turnover of ₹ 200 crore or more during the preceding financial year, or

2) outstanding loans or borrowings from banks or public financial institutions exceeding ₹100 crore or more at any point of time during the preceding financial year.

(2) The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

(b) Transitional period

An existing company covered under any of the above criteria shall comply with the requirements of Section 138 and this rule within 6 months of commencement of such Section.

(c) Who is Internal Auditor

(a) Internal Auditor shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company. Here, the term Chartered Accountant shall mean a Chartered Accountant whether engaged in practice or not.

(b) The internal auditor may or may not be an employee of the company.

D : 1.2 STATUTORY AUDITOR, SPECIAL AUDITOR AND COST AUDITOR - APPOINTMENT, RESIGNATION, REMOVAL, QUALIFICATION, DISQUALIFICATION, RIGHTS, DUTIES AND LIABILITIES

1.2.1 Appointment of auditors [Section 139]

Section 139 of the Companies Act, 2013 provides for appointment of auditors. This provision came into force from 1st April, 2014. This Section provides:

1.2.1.1 Appointment of auditor [Section 139 (1)]

(a) Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor of the company.

(b) The auditor shall hold office from the conclusion of 1st annual general meeting (AGM) till the conclusion of its 6th AGM and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at AGM has been prescribed under the Companies (Audit and Auditors) Rules, 2014. According to the Rules:

(c) Manner and Procedure of selection and appointment of auditors [Rule 3 of Companies (Audit and Auditors) Rules, 2014]:

(1) In case of a company that is required to constitute an Audit Committee under Section 177, the committee and in case where such a committee is not required to be constituted, the Board shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.

(2) Audit Committee or the board, as the case may be, shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court.

(3) It may call for such other information from the proposed auditor as it may deem fit.

(4) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the AGM.

(5) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.

(6) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.

(d) Before the appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.

(e) Certificate by Auditor: The Companies (Audit and Auditors) Rules, 2014 provides the content of the

Certificate. According to this, the auditor appointed shall submit a certificate that:

(1) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made there under.

(2) the proposed appointment is as per the term provided under the Act.

(3) the proposed appointment is within the limits laid down by or under the authority of the Act.

(4) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

(f) The certificate shall also indicate whether the auditor satisfies the criteria provided in Section 141 [Section 141 provides provisions on eligibility, qualification and disqualification of Auditor which will be discussed later].

(g) Further, the company shall inform the auditor concerned of his or its appointment, and also file a notice (in the Form ADT-1) of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

Note : It may kindly be noted that appointment includes reappointment also.

1.2.1.2 Term of Auditor [Section 139 (2)]

(a) Section 139 (2) provides that listed companies and other prescribed class or classes of companies (except one person companies and small companies) shall not appoint or re-appoint:

(1) an individual as auditor for more than one term of five consecutive years, and

(2) an audit firm as auditor for more than two terms of five consecutive years.

(b) Rule 5 of the Companies (Audit and Auditors) Rules, 2014 has prescribed the following classes of companies for the purposes of Section 139 (2):

(1) all unlisted public companies having paid up share capital of ₹ 10 crore or more.

(2) all private limited companies having paid up share capital of ₹ 20 crore or more.

(3) all companies having paid up share capital of below threshold limit mentioned in (1) and (2) above, but having public borrowings from financial institutions, banks or public deposits of ` 50 crores or more.

(c) Cooling off Period:

(1) An individual auditor who has completed his term (i.e., one term of five consecutive years) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term.

(2) An audit firm which has completed its term (i.e., two terms of five consecutive years) shall not be eligible for re- appointment as auditor in the same company for five years from the completion of such term.

(d) Further, as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

(e) Every company, existing on or before the commencement of this Act which is required to comply

with provisions of Section 139 (2), shall comply with the requirements of this Sub-Section within three years from the date of commencement of this provision.

(f) It is also provided that nothing contained in this Sub-Section shall prejudice the right of the company to remove an auditor or the right of the auditor to resign from such office of the company.

1.2.1.3 Rotation of auditor [Section 139 (3) and (4)]

(a) Members of a company may resolve to provide that:

(1) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members, or

(2) audit shall be conducted by more than one auditor.

(b) The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors.

(c) Manner of rotation of auditors by the companies on expiry of their term as provided under the Companies (Audit and Auditors) Rules, 2014:

(1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.

(2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

(3) For the purpose of the rotation of auditors:

a) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be.

b) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

The term: same network includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

c) For the purpose of rotation of auditors:

1) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation.

2) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

1.2.1.4 First auditors [Section 139 (6)]

(a) Notwithstanding anything contained in Sub-Section (1), the first auditor of a company, other than a Government Company, shall be appointed by the Board of directors within 30 days of the date of registration of the company and the auditor so appointed shall hold office until the conclusion of the first annual general meeting.

(b) If the Board fails to exercise its powers i.e. appointment of first auditor, it shall inform the members of

the company and the company in general meeting may appoint the first auditor within 90 days at an extra ordinary general meeting and such auditor shall hold office till the conclusion of the first annual general meeting.

1.2.1.5 Filling up casual vacancy [Section 139 (8)]

(a) The Board may fill any casual vacancy in the office of an auditor within 30 days but where such vacancy is caused by the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board.

(b) Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting.

1.2.1.6 Appointment of auditors in case of Government Company or any other company having controlled by State Government or Central Government [Sections 139 (5), 139 (7) and 139 (8)]

(a) As per Section 139 (5), the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act in the case of:

(1) a Government company, or

(2) any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments.

(b) The auditor shall be appointed within a period of 180 days from the commencement of the financial year. The auditor appointed shall hold office till the conclusion of the annual general meeting.

(1) **First auditor [Section 139 (7)]**

a) In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor General of India within 60 days from the date of registration of the company.

b) In case the Comptroller and Auditor General of India does not appoint first auditor within the said period, the Board of Directors of the company shall appoint such auditor within the next 30 days.

c) Further, in the case of failure of the Board to appoint such auditor within the next 30 days, it shall inform the members of the company who shall appoint such auditor within the 60 days at an extraordinary general meeting, who shall hold office till the conclusion of the first annual general meeting.

(2) **Casual vacancy [Section 139 (8)]**

a. In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor General of India, casual vacancy of an auditor be filled by the Comptroller and Auditor General of India within 30 days.

b. In case the Comptroller and Auditor-General of India do not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next 30 days.

(3) **Clarification with regard to applicability of Sections 139 (5) and 139 (7) by MCA**

Deemed government Company (as per Section 619B of the Companies Act, 1956):

The following companies shall be deemed to be a Government company, if not less than 51% (impliedly, may be more) of the paid up share capital is held by one or more of the following or any combination thereof:

1) the Central Government and one or more Government companies.

2) any State Government or Governments and one or more Government companies.

3) the Central Government, one or more State Governments and one or more Government companies.

4) the Central Government and one or more corporations owned or controlled by the Central Government.

5) the Central Government, one or more State Governments and one or more corporations owned and controlled by the Central Government.

6) one or more corporations owned or controlled by the Central Government or the State Government.

7) more than one Government company.

1.2.1.7 Re-appointment of retiring auditor [Sections 139 (9), (10) and (11)]

(a) At any annual general meeting, a retiring auditor may be re-appointed at an AGM, if:

(1) he is not disqualified for re-appointment;

(2) he has not given the company a notice in writing of his unwillingness to be reappointed, and

(3) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

(b) Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

1.2.1.8 Audit committee's recommendation [Section 139 (11)]

Where a company is required to constitute an Audit Committee under Section 177, all appointments, including the filling of a casual vacancy of an auditor under this Section shall be made after taking into account the recommendations of such committee.

1.2.1.9 Removal, resignation of auditor and giving of special notice (Section 140)

Section 140 of the Companies Act, 2013 came into force partially from 1st April, 2014 which provides for removal, resignation of auditor and giving of special notice. According to this Section:

(a) The auditor appointed under Section 139 may be removed from his office before the expiry of his term only by a special resolution of the company and after obtaining the previous approval of the Central Government by making an application in E-Form ADT-2 and shall be accompanied with the prescribed fees.

(b) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.

(c) The Company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution. [Every special resolution is required to be filed in E-Form MGT-14 as per Section 117(3)(a)].

(d) Giving opportunity of being heard (Audi Alteram Partem) i.e., before taking any action for removal of auditor before the expiry of his term, the auditor concerned shall be given a reasonable opportunity of being heard.

1.2.1.10 Resignation by Auditor [Sections 140 (2) & (3)]

(a) If the Auditor has resigned from the company, he shall file within a period of 30 days from the date of resignation, a statement in the form ADT-3 with the company and the Registrar.

(b) In case of government companies or company controlled by Central Government or State Government, the auditor shall also file such statement with the Comptroller and Auditor General of India also along with company and the Registrar.

(c) The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation, in the statement

(d) If the auditor does not comply with aforesaid provision, he or it shall be punishable with fine which shall not be less than ₹ 50,000 but which may extend to ₹ 5 Lacs.

1.2.1.11 Special Notice for removing Auditor before the expiry of his term [Section 140 (4)]

(a) If the retiring auditor has not completed a consecutive tenure of 5 years or, as the case may be, 10 years, as provided under Sub-Section (2) of Section 139, special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed.

(b) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.

(c) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so:

(1) in any notice of the resolution given to members of the company, state the fact of the representation having been made, and

(2) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company.

(d) If a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.

(e) However, if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar.

1.2.2 Eligibility, qualifications and disqualifications of auditors (Section 141)

1.2.2.1 Qualifications of an auditor [Section 141 (1) & (2)]

(a) A person shall be eligible to be appointed as auditor of a company only if he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.

(b) A firm whereof majority of partners practicing in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

(c) Where a firm including a Limited Liability Partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

1.2.2.2 Disqualifications of auditors [Section 141 (3)]

The following persons shall not be qualified for appointment as auditor of a company:

(a) A body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008.

(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, or his relative or partner

(1) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:

Provided that the relative may hold security or interest in the company of face value not exceeding 1,00,000 rupees as prescribed under the Company (Audit and Auditors) Rules, 2014.

The Company (Audit and Auditors) Rules, 2014 provides that a relative of an auditor may hold securities in the company of face value not exceeding ₹ 1 Lac. Further, the above condition shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities. If the relative acquires any security or interest above the prescribed threshold i.e., ₹ 1 Lac, the corrective action to maintain the limits as specified above shall be taken by the auditor within sixty days of such acquisition or interest.

(2) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 5 Lacs, or

(3) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 1 Lac.

(e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company. According to the Companies (Audit and Auditors) Rules, 2014, the term business relationship shall be construed as any transaction entered into for a commercial purpose, except:

(1) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts.

(2) commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

(f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel.

(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies other than one person companies, dormant companies and private companies having paid-up share capital less than one hundred crore rupees. [MCA vide Notification No. 464(E) dated 05/06/2015]. It may be clarified that now the Limit of 20 Companies includes only: a) Public Companies and b) Private Companies having paid up capital of ₹ 100 crore or more.

(h) a person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction.

(i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in Section 144 (This Section deals with certain services not to be tendered by auditor).

1.2.2.3 Vacation of office by an auditor [Section 141 (4)]

If a person appointed as an auditor of a company incurs any of the disqualification specified in Section 141 (3), he shall be deemed to have vacated his office. Such vacation shall be deemed to be a casual vacancy in the office of the auditor.

1.2.3 Remuneration of auditors (Section 142)

(a) The remuneration of the auditors of a company shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

(b) In the case of first auditor, remuneration may be fixed by the Board.

(c) The remuneration mentioned aforesaid shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him. But the remuneration does not include any remuneration paid to him for any other service rendered by him at the request of the company.

1.2.4 Powers and duties of auditors and auditing standards (Section 143)

1.2.4.1 Powers of Auditors [Section 143 (1)]

(a) Access to books of account and vouchers: Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place.

(b) Entitled to have necessary information and explanation: He shall be entitled to require from the officers of the company such information and explanations as the auditor may consider necessary for the performance of his duties as auditor.

(c) Matters of inquiry: The auditor may also inquire into the following matters, namely:

(1) Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members.

(2) Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company.

(3) Where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company.

(4) Whether loans and advances made by the company have been shown as deposits.

(5) Whether personal expenses have been charged to revenue account.

(6) Where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

(d) Access to record of all its subsidiaries: The auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries.

1.2.4.2 Duties of auditors [Sections 143 (2), (3) and (4)]

(a) The auditor shall make a report to the members of the company on the following:

(1) On the accounts examined by him, and

(2) On every financial statements which are required by or under this Act to be laid before the company in general meeting. And

(b) The auditor while making the report shall take into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under Section 143 (11).

(c) The auditor shall express his opinion of the accounts and financial statements examined by him. He shall express the opinion which according to him and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

(d) The auditors' report shall also state:

(1) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements.

(2) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him.

(3) whether the report on the accounts of any branch office of the company audited under Sub-Section (8) by a person other than the company's auditor has been sent to him under the proviso to that Sub-Section and the manner in which he has dealt with it in preparing his report.

(4) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns.

(5) whether, in his opinion, the financial statements comply with the accounting standards.

(6) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company.

(7) whether any director is disqualified from being appointed as a director under Sub-Section (2) of Section 164.

(8) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.

(9) whether the company has adequate internal financial controls with reference to financial statement in place and the operating effectiveness of such controls.

(10) Such other matters as prescribed under Rule 11 of the Companies (Audit and Auditors) Rules, 2014 which provides that the auditor's report shall also include their views and comments on the following matters, namely:

(1) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

(2) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative

contracts.

(3) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

(e) Where any of the matters is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

(f) Compliance with auditing standards:

(1) Every auditor shall comply with the auditing standards [Section 143(9)].

(2) The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under Section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

(3) It is further provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

(g) Additional matters to be reported in case of specified companies: In respect of such class or description of companies, as may be specified in the general or special order by the Central Government may, in consultation with the National Financial Reporting direct, the auditor's report shall also include a statement on such matters as may be specified therein.

(h) Reporting of frauds by auditors [Section 143 (12)]

(1) Notwithstanding anything contained in this Section, if an auditor of a company in the course of performance of his duties as auditor, has reason to believe that a offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government immediately but not later than 60 days of his knowledge and after following the procedure as prescribed in Rule 13 of the Companies (Audit and Auditors) Rules, 2014:

a) Auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within 45 days;

b) on receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days of receipt of such reply or observations;

c) In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.

d) The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same.

e) The report shall be on the letter head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number.

f) The report shall be in the form of a statement as specified in Form ADT-4.

(2) No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred above if it is done in good faith [Section 143(13)].

(3) The provision of this section shall mutatis mutandis apply to the cost accountant in practice conducting cost audit under section 148 and also to the company secretary in practice conducting secretarial audit under section 204 [Section 143(14)].

(4) Penalty for non compliance of Section 143 (12): If any auditor, the cost accountant or the company secretary in practice do not comply with the provisions of Section 143 (12) (reporting about the offence to the Central Government), he shall be punishable with fine which shall not be less than ₹ 1 Lacs but which may extend to ₹25 Lacs [Section 143(15)].

1.2.5 Audit of Government Companies [Sections 143 (5), (6) & (7)]

(a) In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor General of India shall appoint the auditor under Section 139 (5) or 139 (7) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor General of India.

(b) The audit report among other things, include the following:

(1) the directions, if any, issued by the Comptroller and Auditor General of India,

(2) the action taken thereon and

(3) its impact on the accounts and financial statement of the company.

(c) The Comptroller and Auditor General of India shall within 60 days from the date of receipt of the audit report have a right to:

(1) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorise in this behalf and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor General of India may direct, and

(2) comment upon or supplement such audit report.

(d) Any comments given by the Comptroller and Auditor General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under Section 136 (1) and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

(e) Test Audit: For Government Company or Company controlled by State Government or Central Government, the Comptroller and Auditor General of India may, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company, without prejudice to the provisions related to Audit and Auditors. The provisions of Section 19A of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

1.2.6 Audit of accounts of branch office of company [Section 14 3(8)]

(a) Branch office in India:

Where a company has a branch office, the accounts of that office shall be audited either by:

(1) the company's auditor appointed under Section 139, or

(2) by any other person qualified for appointment as an auditor of the company under Section 139.

(b) Branch office outside India:

(1) If the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by:

a) the company's auditor, or

b) by an accountant, or

c) by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

(c) The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in Sub-Sections (1) to (4) of Section 143.

(d) The branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

(e) The provisions of regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

1.2.7 Auditor not to render certain services (Section 144)

(a) An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be. But such services shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

(1) accounting and book keeping services.

(2) internal audit.

(3) design and implementation of any financial information system.

(4) actuarial services.

(5) investment advisory services.

(6) investment banking services.

(7) rendering of outsourced financial services.

(8) management services. and

(9) any other kind of services as may be prescribed.

(b) According to the explanation given under Section 144, the term directly or indirectly shall include rendering of services by the auditor:

(1) in case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual.

(2) in case of auditor being a firm, either itself or through any of its partners or through its parent,

subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

1.2.8 Auditors to sign audit reports, etc. (Section 145)

(a) The person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of Sub-Section (2) of Section 141 (i.e. in case of firm including LLP, only Chartered Accountants are authorised to act and sign).

(b) The qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor' report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

1.2.9 Auditors to attend general meeting (Section 146)

(a) All notices of and other communications relating to, any general meeting shall be forwarded to the auditor of the company.

(b) The auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting.

(c) The auditor shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

1.2.10 Punishment for contravention (Section 147)

(a) Penalty on company [Section 147 (1)]

If any of the provisions of Sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 5 lacs.

(b) Penalty on officers [Section 147 (1)]

If any of the provisions of Sections 139 to 146 (both inclusive) is contravened, every officer of the company who is in default shall be punishable with:

(1) imprisonment for a term which may extend to 1 year or

(2) With fine which shall not be less than ₹ 10,000 but which may extend to ₹ 1 lacs, or

(3) Both with imprisonment and fine.

(c) Penalty on auditor [Sections 147 (2) & (3)]

(a) If an auditor of a company contravenes any of the provisions of Section 139, Section 143, Section 144 or Section 145, the auditor shall be punishable with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 5 lacs.

(b) If an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with:

(1) imprisonment for a term which may extend to 1 year and

(2) fine which shall not be less than ₹ 50,000 but which may extend to ₹ 25 lacs or eight times of the remuneration of the auditor which ever is less.

(c) Further, where an auditor has been convicted as above, he shall be liable to:

(1) refund the remuneration received by him to the company, and

(2) pay for damages to the company, statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.

(d) Filing of Report with the Central Government [Section 147 (4)]

The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons. Such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

(e) Liability of Audit firm [Section 147 (5)]

Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in the Companies Act, 2013, or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

1.2.11 Cost Audit [Section 148]

According to Section, the Central Government may specify audit of items of cost in respect of certain companies. These provisions are detailed below:

(a) Notwithstanding anything contained in the provisions related to audit and auditor (Chapter X), the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept under Section 128 by that class of companies in Form CRA-1 as per Rule 5(1) of the Companies (Cost Records and Audit) Rules, 2014.

(b) The Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

(c) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered aforesaid and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

(d) The cost audit shall be conducted by a Cost Accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed [Section 148(3)].

D : 1.3 COMPANIES AUDITOR REPORT ORDER (CARO) RULES, 2016

The MCA has issued the Companies (Auditor's Report) Order, 2016 (CARO 2016), on 29th March 2016. This order has been issued in supersession of the Companies (Auditor's Report) Order, 2015, and is applicable for reporting on financial statements of companies whose financial year commences on or after 1st April 2015. CARO 2015 was issued by MCA in supersession of CARO 2003 which was issued earlier in pursuance with the provision of Section 227 (4A) of Companies Act 1956.

Now, the MCA has relaxed the applicability of CARO 2016 to private companies by increasing applicability thresholds. CARO 2016 will not apply to the auditor's report on consolidated financial statements. The total number of clauses in the new CARO is 16. CARO 2016 has enhanced the auditor's reporting requirements in certain areas, such as related party transaction and managerial remuneration. The provisions of the CARO 2016 are furnished below:

CARO 2016 is applicable from FY 2015-16 and the matters specified therein shall be included in each report made

by the auditor under Section 143 of the Companies Act, 2013 on the account of every company to which CARO 2016 applies.

Section 143 (11) of the Act stipulates that the Central Government may order for the inclusion of statement on specified matter in the auditor's report for specified class or description of companies. Accordingly, CARO 2016 is issued in pursuance of Section 143 (11) of Companies Act 2013 for inclusion of the matters specified therein in auditors' report. Hence, CARO 2016 should be complied by the statutory auditor of every company on which it applies.

CARO 2016 applicable to every company including a foreign company as defined in clause (42) of Section 2 of the Companies Act 2013.

1.3.1 The following classes of companies are outside the purview of the CARO 2016.

(a) Banking company as defined under Section 5 (c) of the Banking Regulation Act, 1949.

(b) Insurance company as defined under the Insurance Act 1938.

(c) Company licensed to operate under Section 8 of the Companies Act 2013 (companies registered with charitable object).

(d) A one person company (OPC) as defined under clause (62) of Section 2 of Companies Act 2013 (OPC means a company which has only one person as a member).

(e) A small company under Section 2 (85) of the Companies Act, 2013.

(1) As per sec 2(85) of Companies Act 2013 small company means a company, other than a public company:

a) Paid up share capital of which does not exceed ₹ 50 lacs or such higher amount as may be prescribed which shall not be more than ₹ 5 crore, and

b) Turnover of which as per its last profit and loss account does not exceed ₹ 2 crore or such higher amount as may be prescribed which shall not be more than ₹ 20 crore.

(2) The following company shall not qualify as a small company:

a) A holding company or a subsidiary company.

b) A company registered under Section 8 of the Act.

c) A company or body corporate governed by any special act.

(f) The auditor of following type of Private Companies are not required to comment on the matter prescribed under CARO 2016:

(1) A private company which is not holding or subsidiary company of a public company, and

(2) A private company having a paid up capital and reserve and surplus not more than ₹ 1 crore as on the balance sheet date, and

(3) A private company which does not have total borrowing exceeding ₹ 1 crore from any bank and financial institution at any point of time during the financial year, and

(4) A private company which does not have total revenue exceeding ₹ 10 crore during the financial year.

Note: Such revenue means revenue as disclosed in scheduled III to the Companies Act, 2013 and includes revenue from discontinuing operation.

1.3.2 Matters included in CARO 2016 are discussed below:

1.3.2.1 Fixed Asset [clause 3 (i)]

(a) Whether the company is maintain proper records showing full particulars including quantitative details and situation of fixed asset.

(b) Whether these fixed asset have been physically verified by management at reasonable interval.

(c) 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.

1.3.2.2 Inventory [Clause 3 (ii)]

(a) Whether physical verification of inventory has been conducted at reasonable interval by the management.

(b) Whether any material discrepancies has been noticed on such verification and if so, whether the same has been properly dealt with in the books of account

1.3.2.3 Loan given by Company [Clause 3 (iii)]

Whether the company has granted any loans, secured or unsecured to companies, firms, LLP or other parties covered in the registered maintained under Section 189 of the Companies Act, 2013. If so,

(a) Whether terms and conditions of the grant of such loan are not prejudicial to the company's interest.

(b) Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments and receipts are regular

(c) If the amount is overdue, state the total amount overdue, state the total amount overduefor more than 90 days and whether reasonable steps have been taken by the company for recovery of principal.

1.3.2.4 Loan to director and investment by the company [Clause 3 (iv)]

In respect of loan, investment, guarantees and security whether provision of Sections 185 and 186 of the Companies Act, 2013 has been complied with. If not, provide the details thereof.

1.3.2.5 Deposits [Clause 3 (v)]

In case, the company has accepted deposits, whether the following has been complied with:

Directives issued by the reserve bank of India

(a) The provision of sec 73 to 76 or any other relevant provision of Companies Act, 2013 and the rules framed there under, and

(b) If the order has been passed by company law board (CLB) or National company law tribunal (NCLT) or RBI or any court or any other tribunal.

(c) However, if any of the above not complied with, the nature of contraventions should be stated.

1.3.2.6 Cost Records [Clause 3 (vi)]

If Central Government has specified maintenance of cost records under sec 148 (1) of Companies Act, 2013 whether such accounts and records have been made and maintained.

1.3.2.7 Statutory Dues [Clause 3 (vii)]

(a) Whether the company is regular in depositing undisputed statutory dues with the appropriate authorities including Provident fund, Employees State Insurance fund, income tax, sales tax, service tax, duty of custom, duty of excise, value added tax, cess or any other statutory dues. If the company is not regular in depositing such statutory dues, the extent of 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 become payable, shall be indicated by the auditor.

(b) In case dues of income tax and sales tax or service tax or duty of custom or duty of excise or value added tax have not been deposited on account of any dispute, then the amount involved and the forum where dispute is pending shall be disclosed.

1.3.2.8 Repayment of Loan [Clause 3 (viii)]

Whether the company has defaulted in repayment of loans and borrowing to a financial institution, banks, government or dues to debenture holders. If yes, the period and the amount of default to be reported.

1.3.2.9 Utilisation of IPO and further public offer [Clause 3 (ix)]

Whether money raised by way of initial public offer or further public offer and the term loans were applied for the purpose for which those are raised. If not, the details together with delays and defaults and subsequent rectification, if any, as may be applicable, be reported

1.3.2.10 Reporting of Fraud [Clause 3 (x)]

Whether any fraud by the company or any fraud on the company by its officers and employees has been noticed or reported during the year: if yes, the nature and the amount involved is to be indicated.

1.3.2.11 Approval of managerial remuneration [Clause 3 (xi)

Whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provision of Section 197 read with schedule 5 to the Companies Act, 2013. If not, state the amount involved and step taken by the company for securing refund of the same.

1.3.2.12 Nidhi Company [Clause 3 (xii)]

Whether the Nidhi company has complied with the net owned funds to deposit in the ratio of 1:20 to meet out the liability and whether the Nidhi company is maintain 10% unencumbered term deposit as specified in the Nidhi rules 2014 to meet out the liability.

1.3.2.13 Related Party Transaction [Clause 3 (xiii)]

Whether all transaction with the related party is in compliance with Section 177 and 188 of the Companies Act, 2013 where applicable and the details have been disclosed in the financial statement etc., as required by the applicable accounting standard.

1.3.2.14 Private Placement of Preferential Issues [Clause 3 (xiv)]

Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of Section 42 of Companies Act, 2013 have been complied with and the amount raised has been used for the purpose for which the funds were raised . If not, provide the detail in respect of the amount involved and the nature of non-compliance.

1.3.2.15 Non Cash Transaction [Clause 3 (xv)]

Whether the company has entered into any non-cash transaction with the director or person concerned with his and if so, whether the provision of Section 192 of Companies Act, 2013 has been complied with.

1.3.2.16 Register under RBI Act 1934 [Clause 3(xvi)]

Whether the company is required to be registered under Section 45 IA of Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

A comparative view between CARO 2015 and CARO 2016

CARO 2015	CARO 2016
Fixed assets	Retained with some changes
Inventory	Retained with some changes
Loans to related parties (Sec. 189)	Retained with some changes
Adequate internal control	Deleted
—	Loan Guarantee Security
Deposits	Retained
Cost records	Retained
Statutory dues	Retained with some changes
Accumulated losses	Deleted
Repayment of loan	Retained with some changes
Guarantees	Deleted
Term loans	Retained with inclusion of IPO & FPO
Fraud reporting	Retained with some changes
—	Managerial Remuneration
—	Nidhi company
—	Related party transaction
—	Private placement
—	Non cash transaction
	NBFC

ICAI's Guidance Note on CARO 2016 by MCA [24 April, 2016]

The MCA has issued the Companies (Auditor's Report) Order, 2016 (CARO, 2016) which is applicable for audits of financial statements for periods beginning on or after April 1, 2015. The CARO 2016 contains several new/modified reporting requirements vis-a-vis the CARO 2003/ CARO 2015.

The ICAI, with a view to provide appropriate guidance to it's members, has brought out Guidance Note on the Companies (Auditor's Report) Order, 2016. It is divided into:

(a) Relevant provision which contains Requirement of all clauses.

(b) Audit procedures and Reporting which covers Procedure to be adopted by auditor.

This Guidance Note has been written in an easy to understand language and contains detailed guidance on various Clauses of CARO 2016 and the various issues and intricacies involved therein, so that the requirements and expectations of the Order can be fulfilled in letter and spirit by the auditors. It's a comprehensive and self contained reference document for the members.

Self Assessment Questions

1. What books of account are required to be kept by a company under the Provisions of the Companies Act, 2013?
2. Explain the provisions as to inspection of books of accounts and who are the persons can inspect books of accounts under the Act.
3. List the documents to be attached with the financial statement of a company.
4. What do you mean by Corporate Social Responsibility of a company. Explain its provisions under Companies Act, 2013.
5. Explain the provisions relating to Internal Audit. Who can become Internal Auditor as per Companies Act, 2013.
6. Explain the statutory rights and duties of an auditor.
7. What are the qualification and disqualification of an auditor?
8. Explain the law relating to the authentication, circulation, adoption and filing of the annual accounts.
9. How the first auditor of a company is appointed?
10. What is the procedure for appointment of Auditor other than a retiring Auditor?
11. What is the procedure to remove an Auditor before the expiry of his term?
12. Write a short notes on any two of the following :
    - **(a)** Can a director make inspection of the books of account?
    - **(b)** Rights of retiring Auditor.
    - **(c)** Proper books of accounts
    - **(d)** Can an internal auditor act as a Statutory Auditor?
13. Write a short notes on any two of the following:
    - **(a)** Financial Statements
    - **(b)** Board's Report
    - **(c)** Cost Audit
    - **(d)** Special Audit
    - **(e)** Branch Audit
    - **(f)** True and fair view
    - **(g)** Lying of accounts at the Annual General Meeting
    - **(h)** CARO
14. State the provisions of the Companies Act, 1956 in respect to the filling a casual vacancy of Statutory Auditor.

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Study Note - 1

THE COMPANIES ACT, 2013

PART - E : BOARD OF DIRECTORS & MANAGERIAL PERSONNEL

This Study Note includes:

E : 1.1 Directors and Managerial Personnel - Appointment, Reappointment, Resignation, Removal

E : 1.2 Payment of remuneration to Directors and Managerial Personnel and Disclosure

E : 1.3 Powers of Board of Directors and Restrictions on the Powers of Directors

E : 1.4 Obtaining DIN

E : 1.5 Compensation for Loss of Office

E : 1.6 Waiver of recovery of Remuneration

E : 1.7 Making loans to Directors, Disclosure of Interest of a Director, Holding of Office or Place of Profit by a Director/Relative

E : 1.8 Interested Directors

Chapter XI and Chapter XIII of the Companies Act, 2013 contain the provisions as to Board of Directors and Managerial Personnel.

E : 1.1 DIRECTORS AND MANAGERIAL PERSONNEL - APPOINTMENT, REAPPOINTMENT, RESIGNATION, REMOVAL

1.1.1 Concept of Director

The Board of directors of a company is a nucleus, selected according to the procedure prescribed in the Act and the Articles of Association. Members of the Board of directors are known as directors, who unless especially authorised by the Board of directors of the Company, do not possess any power of management of the affairs of the company. Acting collectively as a Board of directors, they can exercise all the powers of the company except those, which are prescribed by the Act to be specifically exercised by the company in general meeting.

The directors of a company are its eyes, ears, brain, hands, nerves and other essential limbs, upon whose efficient functioning depends the success of the company. The directors formulate policies and establish organisational set up for implementing those policies and to achieve the objectives as contained in the Memorandum, muster resources for achieving the company objectives and control, guide, direct and manage the affairs of the company.

1.1.2 Position of Director

The position that the directors occupy in a corporate enterprise is not easy to explain. They are professional men hired by the company to direct its affairs. Yet they are not the servants of the company. They are rather the officers of the company. 'A director is not a servant of any master. He cannot be described as a servant of the company or of anyone'. 'A director is in fact a director or controller of the company's affairs'. A director may, however, work as an employee in a different capacity.

The senior management positions mainly consist of manager, whole time director or as a managing director. These occupy the prominent position in the decision making of the company.

But, whether a person is to be regarded as a manager, whole time director or as a managing director of the company would depend on the nature and extent of the duties entrusted to him and that the designation under which the appointment is made would not make any difference in this regard. The duties assigned are the main things behind the position. The Companies Act, 2013 has detailed provisions with regard to these key managerial personnel.

1.1.3 Company to have Board of Directors (Section 149)

This section provides for the provisions for companies to have a duly constituted Board of Directors. According to this section:

1.1.3.1 Number of Directors

According to section 149 (1) of the Companies Act, 2013, every company shall have a Board of Directors consisting of individuals as directors and shall have:

(a) **minimum number of directors**

(1) in the case of Public company - 3,

(2) in the case of Private Company - 2, and

(3) in case of One person company (OPC) – 1

(b) **maximum number of directors**: **15**

If the company wants to appoint more than 15 directors, it can do so after passing a special resolution. [Every special resolution is required to be filed in form No. MGT – 14 as per Section 117(3)(a)].

As per the Notification G.S.R. 463(E) dated 5th June, 2015, the limit of maximum of 15 directors and their increase in limit by special resolution shall not apply to Government Company.

Further, as per the Notification G.S.R. 466(E) dated 5th June, 2015, the minimum and maximum limit of number of directors and their increase in limit by special resolution shall not apply to Section 8 companies.

(c) **Women director**

At least one woman director shall be on the Board of such class or classes of companies as may be prescribed. [Second proviso to section 149(1)]

Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides that the following class of companies shall appoint at least one woman director:

(1) every listed company.

(2) every other public company having.

a) paid–up share capital of one hundred crore rupees or more; or

b) turnover of three hundred crore rupees or more.

A company, which has been incorporated under the Act and is covered under provisions of second proviso to sub-section (1) of section 149 shall comply with such provisions within a period of six months from the date of its incorporation.

Further, any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

Example: in XYZ Ltd., an intermittent vacancy of the women director arises on 15th June, 2015. Thus, the vacancy shall be filled-up by the Board at the earliest but not later than the date of the next Board meeting or three months from the date of such vacancy whichever is later.

If after the vacancy, the immediate Board meeting was held on 14th August, 2015, then the vacancy shall be filled-up by 14th August, 2015 or by 14th September, 2015 (3 months from the date of such vacancy) whichever is later. In this case it shall be filled up by 14th September, 2015.

If after the vacancy, the immediate Board meeting was held on 14th October, 2015 then the vacancy shall be filled-up by 14th October, 2015 or by 14th September, 2015 whichever is later. In this case it shall be filled up by 14th October, 2015.

Explanation: For the purposes of this rule (woman director on board), it is clarified that the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

(d) **Resident Director**

Every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the financial year. [Section 149 (3)]

Transition period: Section 149 (5) provides for the transition period of one year from the date of commencement i.e., 1st April, 2014 to comply with section 149 (3).

Section 149 (3) of the Companies Act, 2013 requires every company to have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year. The MCA clarified that residency requirement would be reckoned from the date of commencement of section 149 of the Act i.e., 1st April, 2014. The first previous calendar year for compliance with these provisions would, therefore, be calendar year 2014. The period to be taken into account for compliance with these provisions will be the remaining period of calendar year 2014 (i.e., 1st April to 31st December). Therefore, on a proportionate basis, the number of days for which the director(s) would need to be resident in India, during Calendar year 2014, shall exceed 136 days.

Regarding newly incorporated companies it is clarified that companies incorporated between 1st April, 2014 and 30th September, 2014 should have a resident director either at the incorporation stage itself or within six months of their incorporation. Companies incorporated after 30th September, 2014 need to have the resident director from the date of incorporation itself.

(e) **Independent Director**

Every listed public company shall have at least one-third of the total number of directors as independent directors [Section 149(4)].

The Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

Any fraction contained in such one-third numbers shall be rounded off as one. According to the Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the following class or classes of companies shall have at least 2directors as independent directors:

(1) the Public Companies having paid up share capital of ₹ 10 crore or more, or

(2) the Public Companies having turnover of ₹ 100 crore or more, or

(3) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding ₹ 50 crore.

However, in case a company covered under the above rule is required to appoint a higher number of independent directors due to composition of its audit committee, such higher number of independent

directors shall be applicable to it.

Further, any intermittent vacancy of an independent director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later.

If intermittent vacancy arise in 15th June, 2015 and the immediate next Board meeting after the vacancy was held on 14th August, 2015, then the vacancy shall be filled-up by 14th August, 2015 or by 14th September, 2015 whichever is later. In this case it shall be filled up by 14th September, 2015.

If the immediate next Board meeting after the vacancy was held on 14th October, 2015, then the vacancy shall be filled-up by 14th October, 2015 or by 14th Sept. 2015 whichever is later. In this case it shall be filled up by 14th October 2015.

However, where a company ceases to fulfill any of three conditions laid down above for three consecutive years, it shall not be required to comply with these provisions until such time as it meets any of such conditions.

For the purpose of the above assessment, the paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

A company belonging to any class of companies for which a higher number of independent directors has been specified in the law for the time being in force shall comply with the requirements specified in such law.

1.1.3.2 Appointment of Directors (Section 152)

According to section 152 of the Act:

(a) **Appointment of directors**

(1) Where no provision is made in the articles of a company for the appointment of the first director, the subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed. [Section 152 (1)]

In case of a One Person Company, an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section.[Section 152 (1)]

(2) Save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting. [Section 152 (2)].

(3) No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number (DIN) under section 154. [Section 152 (3)].

(4) Every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number (DIN) and a declaration that he is not disqualified to become a director under this Act. [Section 152 (4)].

(5) A person appointed as a director shall not act as a director unless he gives his consent to hold the office as director and such consent has been filed with the Registrar within 30 days of his appointment in Form DIR-12 along with the fee as prescribed [Section 152 (5)].

Rule 8 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides that every person who has been appointed to hold the office of a director shall on or before the appointment furnish to the company consent in writing to act as director in Form DIR-2. Also under Section 164(2), proposed director need to give declaration in Form DIR – 8 to the company.

The proviso to Section 152 (5) states that in case of appointment of an independent director in the general meeting, an explanatory statement for such appointment, annexed to the notice for the general meeting, shall include a statement that in the opinion of the Board, he fulfils the conditions specified in this Act for such an appointment.

(6) The Ministry of Corporate Affairs has clarified via Notification No. 463(E) and 466(E) dated 5th June, 2015, that section 152 (5) shall not apply:

a) where appointment of such director is done by the Central Government or State Government, as the case may be.

b) to a section 8 company.

(b) **Retirement by rotation [Section 152 (6)]**

Unless the articles provide for the retirement of all directors at every annual general meeting, not less than two-thirds of the total number of directors of a public company shall:

(a) be persons whose period of office is liable to determination by retirement of directors by rotation, and

(b) save as otherwise expressly provided in this Act, be appointed by the company in general meeting.

(c) The remaining directors in the case of any such company shall, in default of, and subject to any regulations in the articles of the company, also be appointed by the company in general meeting.

(d) At the first annual general meeting of a public company held next after the date of the general meeting at which the first directors are appointed and at every subsequent annual general meeting, one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office.

(e) The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot.

(f) At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto.

For the purposes of the above provisions: total number of directors' shall not include independent directors, whether appointed under this Act or any other law for the time being in force, on the Board of a company.

(c) **Vacancy in case of retiring director [Section 152 (7)]**

(a) If the vacancy of the retiring director is not so filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

(b) If at the adjourned meeting also, the vacancy of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless:

(1) at that meeting or at the previous meeting a resolution for the re-appointment of such director has been put to the meeting and lost.

(2) the retiring director has, by a notice in writing addressed to the company or its Board of directors, expressed his unwillingness to be so re-appointed.

(3) he is not qualified or is disqualified for appointment.

(4) a resolution, whether special or ordinary, is required for his appointment or re appointment by virtue of any provisions of this Act, or

(5) section 162 is applicable to the case.

For the purposes of section 152, the retiring director means a director retiring by rotation.

(d) **Non applicability of section 152 (6) and 152 (7)**

The Ministry of Corporate Affairs has clarified via Notification No. 463(E) dated 5th June, 2015, that section 152(6) and (7) of the Companies Act, 2013, shall not apply to:

(1) A Government company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments;

(2) A subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by the Government company.

(e) **Right of persons other than retiring directors to stand for directorship (Section 160)**

According to this section:

(1) a person who is not a retiring director in terms of section 152 shall, subject to the provisions of this Act, be eligible for appointment to the office of a director at any general meeting, if he, or some member intending to propose him as a director, has, not less than 14 days before the meeting, left at the registered office of the company, a notice in writing under his hand signifying his candidature as a director or, as the case may be, the intention of such member to propose him as a candidate for that office.

(2) Such notice must come along with the deposit of ₹ 1,00,000 or such higher amount as may be prescribed. Such deposit shall be refunded to such person or, as the case may be, to the member, if the person proposed get selected as a director or gets more than 25% of the total valid votes cast either on show of hands or on poll on such resolution. Requirement of deposit shall not apply if the appointment of director is recommended by nomination and remuneration committee/board.

(3) The company shall inform its members of the candidature of a person for the office of director (as discussed above) in such manner as may be prescribed.

Notice of candidature of a person for directorship: Rule 13 of the Companies (Appointment and Qualification of Directors) Rules, 2014 lays down the following points for giving notice of candidature of a person for directorship as under:

1) The company shall, at least 7days before the general meeting, inform its members of the candidature of a person for the office of a director or the intention of a member to propose such person as a candidate for that office.

2) by serving individual notices, on the members through electronic mode to such members who have provided their email addresses to the company for communication purposes, and in writing to all other members, and

3) by placing notice of such candidature or intention on the website of the company, if any.

4) However, it shall not be necessary for the company to serve individual notices upon the

members as aforesaid, if the company advertises such candidature or intention, not less than 7days before the meeting at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and circulating in that district, and at least once in English language in an English newspaper circulating in that district.

(4) Non-applicability of section 160: The Ministry of Corporate Affairs has clarified via Notifications No. 463(E), 464(E) and 466(E) dated 5th June, 2015, that section 160 of the Companies Act, 2013, shall not apply to:

a) A Government company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments.

b) A subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by the Government company.

c) A Private company

d) Companies whose articles provide for election of directors by ballot.

(f) **Appointment of additional director, alternate director and nominee director (Section 161)**

(1) **Additional Director [Section 161 (1)]**

Section 161(1) of the Companies Act, 2013 provides for appointment of additional director. According to this section:

a) The articles of a company may confer on its Board of Directors the power to appoint any person as an additional director at any time.

b) A person, who fails to get appointed as a director in a general meeting, cannot be appointed as an additional director.

c) Additional director shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

(2) **Alternate Director [Section 161 (2)]**

Section 161(2) of the Companies Act, 2013 provides for appointment of Alternate director. According to this section:

a) 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 a person to act as an alternate director in place of another director (original director) during his absence for a period of not less than 3 months from India.

b) A person who is holding any alternate directorship for any other director in the company cannot be considered for appointment as above.

c) No person shall be appointed as an alternate director for an independent director unless he is qualified to be appointed as an independent director under the provisions of this Act.

d) An alternate director shall not hold office for a period longer than that permissible to the original director in whose place he has been appointed and shall vacate the office if and when the original director returns to India.

e) If the term of office of the original director is determined before he so returns to India, any provision for the automatic re-appointment of retiring directors in default of another

appointment shall apply to the original, and not to the alternate director.

(3) **Nominee Director [Section 161 (3)]**

Section 161(3) of the Companies Act, 2013 provides for appointment of Nominee director. According to this section: Subject to the articles of a company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company.

(4) **Casual Vacancy [Section 161 (4)]**

Section 161 (4) of the Companies Act, 2013 provides for appointment of director in casual vacancy. According to this section:

(i) In the case of a public company, 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, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board which shall be subsequently approved by the members in immediately next GM.

(ii) Any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.

(g) **Appointment of Directors elected by Small shareholders (Section 151)**

According to section 151 of the Companies Act, 2013:

A listed company may have one director elected by such small shareholders in such manner and on such terms and conditions as may be prescribed.

Here, "Small Shareholders" means a shareholder holding shares of nominal value of not more than ` 20,000 or such other sum as may be prescribed.

The Companies (Appointment and Qualification of Directors) Rules, 2014 provides for the procedure for appointment of small shareholders' director according to which:

(1) A listed company, may upon notice of not less than

a) one thousand small shareholders, or

b) one tenth of the total number of such shareholders, whichever is lower,

have a small shareholders' director elected by the small shareholders.

However, a listed company may opt to have a director representing small shareholders' suo motu and in such a case the provisions of sub-rule (2), given below, shall not apply for appointment of such director.

(2) The small shareholders intending to propose a person as a candidate for the post of small shareholders' director shall leave a notice of their intention with the company at least fourteen days before the meeting under their signatures specifying the name, address, shares held and folio number of the person whose name is being proposed for the post of director and of the small shareholders who are proposing such person for the office of director.

However, if the person being proposed does not hold any shares in the company, the details of shares held and folio number need not be specified in the notice.

(3) The notice shall be accompanied by a statement signed by the person whose name is being

proposed for the post of small shareholders' director stating:

a) his Director Identification Number;

b) that he is not disqualified to become a director under the Act; and

c) his consent to act as a director of the company.

(4) Such director shall be considered as an independent director subject to, his being eligible under sub-section (6) of section 149 and his giving a declaration of his independence in accordance with sub-section (7) of section 149 of the Act.

(5) The appointment of small shareholders' director shall be subject to the provisions of section 152 except that :

a) such director shall not be liable to retire by rotation;

b) such director's tenure as small shareholders' director shall not exceed a period of three consecutive years; and

c) on the expiry of the tenure, such director shall not be eligible for re-appointment.

(6) A person shall not be appointed as small shareholders' director of a company, if he is not eligible for appointment in terms of section 164 which specifies the disqualifications for appointment of a director.

(7) A person appointed as small shareholders' director shall vacate the office if:

a) the director incurs any of the disqualifications specified in section 164;

b) the office of the director becomes vacant in pursuance of section 167;

c) the director ceases to meet the criteria of independence as provided in sub-section (6) of section 149.

(8) No person shall hold the position of small shareholders' director in more than two companies at the same time.

However, the second company in which he has been so appointed shall not be in a business which is competing or is in conflict with the business of the first company.

(9) A small shareholders' director shall not, for a period of three years from the date on which he ceases to hold office as a small shareholders' director in a company, be appointed in or be associated with such company in any other capacity, either directly or indirectly.

(h) **Appointment of directors to be voted individually (Section 162)**

According to this section:

(1) Two or more directors of a company cannot be elected as directors by a single resolution.

(2) Thus, each director shall be appointed by a separate resolution a proposal to move such a resolution has first been agreed to at the meeting without any vote being cast against it.

(3) A resolution moved in contravention of this provision shall be void, whether or not any objection thereto was raised at the time it was so moved.

(4) A motion for approving a person for appointment, or for nominating a person for appointment as a director, shall be treated as a motion for his appointment.

Non applicability of section 162: The Ministry of Corporate Affairs has clarified via Notifications No. 463(E) and 464(E) dated 5th June, 2015, that section 162 of the Companies Act, 2013, shall not apply to:

a) A Government company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments;

b) A subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by the Government company;

c) A Private company

(i) **Option to adopt principle of proportional representation for appointment of directors (Section 163)**

(1) According to this section:

a) Notwithstanding anything contained in the Companies Act, 2013, the articles of a company may provide for the appointment of not less than two-thirds of the total number of the directors of a company in accordance with the principle of proportional representation.

b) Such appointments may be made once in every 3years whether by the single transferable vote or by a system of cumulative voting or otherwise.

Single transferable vote means, a candidate gets elected if he gets the required number of votes fixed as quota. These systems of voting ensure that the Board will have fair representation of the minority interest.

c) Casual vacancies of such directors shall be filled as provided in sub-section (4) of section 161.

(2) Non applicability of section 163:

The Ministry of Corporate Affairs has notified via Notifications No. 463(E) dated 5th June, 2015, that section 163 of the Companies Act, 2013, shall not apply to:

a) A Government company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments;

b) A subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by the Government company.

(j) **Disqualifications for appointment of director (Section 164)**

According to this section:

(1) A person cannot be appointed as director of a company in any of the following cases:

a) he is of unsound mind and stands so declared by a competent court.

b) he is an undischarged insolvent.

c) he has applied to be adjudicated as an insolvent and his application is pending.

d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than 6 months and a period of 5 years has not elapsed from the date of expiry of the sentence.

However, if a person has been convicted of any offence and sentenced in respect thereof

to imprisonment for a period of 7 years or more, he shall not be eligible to be appointed as a director in any company.

Word "or otherwise" in clause (d) above, means any offence in respect of which he has been convicted by s Court under this Act or the Companies Act, 1956. Rule 2(1)(s) of the Companies (Specification of definitions details) Rules, 2014.

e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force.

f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and 6 months have elapsed from the last day fixed for the payment of the call.

g) he has been convicted of the offence of dealing with related party transactions under section 188 at any time during the last preceding 5 years, or

h) he has not complied with sub-section (3) of section 152 which requires a director to have a Director Identification Number under section 154.

(2) No person who is or has been a director of a company which:

a) has not filed financial statements or annual returns for any continuous period of 3 financial years, or

b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for 1 year or more, however, such director shall not incur the disqualification for a period of 6 months from the date of appointment.

shall be eligible to be re-appointed as a director of that company or appointed in other company for period of 5 years from the date on which the said company fails to do so. [Section 164 (2)]

(3) Non applicability of section 164(2):

Section 164(2) is not applicable to Government Company.

(4) A private company may by its articles provide for any disqualifications for appointment as a director in addition to those specified in sub-sections (1) and (2) of section 164 as stated above [i.e., point (1) and (2) above].

(5) However, the disqualifications referred to in clauses (d), (e) and (g) of sub-section (1) [given in point (1) above] shall not take effect:

a) for 30 days from the date of conviction or order of disqualification.

b) where an appeal or petition is preferred within 30 days as aforesaid against the conviction resulting in sentence or order, until expiry of 7 days from the date on which such appeal or petition is disposed off, or

c) where any further appeal or petition is preferred against order or sentence within 7 days, until such further appeal or petition is disposed off.

1.1.3.3 Resignation of Director (Section 168)

Provisions regarding resignation of directors have been provided for the first time under the Companies Act, 2013. According to this section:

(a) a director may resign from his office by giving a notice in writing to the company.

(b) The Board shall on receipt of such notice take note of the same.

(c) The company shall within 30 days from the date of receipt of notice of resignation from a director, intimate the Registrar in Form DIR-12 and post the information on its website, if any.

(d) The company shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the company.

(e) Such director shall also forward a copy of his resignation along with detailed reasons for the resignation to the Registrar within 30days from the date of resignation in Form DIR- 11 along with the prescribed fee.

1.1.3.4 Removal of Directors (Section 169)

Section 169 of the Companies Act, 2013 came into force partially 4 from 1st April, 2014 which provides the provisions for removal of directors. According to this section:

(a) A company may, by ordinary resolution, remove a director other than a director appointed by the Tribunal under section 242 of the Act, before the expiry of the period of his office after giving him a reasonable opportunity of being heard. [Section 169(1)]. Independent director appointed for the second term can be removed by the special resolution.

(b) It is further provided that the directors appointed on the principle of proportional representation under section 163 cannot be removed by an ordinary resolution as aforesaid. {Proviso to section 169(1)].

(c) A special notice shall be required of any resolution, to remove a director under section 169 or to appoint somebody in place of a director so removed, at the meeting at which he is removed. [Section 169 (2)].

(d) On receipt of the notice of a resolution to remove a director under section 169, the company shall forthwith send a copy thereof to the director concerned, and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting. [Section 169(3)].

(e) The vacancy resulting from the aforesaid removal if he had been appointed by the company in general meeting or by the Board, may be filled in by the appointment of another director at the same meeting at which the director is removed, provided special notice of the proposed appointment has been given under section 169(2). [Section 169(5)].

(f) A director so appointed shall hold office for the remaining period for which the director who has been removed would have held office if he had not been removed. [Section 169(6)].

(g) If the vacancy is not filled in the same meeting as above, then it may be filled as a casual vacancy in accordance with the provisions of this Act provided that the director who was so removed from office shall not be reappointed as a director. [Section 169(7)].

(h) Nothing in this section shall be taken to deprive a person removed under this section of his rights to compensation or damages payable to him in respect of the premature termination of the directorship, or terms of his appointment as director or of any appointment terminating with that as a director. [Section 169(8)(a)].

(i) Nothing in this section shall be derogating from any power to remove a director under any other provisions of this Act. [Section 169(8)(b)]

1.1.3.5 Vacation of office of director (Section 167)

According to this section:

(a) The office of a director shall become vacant in case [Section 167(1)]:

(1) he incurs any of the disqualifications specified in section 164.

(2) he absents himself from all the meetings of the Board of Directors held during a period of 12months with or without seeking leave of absence of the Board.

(3) he acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested.

(4) he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of section 184.

(5) he becomes disqualified by an order of a court or the Tribunal.

(6) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than 6 months.

It is further provided that the office shall be vacated by the director even if he has filed an appeal against the order of such court.

(7) he is removed in pursuance of the provisions of this Act.

(8) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

(9) In case a director incurs any of disqualification u/s 164(2) due to default in planning of financial statements or annual return or repayment of deposits or payment of interest or redemption of debentures or repayment of interest on dividend then he shall vacate office in all companies other than the company which has defaulted.

However, if appeal is preferred by such director, the vacation shall not take effect unless such appeal is disposed off.

(b) If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified in sub-section (1), he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ₹ 1,00,000 but which may extend to ₹ 5,00,000, or with both. [Section 167 (2)].

(c) Where all the directors of a company vacate their offices under any of the disqualifications specified in sub-section (1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting. [Section 167 (3)].

(d) A private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to those specified in sub-section (1). [Section 167 (4)].

1.1.3.6 Managing Director [Section 2 (54)]

Section 2(54) of the Companies Act, 2013 defines a 'Managing Director' as a director who is entrusted with substantial powers of management of the affairs of the company by:

(a) virtue of the articles of a company, or

(b) an agreement with the company, or

(c) a resolution passed in its general meeting, or by its Board of Directors, and includes a director occupying the position of the managing director, by whatever name called.

Explanation to Section 2 (54) clarifies that substantial powers of the management shall not be deemed to include the power to do such administrative acts of a routine nature when so authorised by the Board such as:

(a) the power to affix the common seal of the company to any document or

(b) to draw and endorse any cheque on the account of the company in any bank or

(c) to draw and endorse any negotiable instrument or

(d) to sign any certificate of share or

(e) to direct registration of transfer of any share.

1.1.3.7 Whole Time Director [Section 2(94)]

'Whole-time director' includes a director in the whole time employment of the company.

1.1.3.8 Manager [Section 2(53)]

'Manager' means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.

E : 1.2 PAYMENT OF REMUNERATION TO DIRECTORS AND MANAGERIAL PERSONNEL AND DISCLOSURE

1.2.1 Appointment of Managing Director, Whole Time Director or Manager (Section 196)

Section 196 of the Act contain the provisions for appointment of Managing Director, Whole Time Director or Manager. According to this section:

(a) No company shall appoint or employ a managing director and a manager at the same time. [Section 196 (1)].

(b) No company shall appoint or re-appoint any person as its managing director, whole time director or manager for a term exceeding five years at a time; Provided that no re-appointment shall be made earlier than one year before the expiry of his term.

(c) No company shall appoint or continue the employment of any person as managing director, whole-time director or manager who:

(1) is below the age of 21 years or has attained the age of 70 years. Provided that a person who has attained the age of seventy years may be appointed to such office by the passing of a special resolution in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

(2) is an undischarged insolvent or has at any time been adjudged as an insolvent, or

(3) has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them, or

(4) has at any time been convicted by a court of an offence and sentenced for a period of more than six months.

(d) Schedule V to the Companies Act, 2013, prescribes additional conditions for managing or whole-time director or a manager to be eligible for appointment. The schedule stipulates that :

(1) he had not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under 16 Acts as specified under Schedule V.

(2) he had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974:

Provided that where the Central Government has given its approval to the appointment of a person convicted or detained under para (1) or para (2), as the case may be, no further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval.

(3) where he is a managerial person in more than one company, he draws remuneration from one or more companies subject to the ceiling provided in section V of Part II.

(4) he is resident of India.

In this context, 'resident in India' includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of his appointment as a managerial person and who has come to stay in India,

a) for taking up employment in India; or

b) for carrying on a business or vacation in India.

1.2.1.1 Procedure of appointment [section 196 (4)]

(a) Subject to the provisions of section 197 and Schedule V, a managing director, whole-time director or manager shall be appointed, and the terms and conditions of such appointment and remuneration payable be approved by the Board of Directors at a meeting.

(b) The terms and conditions and remuneration approved by Board of Directors as above shall be subject to the approval of shareholders by a resolution at the next general meeting of the company.

(c) In case such appointment is at variance to the conditions specified in the Schedule V of the Companies Act, 2013, the appointment shall be approved by the Central Government.

(d) The notice convening Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, of a director or directors in such appointments, if any.

(e) A return in the prescribed form (Form No. MR-1) along with the prescribed fee shall be filed with the Registrar within sixty days of such appointment.

Subject to the provisions of this Act, where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, any act done by him before such approval shall deemed to be valid [Section 196 (5)].

1.2.1.2 Appointment of Key Managerial Personnel (Section 203)

Section 203 of the Companies Act, 2013 lays down the provisions for appointment of Key Managerial Personnel of companies.

(a) Who is KMP [section 203(1)]: Every company belonging to such class or classes of companies as may be prescribed, shall have the following whole time key managerial personnel:

(1) Managing Director, or Chief Executive Officer or Manager and in their absence, a Whole time Director.

(2) Company Secretary, and

(3) Chief Financial Officer.

According to Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 every listed company and every other public company having a paid up share capital of ₹ 10 crore or more shall have whole-time key managerial personnel.

Further, as per the Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2014, a company other than a company covered under Rule 8 above, which has a paid up share capital of ₹ 5 crore or more shall have a whole-time company secretary.

With the insertion of Rule 8 A to the above rules, it is now mandatory of every other company to have a whole time company secretary if it's paid up share capital is ₹ 5 Crores or more.

(b) Prohibition on individual to be appointed as chairperson as well as Managing Director or Chief Executive Officer at the same time [Proviso to section 203(1)].

After the date of commencement of this Act, an individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of the articles of the company, as well as the managing director or Chief Executive Officer of the company at the same time unless:

(1) the articles of such a company provide otherwise; or

(2) the company does not carry multiple businesses. [First proviso to section 203(1)].

Provided that the above mentioned prohibition shall not apply to such class of companies engaged in multiple businesses and which has appointed one or more Chief Executive Officers for each such business as may be notified by the Central Government. [second proviso to section 203(1)].

(c) Conditions for appointment:

(1) Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration. [Section 203 (2)].

(2) A whole-time key managerial personnel shall not hold office in more than one company at the same time except in its subsidiary company [Section 203 (3)].

Provided that nothing in the above sub section shall disentitle a key managerial personnel from being a director in any company with the permission of the Board.

(d) Transitional period: If the whole-time KMP is holding office in more than one company at the same time on the commencement of this Act, he shall, within a period of months from such commencement, choose one company, in which he wishes to continue to hold the office of KMP.

(e) Managing Director or manager in more than one company [Third proviso to section 203(3)]:

(1) A company may appoint or employ a person as its managing director, if he is the managing director or manager of one, and of not more than one, other company.

(2) Such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting.

(3) It is further provided that specific notice of such meeting, and of the resolution to be moved thereat has been given to all the directors then in India.

(f) Casual Vacancy [section 203(4)]: If the office of any whole-time KMP is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

(g) Penalty for contravention [Section 203(5)]:

(1) On company: If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than ₹ 1 lac but which may extend to ₹ 5 Lacs.

(2) On director and KMP: Every director and KMP of the company who is in default shall be punishable with fine which may extend to ₹ 50,000 and where the contravention is a continuing one, with a further fine which may extend to ₹ 1,000 for every day after the first during which the contravention continues.

1.2.1.3. Overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits (Section 197)

Section 197 of the Companies Act, 2013 lays down the provisions for overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits. According to this section:

(a) **Overall Maximum Managerial Remuneration [Section 197(1)]**

(1) The overall managerial remuneration to the Directors including managing director, whole time director and manager is summarized as under: Where the company has defaulted in the payment to any bank /PFI or NSD or any secured creditor, prior approval of bank/PFI, shall be obtained before special resolution, If required. Auditor to give a certificate that remuneration paid is within limit as per the provision.

Persons entitled for remuneration	Maximum remuneration in any financial year	If remuneration exceeds maximum remuneration in any financial year as provided under column (b)
(a)	(b)	(c)
Directors including managing director, whole time director and manager of public companies	11% of the net profits of the company for that financial year	Company in general meeting with approval of Central Government subject to provisions of Schedule V may pay remuneration in excess of 11% of the net profits of the company
One Managing director/ Whole time director/ manager	5% of the net profits of the company for that year	With the approval of the company in general meeting this limit may be exceeded
More than one Managing director/ Whole time director/ manager	10% of the net profits	With the approval of the company in general meeting this limit may be exceeded.
Directors who are neither Managing director nor whole time directors	1% of the net profits of the company if there is a managing director or a whole time director	Approval of the company in general meeting is required
Directors who are neither Managing director nor whole time directors	3% of the net profits of the company if there is no managing director or whole time director	Approval of the company in general meeting is required

(2) Section 197(8) further provides that the net profits shall be computed in the manner laid down in section 198 except that the remuneration of the directors shall not be deducted from the gross profits.

(b) **Remuneration rendered in any other capacity [Section 197 (4)]**

(1) The remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either

a) by the articles of the company, or

b) by a resolution or,

c) if the articles so require, by a special resolution, passed by the company in general meeting, and

(2) the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

(3) Any remuneration for services rendered by any such director in other capacity shall not be so included if:

a) the services rendered are of a professional nature, and

b) in the opinion of the Nomination and Remuneration Committee, if the company is covered under sub-section (1) of section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

(c) **Sitting Fees to directors [Section 197 (5)]**

(1) A director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board.

(2) The sitting fees shall not exceed one lakh rupees per meeting of the Board or committee thereof. [As per the Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014].

However, for Independent Directors and Women Directors, the sitting fee shall not be less than the sitting fee payable to other directors.

(3) The percentages under sub-section (1) shall be exclusive of any sitting fees payable to directors for attending meetings of the Board or committee thereof or for any other purpose whatsoever as may be decided by the Board.

(4) Different fees for different classes of companies and fees in respect to independent directors may be such as may be prescribed.

(d) **Mode of remuneration [Section 197 (6)]**

A director or manager 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.

(e) **No profits or profits are inadequate [Section 197 (3) & (11)]**

(1) If in any financial year, a company has no profits or its profits are inadequate, the company shall not pay by way of remuneration any sum exclusive of sitting fees to its directors, including any managing or whole- time director or manager except in accordance with the provisions of Schedule V.

(2) If the company is not able to comply with such provisions of Schedule V in the above case, then previous approval of the Central Government shall be taken.

(3) In cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, whether the provision be contained in the company's memorandum or articles, or in an agreement entered into by it, or in any resolution passed by

the company in general meeting or its Board, shall not have any effect unless such increase is in accordance with the conditions specified in that

Schedule and if such conditions are not being complied, the approval of the Central Government had been obtained.

(f) **Remuneration of Independent Director [Section 197 (7)]**

Notwithstanding anything contained in any other provision of this Act but subject to the provisions of this section, an independent director shall not be entitled to any stock option and may receive remuneration by way of:

(a) sitting fees in terms of section 197 (5),

(b) reimbursement of expenses for participation in the Board and other meetings, and

(c) profit related commission as may be approved by the members.

(g) **Refund of excess [Section 197 (9)]**

If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section 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.

The company shall not waive the recovery of any sum refundable to it under sub-section (9) unless permitted by the Central Government. [Section 197(10)].

(h) **Disclosure by listed company [Section 197 (12)]**

(1) Every listed company shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed. The details are prescribed under the Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014.

(2) The board's report shall include a statement showing the name of every employee of the company, who:

a) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than sixty lakh rupees.

b) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than five lakh rupees per month.

c) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

(3) The statement referred to in above para (b) shall also indicate some particulars of the above employees like designation, remuneration received, nature of employment, qualification and experience, date of commencement of employment, age, last employment held by such employee before joining the company, the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of para (b) above, and whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager.

(i) **Insurance for indemnification [Section 197 (13)]**

(1) Where any insurance is taken by a company on behalf of its managing director, whole time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel.

(2) Provided that, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.

(j) **Receiving Commission [Section 197 (14)]**

Subject to the provisions of this section, any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's report.

(k) **Contravention [Section 197 (15)]**

If any person contravenes the provisions of section 197, he shall be punishable with fine which shall not be less than ₹ 1 Lakh but which may extend to ₹ 5 Lakhs.

1.2.1.4 Calculation of profits (Section 198)

According to this section

Profits for the purpose of manageria remuneration shall be calculated as follows:

Credit shall be given for the sums specified in section 198(2)	Credit shall not be given for those specified in section 198(3)
Add:	Less: (if credited to the P&L A/c for arriving at Profit before tax
Bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs.	a. profits, by way of premium on shares or debentures of the company, which are issued or sold by the company; b. profits on sales by the company of forfeited shares; c. profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof; d. profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets: Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written- down value; e. any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

Sums specified in section 198(4) shall be deducted	Sums specified in section 198 (5) shall not be deducted:
a. all the usual working charges; b. directors ''remuneration; c. bonus or commission paid or payable to any member of the company's staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis; d. any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits; e. any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf; f. interest on debentures issued by the company; g. interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets; h. interest on unsecured loans and advances; i. expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature; j. outgoings inclusive of contributions made under section 181; k. depreciation to the extent specified in section 123; l. the excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year which begins at or after the commencement of this Act, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained; m. any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract; n. any sum paid by way of insurance against the risk of meeting any liability such as is referred to in clause (m) above; o. debts considered bad and written off or adjusted during the year of account.	(a) income-tax and super-tax payable by the company under the Income-tax Act, 1961, or any other tax on the income of the company not falling under clauses (d) and (e) of subsection (4) of Section 198; (b) any compensation, damages or payments made voluntarily, that is to say, otherwise than in the nature of a liability such as is referred to in clause (m) of sub-section (4) of section 198; (c) loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value; (d) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

1.2.1.5 Central Government or company to fix limit with regard to remuneration (Section 200)

(a) According to section 200 of the Companies Act, 2013, notwithstanding anything contained in this Chapter, the Central Government or a company may, while according its approval under section 196, to any appointment or to any remuneration under section 197 in respect of cases where the company has inadequate or no profits, fix the remuneration within the limits specified in this Act, at such amount or percentage of profits of the company, as it may deem fit and while fixing such remuneration the Central Government shall have regard to:

(1) the financial position of the company.

(2) the remuneration or commission drawn by the individual concerned in any other capacity.

(3) the remuneration or commission drawn by him from any other company.

(4) professional qualifications and experience of the individual concerned.

(5) any other matters as may be prescribed

(b) According to Rule 6 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, for the purposes of clause (e) above the Central Government or the company shall have regard to the following matters, namely:

(1) the Financial and operating performance of the company during the three preceding financial years.

(2) the relationship between remuneration and performance.

(3) the principle of proportionality of remuneration within the company, ideally by a rating methodology which compares the remuneration of directors to that of other directors on the board and employees or executives of the company.

(4) whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference.

(5) the securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.

E : 1.3 POWERS OF BOARD OF DIRECTORS AND RESTRICTIONS ON THE POWERS OF DIRECTORS

1.3.1 Power of the Board of Directors (Section 179)

Section 179 of the Act, provides Powers of Board. According to this section:

(a) 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, while exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting [Section 179 (1)].

(b) The Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting [Section 179 (1)].

(c) No regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made [Section 179 (2)].

(d) Powers of the Board to be exercised by the Board by means of the resolution passed at a duly convened Board meeting [Section 179 (3)]:

(1) to make calls on shareholders in respect of money unpaid on their shares;

(2) to authorise buy-back of securities under section 68;

(3) to issue securities, including debentures, whether in or outside India;

(4) to borrow monies;

(5) to invest the funds of the company;

(6) to grant loans or give guarantee or provide security in respect of loans;

(7) to approve financial statement and the Board's report;

(8) to diversify the business of the company;

(9) to approve amalgamation, merger or reconstruction;

(10) to take over a company or acquire a controlling or substantial stake in another company;

(11) any other matter which may be prescribed

(e) Additionally, Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014 has prescribed certain more powers that shall also be exercised by the Board of Directors only by means of resolutions passed at meetings of the Board:

(1) to make political contributions;

(2) to appoint or remove KMP

(3) to appoint internal auditors and secretarial auditor;

Vide Notification No. G.S.R. 206(E) dated 18th March, 2015, in rule 8 item numbers(3),(5),(6),(7),(8),and (9) and the entries relating thereto have been omitted by the Companies(Meetings of Board and its Powers) Amendment Rules, 2015.

(f) Power to delegate certain powers of the Board: The Board may, by a resolution passed at a meeting, delegate the powers specified in points (d) to (f) above, on such conditions as it may specify to:

(1) any committee of directors,

(2) the managing director,

(3) the manager or any other principal officer of the company, or

(4) the principal officer of the branch office (in the case of a branch office of the company).

Matters referred to in clauses (d), (e), and (f) of sub-section (3) of section 179 may be decided by the board by circulation instead of at a meeting in respect to the companies covered under section 8 of the Companies Act, 2013.

However, the acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of this section [Section 179 (3)].

(g) Nothing in this section shall however be deemed to affect the right of the company in the general meeting, to impose restrictions and conditions on the exercise by the Board of any of the powers specified in this section above [Section 179 (4)].

1.3.2 Restrictions on powers of Board (Section 180)

Section 180 of the Act, provides for Restrictions on powers of Board. According to section 180 (1):

The Board of Directors of a company shall exercise the following powers only with the consent of the company by a special resolution, namely:

(a) To sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.

(1) 'Undertaking' shall mean an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent. of the total income of the company during the previous financial year.

(2) The expression 'substantially the whole of the undertaking' in any financial year shall mean

twenty per cent. or more of the value of the undertaking as per the audited balance sheet of the preceding financial year.

(b) To invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation.

This section is not applicable to private company.

(c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business.

The acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

'Temporary loans' means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature;

(d) To remit, or give time for the repayment of, any debt due from a director.

(1) Every special resolution passed by the company in general meeting in relation to the exercise of the powers referred to in point (c) above shall specify the total amount up to which monies may be borrowed by the Board of Directors [Section 180 (2)].

(2) Nothing contained in above point (a) shall affect:

a) the title of a buyer or other person who buys or takes on lease any property, investment or undertaking as is referred to in that clause, in good faith, or

b) The sale or lease of any property of the company where the ordinary business of the company consists of, or comprises, such selling or leasing.

(3) Any special resolution passed by the company consenting to the transaction as is referred to in above point (a) may stipulate such conditions as may be specified in such resolution, including conditions regarding the use, disposal or investment of the sale proceeds which may result from the transactions.

Provided that, this sub section shall not be deemed to authorise the company to effect any reduction in its capital except in accordance with the provisions contained in this Act.

(4) No debt incurred by the company in excess of the limit imposed by above point (c) shall be valid or effectual, unless the lender proves that he advanced the loan in good faith and without knowledge that the limit imposed by that clause had been exceeded.

E : 1.4 OBTAINING DIN

'Director Identification Number' (DIN) means an identification number allotted by the Central Government to any individual, intending to be appointed as director or to any existing director of a company, for the purpose of his identification as a director of a company. Section 153 to 157 of the Companies Act, 2013 provide for making application to Central Government for allotment of DIN and other matters connected there with.

1.4.1 Application for allotment of Director Identification Number (Section 153)

Section 153 of the Act deals with the filing of application to the Central Government for allotment of DIN. According to it, every individual intending to be appointed as director of a company shall make an application for allotment of DIN to the Central Government in such form and manner and along with such fees as may be prescribed, provided Central Government may prescribe any identification number which may be considered as DIN.

Rule 9 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides a detailed procedure for making application for allotment of DIN. The procedure is detailed below:

(a) Every individual, who is to be appointed as director of a company shall make an application electronically in Form DIR-3, to the Central Government for the allotment of a DIN along with such fees as prescribed.

(b) The Central Government shall provide an electronic system to facilitate submission of application for the allotment of DIN through the portal on the website of the Ministry of Corporate Affairs.

(c) The applicant shall download Form DIR-3 from the portal, fill in the required particulars sought therein, verify and sign the form and after attaching copies of the following documents, scan and file the entire set of documents electronically:

(1) photograph;

(2) proof of identity;

(3) proof of residence; and

(4) specimen signature duly verified.

(d) Form DIR-3 shall be signed and submitted electronically by the applicant using his or her own Digital Signature Certificate and shall be verified digitally by:

(1) a chartered accountant in practice or a company secretary in practice or a cost accountant in practice, or

(2) a company secretary in full time employment of the company or by the managing director or director of the company in which the applicant is to be appointed as director.

(e) In case the name of a person does not have a last name, then his or her father's or grandfather's surname shall be mentioned in the last name along with the declaration in Form No. DIR-3A.

1.4.2 Allotment of Director Identification Number (Section 154)

According to this section, the Central Government shall, within one month from the receipt of the application under section 153, allot a Director Identification Number (DIN) to the applicant in such manner as may be prescribed.

Rule 10 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides the procedure for allotment of DIN according to which:

(a) On the submission of the Form DIR-3 on the portal and payment of the requisite amount of fees through online mode, an application number shall be generated by the system automatically.

(b) After generation of application number, the Central Government shall process the applications received for allotment of DIN and decide on the approval or rejection thereof and communicate the same to the applicant along with the DIN allotted in case of approval by way of a letter by post or electronically or in any other mode, within a period of one month from the receipt of such application.

(c) If the Central Government, on examination, finds such application to be defective or incomplete in any respect, it shall give intimation of such defect or incompleteness, by placing it on the website and by email to the applicant who has filed such application, directing the applicant to rectify such defects or incompleteness by resubmitting the application within a period of 15days of such placing on the website and email.

Provided that the Central Government shall:

(1) reject the application and direct the applicant to file fresh application with complete and correct information, where the defect has been rectified partially or the information given is still found to be defective.

(2) treat and label such application as invalid in the electronic record in case the defects are not removed within the given time, and

(3) inform the applicant either by way of letter by post or electronically or in any other mode.

(4) In case of rejection or invalidation of application, the fee so paid with the application shall neither be refunded nor adjusted with any other application.

(5) All DIN allotted to individual(s) by the Central Government before the commencement of these rules shall be deemed to have been allotted to them under these rules.

(6) The DIN so allotted under these rules is valid for the life-time of the applicant and shall not be allotted to any other person.

The MCA vide Notification No. S.O. 1354(E) dated 21st May, 2014 delegates the powers and functions of the Central Government in respect of allotment of Director Identification Number under section 154 of the Companies Act, 2013 to the Regional Director, Joint Director, Deputy Director or Assistant Director posted in the office of Regional Director at Noida.

1.4.3 Prohibition to obtain more than one DIN (Section 155)

According to this section, no individual, who has already been allotted a DIN under section 154, shall apply for, obtain or possess another Director Identification Number (DIN).

1.4.4 Director to intimate DIN (Section 156)

Section 156 of the Companies Act, 2013, provides for a Director to intimate the DIN allotted to him. According to this section, every existing director shall, within one month of the receipt of DIN from the Central Government, intimate his DIN to the company or all companies wherein he is a director.

1.4.5 Company to inform DIN to Registrar (Section 157)

(a) According to this section:

(1) Every company shall, within 15 days of the receipt of intimation under section 156, furnish the DIN of all its directors to the Registrar or any other officer or authority as may be specified by the Central Government with such fees as may be prescribed or with such additional fees as may be prescribed within the time specified under section 403.

Every such intimation shall be furnished in such form and manner as may be prescribed. [Section 157(1)].

(2) If a company fails to furnish the DIN under sub-section (1) above, before the expiry of the period specified under section 403 with additional fee, the company shall be punishable with fine which shall not be less than ` 25,000 but which may extend to ` 1,00,000 and every officer of the company who is in default shall be punishable with fine which shall not be less than ` 25,000 but which may extend to ` 1,00,000. [Section 157(2)].

(b) According to Rule 10A of the Companies (Appointment and Qualification of Directors) Amendment Rules, 2014:

(1) Every director, functioning as a director in one or more companies on or before the 30th June, 2007 and who has not yet intimated his DIN to such company or companies shall, within one month of the receipt of Director Identification Number from the Central Government, intimate his Director Identification Number to the company or all companies wherein he is a director as per Form DIR-3B.

(2) The intimation by the company of Director Identification Number of its directors under section 157 of the Act shall be furnished in Form DIR-3C within 15 days of receipt of intimation under section 156.

1.4.6 Obligation to indicate DIN (Section 158)

According to section 158 of the Companies Act, 2013,every person or company, while furnishing any return, information or particulars as are required to be furnished under this Act, shall mention the Director Identification Number in such return, information or particulars in case such return, information or particulars relate to the director or contain any reference of any director.

1.4.7 Punishment for contravention (Section 159)

Section 159 of the Companies Act, 2013 provides for Punishment for contravention of any of the provisions of section 152, 155 and 156 of the Act.

According to the section, if any individual or director of a company, contravenes any of the provisions of section 152, 155 and 156, such individual or director of the company shall be punishable with imprisonment for a term which may extend to 6 months or with fine which may extend to ` 50,000 and where the contravention is a continuing one, with a further fine which may extend to ` 500 for every day after the first during which the contravention continues.

1.4.8 Cancellation or surrender or Deactivation of DIN

Rule 11 of the Companies (Appointment and Qualification of Directors) Rules, 2014 as amended by the Companies (Appointment and Qualification of Directors) Amendment Rules, 2014, lays down the procedure for cancellation or surrender or deactivation of DIN as under:

The Central Government or Regional Director (Northern Region), Noida or any officer authorised by the Regional Director may, upon being satisfied on verification of particulars or documentary proof attached with the application received along with fee as specified in Companies (Registration Offices and Fees) Rules, 2014, from any person, cancel or deactivate the DIN in case:

(a) the DIN is found to be duplicated in respect of the same person provided the data related to both the DINs shall be merged with the validly retained number.

(b) the DIN was obtained in a wrongful manner or by fraudulent means; Provided that before cancellation or deactivation of DIN pursuant to the above clause (b), an opportunity of being heard shall be given to the concerned individual.

For this purpose:

(1) the term wrongful manner means if the DIN is obtained on the strength of documents which are not legally valid or incomplete documents are furnished or on suppression of material information or on the basis of wrong certification or by making misleading or false information or by misrepresentation.

(2) the term fraudulent means means if the DIN is obtained with an intent to deceive any other person or any authority including the Central Government.

(c) of the death of the concerned individual.

(d) the concerned individual has been declared as a person of unsound mind by a competent Court.

(e) if the concerned individual has been adjudicated an insolvent.

(f) on an application made in Form DIR-5 by the DIN holder to surrender his or her DIN along with declaration that he has never been appointed as director in any company and the said DIN has never been used for filing of any document with any authority, the Central Government may deactivate such DIN.

Provided that before deactivation of any DIN in such case, the Central Government shall verify e-records.

1.4.9 Intimation of changes in particulars specified in DIN application

Rule 12 of the Companies (Appointment and Qualification of Directors) Rules, 2014 as amended by the Companies (Appointment and Qualification of Directors) Amendment Rules, 2014, provides for the procedure for Intimation of changes in particulars specified in the DIN application according to which:

(a) Every individual who has been allotted a DIN under these rules shall, in the event of any change in his particulars as stated in Form DIR-3, intimate such change(s) to the Central Government within a period of thirty days of such change(s) in Form DIR-6 in the following manner, namely:

(1) The applicant shall download Form DIR-6 from the portal, fill in the relevant changes, verify the Form and attach duly scanned copy of the proof of the changed particulars and submit electronically.

(2) the form shall be digitally signed by a chartered accountant in practice or a company secretary in practice or a cost accountant in practice.

(3) the applicant shall submit the Form DIR-6.

(b) The Central Government, upon being satisfied, after verification of such changed particulars from the enclosed proofs, shall incorporate the said changes and inform the applicant by way of a letter by post or electronically or in any other mode confirming the effect of such change in the electronic database maintained by the Ministry.

(c) The DIN cell of the Ministry shall also intimate the change(s) in the particulars of the director submitted to it in Form DIR-6 to the concerned Registrar(s) under whose jurisdiction the registered office of the company(s) in which such individual is a director is situated.

(d) The concerned individual shall also intimate the change(s) in his particulars to the company or companies in which he is a director within 15 days of such change.

E : 1.5 COMPENSATION FOR LOSS OF OFFICE

1.5.1 Compensation for loss of office of managing or whole-time director or manager (Section 202)

Section 202 of the Companies Act, 2013 provides the provisions for compensation for loss of office of managing or whole-time director or manager as under:

(a) A company may make payment to a managing or whole-time director or manager, but not to any other director, by way of compensation for loss of office, or as consideration for retirement from office or in connection with such loss or retirement.

(b) No payment of compensation shall be made in the following cases:

(1) where the director resigns from his office as a result of the reconstruction of the company, or of its amalgamation with any other body corporate or bodies corporate, and is appointed as the managing or whole-time director, manager or other officer of the reconstructed company or of the body corporate resulting from the amalgamation.

(2) where the director resigns from his office otherwise than on the reconstruction of the company or its amalgamation as aforesaid.

(3) where the office of the director is vacated under sub-section (1) of section 167.

(4) where the company is being wound up, whether by an order of the Tribunal or voluntarily, provided the winding up was due to the negligence or default of the director.

(5) where the director has been guilty of fraud or breach of trust in relation to, or of gross negligence in or gross mismanagement of, the conduct of the affairs of the company or any subsidiary company or holding company thereof, and

(6) where the director has instigated, or has taken part directly or indirectly in bringing about, the termination of his office.

(c) The compensation payable to such managing director or whole-time director or manager shall not exceed the remuneration he would have earned if he would have been in office for the remainder of his term or three years, whichever is shorter, calculated on the basis of the average remuneration earned by him during a period of three years immediately preceding the date on which he ceased to hold such office, or where he held the office of less than three years, then for such shorter period.

(d) No such payment however can be made at all if winding up of the company is commenced whether before or within 12 months after, the date on which he ceased to hold office, if the assets on winding up (after deducting expenses on winding up) are not sufficient to repay the shareholders the capital, including premiums if any, contributed by them.

(e) Nothing in this section shall be deemed to prohibit the payment to a managing or whole - time director, or manager, of any remuneration for services rendered by him to the company in any other capacity.

E : 1.6 WAIVER OF RECOVERY OF REMUNERATION

Section 199 of the Act provides for recovery of remuneration in certain cases.

According to this section:

Without prejudice to any liability incurred under the provisions of this Act or any other law for the time being in force, where a company is required to re-state its financial statements due to fraud or non-compliance with any requirement under this Act and the rules made thereunder, the company shall recover from any past or present managing director or whole-time director or manager or Chief Executive Officer (by whatever name called) who, during the period for which the financial statements are required to be re-stated, received the remuneration (including stock option) in excess of what would have been payable to him as per restatement of financial statements.

E : 1.7 MAKING LOANS TO DIRECTORS, DISCLOSURE OF INTEREST OF A DIRECTOR, HOLDING OF OFFICE OR PLACE OF PROFIT BY A DIRECTOR/RELATIVE

1.7.1 Loan to directors, etc. (Section 185)

Section 185 of the Act provides for Loan to directors, etc. According to this section:

No company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person.

Exceptions: The above restriction does not apply in the following circumstances:

(a) the giving of any loan to a managing or whole-time director:

(1) as a part of the conditions of service extended by the company to all its employees; or

(2) pursuant to any scheme approved by the members by a special resolution; or

(b) a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the bank rate declared by the Reserve Bank of India.

(c) any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company, or

(d) Any guarantee given or security provided by a holding company in respect of any loan made by any bank or financial institution to its subsidiary company:

Provided that the loans made under clauses(c) and (d) are utilized by the subsidiary company for its principal business activities. [Inserted by the Companies (Amendment) Act, 2015]

Explanation

The expression to any other person in whom director is interested means:

a) any director of the lending company, or of a company which is its holding company or any partner or relative of any 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.

1.7.2 Penalty for contravention

If any loan is advanced or a guarantee is given or provided in contravention of the provisions of section 185, the following penalties shall be leviable:

(a) On Company: Minimum- ₹ 5 lakhs and maximum- ₹ 25 lakhs.

(b) On defaulting director and the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person: Imprisonment- Maximum 6 months, or, Fine- Minimum- 5 lakhs and maximum- 25 lakhs, or, Both imprisonment and fine.

Thus, penalty is leveiable only on the company or director or person to whom the loan is given or guarantee or security is provided. However, all other persons who are knowingly a party to default has been kept outside the ambit of penalty clause of section 185. The Companies (Meetings of Board and its Powers) Rules, 2014 has exempted the following from the ambit of section 185 provided the

loans are to utilize by the subsidiary company for its principal business activities.

(1) Any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company is exempted from the requirements under this section, and

(2) Any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company is exempted from the requirements under this section.

Vide Notification G.S.R 464(E), dated 5th June 2015, section 185 shall not apply to a private company:

(a) In whose share capital no other body corporate has invested any money.

(b) If the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower, and

(c) Such company has no default in repayment of such borrowings subsisting at the time of making transactions under this section.

1.7.3 Disclosure of interest by director (Section 184)

Section 184 of the Act provides for Disclosure of interest by director. According to this section:

Section 184 is applicable on all directors of the company and all types of Companies.

(a) When to disclose: Every director shall:

(1) At the First meeting of the Board in which he participates as a director, and

(2) Thereafter, at the first meeting of the Board in every financial year, or

(3) Whenever there is any change in the disclosures already made, then at the first Board meeting held after such change.

(b) What to disclose: Every director shall disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in such manner as may be prescribed.

The Companies (Meetings of Board and its Powers) Rules, 2014 has prescribed that the directors shall disclose his concern or interest, by giving a notice in writing.

(c) Circumstances in which disclosure is necessary: Whenever any director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting. Following are the circumstances where disclosure is necessary:

Whenever any director of the company, who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into:

(1) with a body corporate in which such director or such director in association with any other director, holds more than two per cent. shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate, or

(2) with a firm or other entity in which, such director is a partner, owner or member, as the case may be.

However, where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

Whereas with respect to the companies covered under section 8 of the Companies Act, 2013, vide Notification G.S.R. 466 (E), dated 5th June 2015, the Section 184 (2) shall apply only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees.

Consequences of non disclosure:

a) Voidable at the option of company: A contract or arrangement entered into by the company without disclosing or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company.

b) Penalty: If a director of the company contravenes the provisions of sub-section (1) or subsection (2) of section 184, such director shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees, or with both.

(d) No restriction on directors: Nothing in section 184 shall be taken to prejudice the operation of any rule of law restricting a director of a company from having any concern or interest in any contract or arrangement with the company.

The Act requires the disclosure of interest by a director and prohibits an interested director to participate or vote in respect of that particular transaction at the Board meeting. Further his presence will not be counted for quorum also. But where a whole body of directors is aware of the facts relating to an interest of a director, a formal disclosure is not necessary. [Ramakrishna Rao v Bangalore Race Club; 1970 40 CompCas 1154 Kar.].

(e) Exception: Section 184 shall not apply to any contract or arrangement entered into or to be entered into between 2 companies where any of the directors of the one company or two or more of them together holds or hold not more than 2% of the paid-up share capital in the other company.

1.7.4 Office or place of profit [Section 188]

The introduction of Companies Act, 2013 has brought out a new phase to the corporate sector. To make Corporate Law more effective much reliance is placed on the disclosure. There are number of sections which places reliance on disclosure norms, one of such section is section 188 relating to 'Related Party Transaction' which combines the provisions of Sections 297 and 314 of the Companies Act, 1956 along with some more provisions.

In order to mitigate the practical difficulties and to clarify the ambiguity of law, Ministry of Corporate Affairs has issued a number of amendments, clarifications, notifications, circulars etc., on the subject.

The expression 'office or place of profit' means any office or place:

Where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

Where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise.

1.7.5 Provisions relating the related party

Section 188 of the Companies Act, 2013 contemplates the approval required in order to enter into related party transactions. The section provides for the various transactions which cannot be entered into by the company without the consent of the Board of Directors. Meaning thereby unless the Board of Directors have given their consent by way of a resolution at a meeting of the Board, the company cannot enter into the prescribed transactions.

(a) **Omnibus approval for related party transactions on annual basis**

All related party transactions shall require approval of the Audit Committee and the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to the following conditions, namely:-

(1) The Audit Committee shall, after obtaining approval of the Board of Directors, specify the criteria for making the omnibus approval which shall include the following, namely:

a) maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year.

b) the maximum value per transaction which can be allowed.

c) extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval.

d) review, at such intervals as the Audit Committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made.

e) transactions which cannot be subject to the omnibus approval by the Audit Committee.

(2) The Audit Committee shall consider the following factors while specifying the criteria for making omnibus approval, namely:

a) repetitiveness of the transactions (in past or in future).

b) justification for the need of omnibus approval.

(3) The Audit Committee shall satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company.

(4) The omnibus approval shall contain or indicate the following:

a) name of the related parties.

b) nature and duration of the transaction.

c) maximum amount of transaction that can be entered into.

d) the indicative base price or current contracted price and the formula for variation in the price, if any, and

e) any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:

Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

(5) Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year.

(6) Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

(7) Any other conditions as the Audit Committee may deem fit.

(b) **Transactions [Section 188 (1)]**

(1) Sale, Purchase or supply of any goods or materials.

(2) Selling or otherwise disposing of, or buying, property of any kind.

(3) Leasing of property of any kind.

(4) Availing or rendering of any services.

(5) Appointment of any agent for purchase or sale of goods, materials, services or property.

(6) Such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company, and

(7) Underwriting the subscription of any securities or derivatives thereof of the company.

It is to be noted that the proviso to the Section 188 provides that a company, whose paid-up capital is more than Rupees Ten crore or is proposed to enter into transactions exceeding such sums as prescribed under Rule 15 of the Companies (Meetings of Board and its Powers) Rules 2014, cannot enter into the transactions, except with the previous approval of shareholders by way of Special resolution. The transactions, as prescribed under Rule 15(3), which require prior approval of Shareholders by way of Special Resolution.

(c) **Contracts or arrangements as per their respective limits [Section 188 (1)]**

(1) Any Sale, purchase or supply of goods or materials directly or through any agents amount of which exceeds twenty five percent of the annual turnover of the Company.

(2) Selling or otherwise disposing of, or buying, property of any kind directly or through the agent amount of which exceeds ten percent of net worth of the company.

(3) any leasing of property which amounts ten percent or more of the turnover of the company.

(4) Availing or rendering of any services directly or through the agent amount of which exceeds ten percent of the net worth of the company.

a) Appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rupees Two Lakh Fifty Thousand;

b) The remuneration for underwriting the subscription of securities or derivatives thereof of the company exceeding one percent of the net worth of the company.

Earlier, the Companies having paid-up capital of ₹10 Crore or more were required shareholders approval by way of special resolution. This limit has been dispensed with and the new threshold limits have been introduced. The revised provision states that a company shall not enter into transaction(s) or transactions without the previous approval of shareholders, where the transaction(s) to be entered into involves the following:

(d) **Contracts or arrangements involving the following [Section 188 (1) (a) to (e)]**

(1) Sale, purchase or supply of any goods or materials, whether directly or through any agent and wherein the amount involved exceeds ten per cent. of the turnover of the company or Rupees Hundred crore, whichever is lower.

(2) Selling or otherwise disposing of or buying property of any kind, directly or through any agent and where the amount involved exceeds ten percent of the net worth of the company or Rupees Hundred crore, whichever is lower.

(3) Leasing of property of any kind and the amount involved exceeds ten percent of net worth of the company or ten per cent. of turnover of the company or Rupees One Hundred crore.

(4) Availing and rendering of any kind of services, directly or through appointment of agent and

which involves amount exceeding ten per cent. Of the turnover of the company or Rupees Fifty Crore, whichever is lower.

The Notification issued by Ministry provides the explanation that the above mentioned limits that are specified for the transaction(s) shall apply to the transactions to be entered into either individually or taken together with the previous transactions during a financial year.

a) Appointment of any person in the office or any place of profit in the company, its subsidiary or associate company at a monthly remuneration exceeding Rupees Two lakh Fifty Thousand.

b) Remuneration for underwriting of subscription of any securities or derivatives of the Company exceeding one percent of net worth of the company.

The Notification issued by Ministry provides the explanation in regard to above provisions that the turnover or the net worth referred in the above Sub rules shall be computed on the basis of the Audited Financial Statements of the preceding financial year.

Further, the Explanation (2) of Rule -15 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that, in case of wholly owned subsidiary, the special resolution passed by the holding company for entering into the transactions between the wholly owned subsidiary and the holding company shall suffice.

Explaining further, the Ministry provides that the explanatory statement which is required to be annexed to the notice of General Meeting shall contain the following viz. name of the related party, name of the director or key managerial personnel interested in such transaction, nature of relationship, material value or monetary terms attached to such transaction or any other information which is necessary or important for the members for taking the decision on proposed resolution respectively4.

The Ministry has provided major changes only in the limits of Contracts or arrangements with respect to clause (a) to (e) of Section 188 (1), whereas the companies are also waiting for amendment related to transaction between two wholly-owned subsidiaries. But this major change in the limits of contracts or arrangements is also appreciated.

E : 1.8 INTERESTED DIRECTORS

According to Section 2 (49) of the Companies Act, 2013 'Interested director' means a director who is in any way, whether by himself or through any of his relatives or firm, body corporate or other association of individuals in which he or any of his relatives is a partner, director or a member, interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into by or on behalf of a company.

1.8.1 Disclosure of Interest

Interested Director means any director whose presence cannot count for the purpose of forming a quorum at a meeting of the Board, at the time of the discussion or vote on any matter.

A quorum is the minimum number of qualified persons who must attend in order to transact business at a duly convened Board meeting. A meeting shall not be deemed to have been properly held unless the quorum was present at that meeting. Section 174 of the Companies Act, 2013 provides for Quorum for meetings of Board. According to this section:

Where at any time the number of interested directors exceeds or is equal to two thirds of the total strength of the Board of Directors, the quorum shall be the number of directors who are present at the meeting and not interested directors and are not be less than 2.

'Interested director' for the purposes of this sub section means a director within the meaning of section 184 (2). Under section 184 (2) interested director means every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into:

(a) with a body corporate in which such director or such director in association with any other director, holds more than two per cent. shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate, or

(b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be,

shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting;

Provided, where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested [Section 184 (2)].

Further, a contract or arrangement entered into by the company without disclosure under sub-section (2) or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company [Section 184 (3)].

The Act prohibits an interested director from participating in the discussion of or voting on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company in which his presence shall not be counted for the purpose of forming a quorum at the time of any such discussion or vote and if he does vote, his vote shall be void. Interest here means personal interest and not official or any other interest. It may be financial interest and includes interest arising out of fiduciary duties or closeness or relationship such as that of husband and wife, father and son [Firestone Tyre & Rubber Co. v. Synthetics & Chemicals Ltd., (1970) Comp. L.J. 200].

The Act further imposes an obligation on a director to disclose the nature of his concern or interest whether (direct or indirect) if any, at a meeting of the Board of directors. A director is in a fiduciary position. A person in fiduciary position is not permitted to obtain profit from his position except with the consent of his beneficiaries or other persons to whom he owes the duty. Further, an interested director shall not participate or vote in Board's proceedings.

Disclosure of interest has to be made at meeting of the Board of directors. It has to be made formally, even if the interest in question is otherwise known to them. [Guinness PLC v. Saunders (1988) 2 ALL ER 940].

Self Assessment Questions

1. What are the qualifications of a director? When is a person disqualified for appointment as a director of the company?
2. What are the rules as regards disqualification of Directors?
3. How can the directors be removed from the office before the expiry of their term?
4. Discuss the duty of a director to disclose his interest in contracts to be entered into by the company. What are the consequences of non-disclosure?
5. Under what circumstances is a director deemed to have vacated the office of directorship?
6. State the provisions of the Companies Act regarding the remuneration of directors.
7. Discuss in detail the provisions relating to holding of office or place of profit by a director, relative etc. in a company.
8. Discuss the liabilities of directors to the company and to outsiders for their acts.
9. Directors are not only agents but are also in some sense trustee of the company. Discuss.
10. Can a Managing Director be paid compensation for loss of office?

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Study Note - 1

THE COMPANIES ACT, 2013

PART - F : BOARD MEETINGS AND PROCEDURES

This Study Note includes:

F : 1.1 Board Meetings, Minutes and Registers

F : 1.2 Powers of the Board

F : 1.3 Corporate Governance & Audit Committee

F : 1.4 Nomination and Remuneration Committee

F : 1.5 Stakeholders Relationship Committee

F : 1.6 Corporate Social Responsibility Committee

F : 1.7 Duties and Liabilities of Directors

F : 1.8 Powers related to Political Contributions

Chapter XII of the Companies Act, 2013(from Section 173 to Section 195) includes the provisions as to conduct of Board Meetings, Constitution of Audit Committee, Nomination and Remuneration Committee and Stakeholders Relationship Committee, Powers of the Board, Restrictions on the Powers of the Board, Prohibition regarding Political contributions etc. According to Section 118(10) of the Companies Act, 2013, every Company shall also observe Secretarial Standards with respect to general meetings and Board meetings, specified by the Institute of Company Secretaries of India. Accordingly, upon receipt of approval from MCA, ICSI has vide notification ICSI No.1(SS) of 2015 dated 23 April, 2015 notified two Secretarial Standards viz. SS-1: Meetings of Board of Directors and General Meetings.

F : 1.1 BOARD MEETINGS, MINUTES AND REGISTERS

1.1.1 Meetings of Board (Section 173)

Section 173 of the Act provides for Meetings of Board. According to this section:

1.1.1.1 Frequency of Board Meetings [Section 173 (1)]

(a) First Board meeting: Every company shall hold the first meeting of the Board of Directors within 30 days of the date of its Incorporation.

(b) Subsequent Board meetings: Every company shall hold minimum of 4 meetings every year provided that the gap between two consecutive board meetings shall not be more than 120 days.

However, the Central Government may by notification, direct that these provisions will not apply in relation to any class or descriptions of companies or will apply in relation thereto subject to such exceptions, modifications or conditions as may be specified in the notification.

Exceptions:

(a) A one person company, small company and dormant company shall be deemed to have complied with the provisions of section 173, if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than 90 days.

(b) Provided that, a one person company in which there is only one director on its Board of Directors shall not be required to hold at least one Board meeting in each half of a calendar year. Thus, it is exempt from following the provisions of section 173(5).

(c) Vide Notification G.S.R. 466(E) dated 5th June 2015, this sub-section 1 of section 173 shall apply to the company formed under section 8 of the Companies Act, 2013 only to the extent that the Board of Directors of such companies shall hold at least one meeting within every six calendar months.

(d) Meetings of Committees: As per Secretarial Standards, Committees shall meet as often as necessary subject to the minimum number and frequency stipulated by the Board, or as prescribed by any law or authority.

(e) Meeting of Independent Directors: As per Secretarial Standards, where a company is required to appoint Independent Directors under the Act, such Independent Directors shall meet atleast once in a calendar year.

1.1.1.2 Participation in Board meeting [Section 173 (2)]

(a) Sub section (2) of section 173 allows directors to attend Board meetings:

(1) in person, or,

(2) through video conferencing, or,

(3) other audio visual means as may be prescribed.

(b) Such audio visual means should be capable of recording and recognising the participation of the directors and of recording and storing the proceedings of such meetings along with date and time.

(c) However, the Central Government may by notification specify such matters as given under Rule 4 of the Companies (Meetings of Board and its powers) Rules, 2014 which shall not be dealt within a meeting through video conferencing and other audio visual means provided the quorum is present physically, others can participate through video.

(d) Video conferencing - Key Points: Key points related to meetings of Board that are held through conferencing or other audio visual means, as provided in Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 are as under:

(1) Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.

(2) The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care:

a) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;

b) to ensure availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorised participants at the Board meeting;

c) to record proceedings and prepare the minutes of the meeting;

d) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year;

e) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and

f) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting.

However, the differently disabled persons may make a request to the Board to allow a person to accompany him.

(e) Matters not to be dealt with in a meeting through video conferencing or other audio-visual means:- The following matters shall not be dealt with in any meeting held through video conferencing or other audio-visual means, as provided in Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014:

(i) the approval of annual financial statements;

(ii) the approval of the Board's report;

(iii) the approval of the prospectus;

(iv) the Audit Committee Meetings for consideration of financial statement including consolidated financial statement, if any to be approved by the Board; and

(v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

1.1.1.3 Notice of the Meeting [Section 173 (3)]

(a) According to section 173(3), every board meeting shall be called by giving at least 7 days notice in writing to all the directors at their registered address (whether in India or outside India). The notice may be sent by hand delivery or by post or by electronic means.

Provided that a meeting of the Board of Directors may be called on a shorter notice (than 7 days) in order to transact an urgent business, subject to the condition that at least one independent director, if any, shall be present at the meeting. If no independent director is present at such a meeting of the Board then the decisions taken at such a meeting shall be circulated to all the directors and shall be final only on ratification thereof by at least one independent director, if any.

As per Secretarial Standards, the fact that meeting is being called at shorter notice, shall be stated in the notice.

(b) The Companies (Meetings of Board and its Powers) Rules, 2014 further provides that

(i) The notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio visual means.

(ii) On receiving such a notice, a director intending to participate through video conferencing or audio visual means shall communicate his intention to the chairperson or the company secretary of the company. He shall give prior intimation to that effect sufficiently in advance so that the company is able to make suitable arrangements in this behalf.

(i) If the director does not give any intimation of his intention to participate that he wants to participate through the electronic mode, it shall be assumed that the director shall attend the meeting in person.

(ii) The director, who desires, to participate may intimate his intention of participation through the electronic mode at the beginning of the calendar year and such declaration shall be valid for one calendar year. In the absence of any such intimation from the director, it shall be assumed that he will attend the meeting in person.

(iii) Notice of the meeting, wherein the facility of participation through Electronic mode is provided, shall clearly mention a venue to be the venue of the meeting and it shall be the place where all the recordings of the proceedings at the meeting would be made.

(c) The SS-1 (Secretarial Standards on the Meeting of Board) provides that:

(i) Where director specifies a particular means of delivery of notice, notice shall be given to him by such means.

(ii) Notice shall be issued by the Company Secretary or where there is no Company Secretary, by any director or any other person authorized by the Board for the purpose.

(iii) The notice shall specify the serial number, day, date, time and full address of the venue of the meeting.

(iv) In case the facility of participation through Electronic Mode is being made available, the notice shall provide the available option of such facility, information to avail such facility, and contact number or e-mail address of the Chairman or Company Secretary or any other authorized person to whom director shall confirm as to whether they will participate through electronic mode in the meeting.

(v) The Agenda, setting out the business to be transacted at the meeting, and Notes to agenda shall also be sent to all the directors alongwith Notice of the Board Meeting.

(vi) Each item of the business to be taken up in the meeting shall be serially numbered.

(vii) Proof of sending notice, agenda and notes on agenda and their delivery shall be maintained by the company.

(viii) Every Meeting shall have a serial number.

(ix) A meeting may be convened at any time and place, on any day, excluding a National Holiday.

National Holiday includes Republic Day i.e. 26th January, Independence Day i.e. 15th August, Gandhi Jayanti i.e. 2nd October and such other day as may be declared as National Holiday by the Central Government.

1.1.1.4 Penalty for failure to give notice [Section 173(4)]

The Act under section 173(4) has prescribed a penalty of ` 25,000 on every officer of the Company whose duty is to give notice under this section and who has failed to do so.

1.1.1.5 Quorum for meetings of Board (Section 174)

A quorum is the minimum number of qualified persons who must attend in order to transact business at a duly convened Board meeting. A meeting shall not be deemed to have been properly held unless the quorum was present at that meeting.

Section 174 of the Companies Act, 2013 provides for Quorum for meetings of Board. According to this section:

(a) The quorum for a Board Meeting shall be one-third of its total strength or two directors, whichever is higher.

(b) The directors who participate by video conferencing or by other audio visual means shall also be counted for the purpose of determining the quorum at the meeting.

Further, the explanation given in the Companies (Meetings of Board and its Powers) Rules, 2014 provides that the a director participating in a meeting through video conferencing or other audio visual means shall be counted for the purpose of quorum, unless he is to be excluded for any items of business under any provisions of the Act or the rules.

(c) The continuing directors may notwithstanding any vacancy in the Board; but, if and so long as their number is reduced below the quorum fixed by the Act for a meeting of the Board, the continuing directors or director may act for the purpose of increasing the number of directors to that fixed for the quorum, or of summoning a general meeting of the company and for no other purpose.

(d) Where at any time the number of interested directors exceeds or is equal to two third of the total strength of the Board of Directors, the quorum shall be the number of directors who are present at the meeting and not interested directors and are not be less than 2.

(e) Interested director for the purposes of this sub section means a director within the meaning of section 184 (2). Under section 184 (2) interested director means every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into:

(1) with a body corporate in which such director or such director in association with any other director, holds more than two per cent shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate, or

(2) with a firm or other entity in which, such director is a partner, owner or member, as the case may be, shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting.

However, where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested. Vide Notification no. G.S.R.464(E) dated 5th June, 2015, Section 184(2) shall apply to the private companies with the exception that interested director may participate in such meeting after disclosure of his interest.

Where a meeting of the Board could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned to the same day at the same time and place in the next week or if that day is a national holiday, till the next succeeding day, which is not a national holiday, at the same time and place.

There is no ban on contract in which a director is interested. The only requirement is that the interest should be disclosed, bonafide and fair. [P. Leslie & Co. v Vo Wapshare; AIR (1969) SC 843]

Notes:

(1) The companies covered under section 8 of the Act shall constitute quorum for the Board meeting, either eight members or 25% of its total strength whichever is less. Provided that quorum shall not be less than two members. [Vide Notification G.S.R.466(E) dated 5th June 2015].

(2) The provisions of section 174 are not applicable to one person company in which there is only one director on its Board of directors.

(3) For the purpose of calculating quorum, any fraction of a number shall be rounded off as one.

(4) Total strength shall not include directors whose places are vacant.

(5) As per the SS-1 (Secretarial Standards on the Meeting of Board):

a) Quorum shall be present throughout the meeting.

b) Meetings of Committees: The presence of all members of any committee constituted by the Board is necessary to form the quorum for the meetings of such committee unless otherwise stipulated in the Act, or any other law, or the Articles or by the Board.

1.1.1.6 Passing of resolution by circulation (Section 175)

The Act requires certain business to be approved only at meetings of the Board. However, other business that require urgent decisions can be approved by means of Resolution passed by circulation. Resolution passed by circulation shall be deemed to be passed at a duly convened Meeting of the Board and have equal authority.

Section 175 of the Act provides for Passing of resolution by circulation. According to this section:

(a) The Act allows the Board of directors to pass resolution by circulation also. No resolution shall be deemed to have been duly passed by the Board or by a Committee thereof by circulation unless:

(1) The resolution has been circulated in draft, together with the necessary papers, if any, to all the directors, or members of the Committee, as the case may be,

(2) at their addresses registered with the company in India,

(3) by hand delivery or by post or by courier, or through such electronic means as may be prescribed, and has been approved by a majority of the directors or members, who are entitled to vote on the resolution.

If at least 1/3rd of the total number of directors of the company for the time being require that any resolution under circulation must be decided at a meeting, the chairperson shall put the resolution to be decided at a meeting of the Board.

(b) A resolution that has been passed by circulation shall have to be necessarily be noted in the next meeting of board or the committee, as the case may be, and made part of the minutes of such meeting.

(c) According to Secretarial Standards, not more than seven days from the date of circulation of draft resolution shall be given to the Directors to respond.

Annexure-A to Secretarial Standards-1 provides illustrative list of items of business which shall not be passed by circulation and shall be placed before the Board at its Meeting, as under:

General Business Items

1. Noting Minutes of Meetings of Audit Committee and other Committees.
2. Approving financial statements and the Board's Report.
3. Considering the Compliance Certificate to ensure compliance with the provisions of all the laws applicable to the company.
4. Specifying list of laws applicable specifically to the company.
5. Appointment of Secretarial Auditors and Internal Auditors.

Specific Items

1. Borrowing money otherwise than by issue of debentures.
2. Investing the funds of the company.
3. Granting loans or giving guarantee or providing security in respect of loans.
4. Making political contributions.
5. Making calls on shareholders in respect of money unpaid on their shares.

6. Approving Remuneration of Managing Director, Whole-time Director and Manager .
7. Appointment or Removal of Key Managerial Personnel.
8. Appointment of a person as a Managing Director / Manager in more than one company.
9. According sanction for related party transactions which are not in the ordinary course of business or which are not on arm's length basis.
10. Purchase and Sale of subsidiaries/assets which are not in the normal course of business.
11. Approve Payment to Director for loss of office.
12. Items arising out of separate meeting of the Independent Directors if so decided by the Independent Directors.

Corporate Actions

1. Authorise Buy Back of securities
2. Issue of securities, including debentures, whether in or outside India.
3. Approving amalgamation, merger or reconstruction.
4. Diversify the business.
5. Takeover another company or acquiring controlling or substantial stake in another company.

Additional list of items in case of listed companies

1. Approving Annual operating plans and budgets.
2. Capital budgets and any updates.
3. Information on remuneration of KMP.
4. Show cause, demand, prosecution notices and penalty notices which are materially important.
5. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.
6. Any material default in financial obligations to and by the company, or substantial non-payment for goods sold by the company.
7. Any issue, which involves possible public or product liability
8. 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.

1.1.2 Minutes

The minute in a literal sense means a note to preserve the memory of anything. The minutes of a meeting are a written record of the business transacted; decisions and resolutions arrived at the meeting.

1.1.2.1 Minutes of the Meeting of the General Meeting/Board Meeting [Section 118]

Section 118 of the Companies Act, 2013 imposes a statutory obligation on every company to cause minutes of all proceedings of general meetings, board meetings and other meeting and resolution passed by postal ballot.

However, vide Notification No.G.S.R.466(E) dated 05th June, 2015, this Section shall not apply as a whole to Section 8 companies except the minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where the articles of association provide for confirmation of minutes by circulation.

According to the Section, every company shall cause minutes of the proceedings of every general meeting of any class of shareholders or creditors, and every resolution passed by postal ballot and every meeting of its Board of Directors or of every Committee of the Board, to be prepared and signed in such manner as may be prescribed and kept within thirty days of the conclusion of every such meeting concerned, or passing of resolution by postal ballot in books kept for that purpose with their pages consecutively numbered [Section 118(1)]

The minutes of each meeting shall contain a fair and correct summary of the proceedings thereat [Section 118(2)].

All appointments made at any of the meetings aforesaid shall be included in the minutes of the meeting [Section 118(3)].

The Chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes [Section 118(6)].

The minutes kept in accordance with the provisions of this Section shall be evidence of the proceedings recorded therein [Section 118(7)].

As per Section 118(10), every company shall observe Secretarial Standards with respect to general and board meetings specified by the Institute of Company Secretaries of India constituted under Section 3 of the Company Secretaries Act, 1980 and approved as such by the Central Government. Accordingly, upon receipt of approval of MCA, ICSI has notified two Secretarial Standards viz. SS-1: Meetings of the Board of Directors and SS-2: General Meetings vide Notification ICSI No.1(SS) of 2015 dated 23rd April, 2015.

1.1.2.2 Inspection of minute books of general meeting [Section 119]

(a) The books containing the minutes of the proceedings of any general meeting of a company or of a resolution passed by postal ballot, shall:

(1) be kept at the registered office of the company, and

(2) be open, during business hours, to the inspection by any member without charge, subject to such reasonable restrictions as the company may, by its articles or in general meeting, impose, so, however, that not less than two hours in each business day are allowed for inspection.

(b) The other statutory requirements relating to keeping of the minutes of meeting are:

(1) The minutes of each meeting shall contain a fair and correct summary of the proceedings thereat.

(2) All appointments made at any of the meetings aforesaid shall be included in the minutes of the meeting.

(3) In the case of a meeting of the Board of Directors or of a committee of the Board, the minutes shall also contain:

a) the names of the directors present at the meeting, and

b) in the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring with the resolution.

(4) There shall not be included in the minutes, any matter which, in the opinion of the Chairman of the meeting:

(a) is or could reasonably be regarded as defamatory of any person, or

(b) is irrelevant or immaterial to the proceedings; or

(c) is detrimental to the interests of the company.

(5) The Chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds specified in sub-section (5).

(6) The draft minutes of the meeting shall be circulated among all the directors within 15 days of the meeting either in writing or in electronic mode as may be decided by the Board. The minutes kept in accordance with the provisions of this section shall be evidence of the proceedings recorded therein.

(7) Where the minutes have been kept in accordance with sub-section (1) then, until the contrary is proved, the meeting shall be deemed to have been duly called and held, and all proceedings thereat to have duly taken place, and the resolutions passed by postal ballot to have been duly passed and in particular, all appointments of directors, key managerial personnel, auditors or company secretary in practice, shall be deemed to be valid.

(8) No document purporting to be a report of the proceedings of any general meeting of a company shall be circulated or advertised at the expense of the company, unless it includes the matters required by this section to be contained in the minutes of the proceedings of such meeting.

(9) Every company shall observe Secretarial Standards with respect to General and Board meetings specified by the Institute of Company Secretaries of India (ICSI) constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

(10) If any default is made in complying with the provisions of this section in respect of any meeting, the company shall be liable to a penalty of twenty five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

(11) If a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty five thousand rupees but which may extend to one lakh rupees.

1.1.3 Registers

The company has to maintain certain registers and records for statutory, statistical, disclosure, information management and MIS purposes. Further, the company is also required to keep these records with in the vicinity of the place prescribed for it by the laws.

Every company incorporated under the Act is required to keep at its registered office, inter alia, the following statutory books and registers:

(a) Register of investments in securities not held in company's name in Form MBP-3. [Section 187(3)]

(b) Register of deposits. [Section 73 and Rule 14 of the Companies (Acceptance of Deposits) Rules, 2014]

(c) Register of securities bought back in Form SH-10. [Section 68(9)]

(d) Register of charges in Form CHG-7. [Section 85 (1)]

(e) Register and index of members in Form MGT-1. [Sections 88(1)(a)]

(f) Register and index of debenture holders in Form MGT-2. [Section 88(1) (b)]

(g) Register and index of beneficial owners. [Section 88 (1) (3)]

(h) Foreign register of members and debenture holders and their duplicates in Form MGT-3. [Section 88 (1) (4)]

(i) Copies of Annual Return [Section 94(1)]

(j) Books containing minutes of general meeting and of Board and of committees of Directors. [Section118]

(k) Register of Postal Ballot [Section 110]

(l) Books of accounts. [Section 128]

(m) Cost account records for Companies engaged in industries so specified by Central Government [Section 128]

(n) Register of contracts with companies/firms in which directors are interested in Form MBP-4. [Section 189 (1)]

(o) Register of Directors and Key Managerial Personnel. [Section 170 (1)]

(p) Register of loans or investments made, guarantees given and security provided to other body corporate in Form MBP-2. [Section 186 (9)]

(q) Register of Renewed and Duplicate Share Certificates in Form SH-2. [Rule 6 of the Companies (Share Capital and Debentures) Rules, 2014]

(r) Register of sweat equity shares in Form SH-3 [Section 54]

1.1.3.1 Place of keeping and inspection of registers, returns, etc. [Section 94]

According to this Section, the registers required to be kept and maintained by a company under section 88 and copies of the annual return filed under section 92 shall be kept at the registered office of the company [Section 94 (1)].

Provided that such registers or copies of return may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company and the Registrar has been given a copy of the proposed special resolution in advance. [Every Special Resolution is required to be filed in Form No. MGT-14 as per Section 117(3)(a)].

Provided further that the period for which the registers, returns and records are required to be kept shall be such as may be prescribed.

The registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture holder, other security holder or beneficial owner, during business hours without payment of any fees and by any other person on payment of such fees as may be prescribed. [Section 94(2)]

Any such member, debenture holder, other security holder or beneficial owner or any person may:

(a) take extract from any register, or index or return without payment of any fee; or

(b) require a copy of any such register or entries therein or return on payment of such fees as may be prescribed.[Section 94(3)].

The Institute of Company Secretaries of India (ICSI) has issued Secretarial Standard (SS-4) on register and records. It seeks to prescribe a set of principles in relation to various registers and records including the maintenance and inspection thereof. Adherence by the Company to the Secretarial Standard is recommendatory.

F : 1.2 POWERS OF THE BOARD

1.2.1 Powers of the Board (Section 179)

Section 179 of the Act provides Powers of Board. According to this section:

(a) 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, while exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the Memorandum or Articles, or in any Regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting.

(b) The Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the Memorandum or Articles of the company or otherwise, to be exercised or done by the company in general meeting.

(c) No regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.

(d) Powers of the Board to be exercised by the Board by means of the resolution passed at a duly convened Board meeting [Sub-Section 3] are furnished below:

(1) to make calls on shareholders in respect of money unpaid on their shares;

(2) to authorise buy-back of securities under section 68;

(3) to issue securities, including debentures, whether in or outside India;

(4) to borrow monies;

(5) to invest the funds of the company;

(6) to grant loans or give guarantee or provide security in respect of loans;

(7) to approve financial statement and the Board's report;

(8) to diversify the business of the company;

(9) to approve amalgamation, merger or reconstruction;

(10) to take over a company or acquire a controlling or substantial stake in another company;

(11) any other matter which may be prescribed

(e) Further, Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014 has prescribed certain more powers that shall also be exercised by the Board of Directors only by means of resolutions passed at meetings of the Board:

(1) to make political contributions

(2) to appoint or remove KMP; and

(3) to appoint internal auditors and secretarial auditor.

Note: In Rule 8 item numbers (3), (5), (6), (7), (8) and (9) and the entries relating thereto have been omitted by the Companies (Meetings of Board and its Powers) Amendment Rules, 2015. [Vide Notification No. G.S.R. 206(E) dated 18th March, 2015]

(f) Power to delegate certain powers of the Board: The Board may, by a resolution passed at a meeting, delegate the powers specified in points (4) to (6) above, on such conditions as it may specify to:

(1) any committee of directors,

(2) the managing director,

(3) the manager or any other principal officer of the company, or

(4) the principal officer of the branch office (in the case of a branch office of the company).

Note: Matters referred to in clauses (4), (5) and (6) of sub-section (3) of section 179 may be decided by the board by circulation instead of at a meeting in respect to the companies covered under section 8 of the Companies Act, 2013. Vide Notification No. G.S.R.466(E) dated 5th June, 2015.

However, the acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of this section.

(g) Nothing in this section shall however be deemed to affect the right of the company in the general meeting, to impose restrictions and conditions on the exercise by the Board of any of the powers specified in this section above.

Note: For the resolution passed in pursuance of Section 179(3), E-Form No. MGT-14 is required to be filed under Section 117(3)(g). However, vide Notification no. G.S.R. 464(E) dated 5th June, 2015, E-Form MGT-14 is not required to be filed by private companies for the resolution passed under Section 179(3).

1.2.2 Restrictions on powers of Board (Section 180)

Section 180 of the Act provides for restrictions on powers of Board. However, this Section shall not apply to private companies vide Notification No. G.S.R. 464(E) dated 05th June, 2015.

According to this section:

(a) The Board of Directors of a company shall exercise the following powers only with the consent of the company by a special resolution, namely:

(1) To sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings;

Here the 'Undertaking' means an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent of the total income of the company during the previous financial year.

Here the expression 'substantially the whole of the undertaking' in any financial year shall mean twenty per cent or more of the value of the undertaking as per the audited balance sheet of the preceding financial year.

Note: For above matter, E-Form No. MGT-14 is required to be filed under Section 117(3)(e).

(2) To invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;

(3) To borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves and security premium, apart from temporary loans obtained from the company's bankers in the ordinary course of business;

The acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

'Temporary loans' means loans repayable on demand or within six months from the date of the loan such as short term, cash credit arrangements, the discounting of bills and the issue of other short term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature;

Note: For above matter, E-Form No. MGT-14 is required to be filed under Section 117(3)(e).

(4) To remit, or give time for the repayment of, any debt due from a director.

Note: Every Special Resolution is required to be filed in Form No. MGT-14 as per Section 117(3)(a).

(b) Every special resolution passed by the company in general meeting in relation to the exercise of the powers referred to in point (3) above shall specify the total amount up to which monies may be borrowed by the Board of Directors.

(c) Nothing contained in above point (1) shall affect:

(1) the title of a buyer or other person who buys or takes on lease any property, investment or undertaking as is referred to in that clause, in good faith, or

(2) The sale or lease of any property of the company where the ordinary business of the company consists of, or comprises, such selling or leasing.

(d) Any special resolution passed by the company consenting to the transaction as is referred to in above point (1) may stipulate such conditions as may be specified in such resolution, including conditions regarding the use, disposal or investment of the sale proceeds which may result from the transactions.

Provided that, this sub section shall not be deemed to authorise the company to effect any reduction in its capital except in accordance with the provisions contained in this Act.

(e) No debt incurred by the company in excess of the limit imposed by above point (3) shall be valid or effectual, unless the lender proves that he advanced the loan in good faith and without knowledge that the limit imposed by that clause had been exceeded.

F : 1.3 CORPORATE GOVERNANCE & AUDIT COMMITTEE

1.3.1 Corporate Governance

Corporate governance refers to the set of systems, principles and processes by which a company is governed. They provide the guidelines as to how the company can be directed or controlled such that it can fulfil its goals and objectives in a manner that adds to the value of the company and is also beneficial for all stakeholders in the long term.

In other words Corporate governance refers to the accountability of the Board of Directors to all stakeholders of the corporation i.e. shareholders, employees, suppliers, customers and society in general; towards giving the corporation a fair, efficient and transparent administration.

1.3.2 Principles of Corporate Governance

1.3.2.1 Transparency

Transparency means the quality of something which enables one to understand the truth easily. In the

context of corporate governance, it implies an accurate, adequate and timely disclosure of relevant information about the operating results etc. of the corporate enterprise to the stakeholders.

1.3.2.2 Accountability

Accountability is a liability to explain the results of one's decisions taken in the interest of others. In the context of corporate governance, accountability implies the responsibility of the Chairman, the Board of Directors and the chief executive for the use of company's resources (over which they have authority) in the best interest of company and its stakeholders.

1.3.2.3 Independence

Good corporate governance requires independence on the part of the top management of the corporation i.e. the Board of Directors must be strong non-partisan body; so that it can take all corporate decisions based on business prudence. Without the top management of the company being independent; good corporate governance is only a mere dream.

1.3.2.4 Need for Corporate Governance

The need for corporate governance is highlighted by the following factors:

(a) Wide Spread of Shareholders

Most of the corporate now a days have a very large number of shareholders spread all over the nation and even the world; and a majority of shareholders being unorganised and having an indifferent attitude towards corporate affairs. The idea of shareholders' democracy remains confined only to the law and the Articles of Association; which requires a practical implementation through a code of conduct of corporate governance.

(b) Changing Ownership Structure

The pattern of corporate ownership has changed considerably, in the present-day-times; with institutional investors (foreign as well Indian) and mutual funds becoming largest shareholders in large corporate private sector. These investors have become the greatest challenge to corporate managements, forcing the latter to abide by some established code of corporate governance to build up its image in society.

(c) Corporate Scams or Scandals

Corporate scams (or frauds) in the recent years of the past have shaken public confidence in corporate management. To overcome the scams like Harshad Mehta, Sathyam scandals, it is necessary to have good governance practices in the corporate management. The need for corporate governance is, imperative for reviving investors' confidence in the corporate sector towards the economic development of society.

(d) Greater Expectations of Society of the Corporate Sector

Society of today holds greater expectations of the corporate sector in terms of reasonable price, better quality, pollution control, best utilisation of resources etc. To meet social expectations, there is a need for a code of corporate governance, for the best management of company in economic and social terms.

(e) Hostile Take Overs

Hostile take overs of corporations witnessed in several countries, put a question mark on the efficiency of managements of take-over companies. This factors also points out to the need for corporate governance, in the form of an efficient code of conduct for corporate managements.

(f) Huge Increase in Top Management Compensation

It has been observed in both developing and developed economies that there has been a great increase in the monetary payments (compensation) packages of top level corporate executives. There is no justification for exorbitant payments to top ranking managers, out of corporate funds, which are a property of shareholders and society. This factor necessitates corporate governance to contain the ill-practices of top managements of companies.

(g) Globalisation

Desire of more and more Indian companies to get listed on international stock exchanges also focuses on a need for corporate governance. In fact, corporate governance has become a buzzword in the corporate sector. There is no doubt that international capital market recognises only companies well-managed according to standard codes of corporate governance.

1.3.2.5 SEBI Code of Corporate Governance

To promote good corporate governance, SEBI (Securities and Exchange Board of India) constituted a committee on corporate governance under the chairmanship of Kumar Mangalam Birla during the year 1999. On the basis of the recommendations of this committee, SEBI issued certain guidelines on corporate governance, which are required to be incorporated in the listing agreement between the company and the stock exchange.

An overview of SEBI guidelines on corporate governance is given below under the following heads:

(a) Board of Directors

(1) The Board of Directors of the company shall have an optimum combination of executive and non-executive directors.

(2) The number of independent directors would depend on whether the chairman is executive or non-executive.

In case of non-executive chairman, at least, one third of the Board should comprise of independent directors; and in case of executive chairman, at least, half of the Board should comprise of independent directors.

(b) Audit Committee

(1) The company shall form an independent audit committee whose constitution would be as follows:

a) It shall have minimum three members, all being non-executive directors, with the majority of them being independent, and at least one director having financial and accounting knowledge.

b) The Chairman of the committee will be an independent director.

c) The Chairman shall be present at the Annual General Meeting to answer shareholders' queries.

(2) 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 considered necessary.

(3) The role of audit committee should include the following:

a) Overseeing 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.

b) Recommending the appointment and removal of external auditor.

c) Reviewing the adequacy of internal audit function.

d) Discussing with external auditors, before the audit commences, the nature and scope of audit; as well as to have post-audit discussion to ascertain any area of concern.

e) Reviewing the company's financial and risk management policies.

(c) Remuneration of Directors

The following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:

(1) All elements of remuneration package of all the directors i.e. salary, benefits, bonus, stock options, pension etc.

(2) Details of fixed component and performance linked incentives, along with performance criteria.

(d) Board Procedure

(1) Board meetings shall be held at least, four times a year, with a maximum gap of 4 months between any two meetings.

(2) A director shall not be a member of more than 10 committees or act as chairman of more than five committees, across all companies, in which he is a director.

(e) Management

A Management Discussion and Analysis Report should form part of the annual report to the shareholders; containing discussion on the following matters.

(1) Opportunities and threats.

(2) Segment-wise or product-wise performance.

(3) Risks and concerns.

(4) Discussion on financial performance with respect to operational performance.

(5) Material development in human resource/industrial relations front.

(f) Shareholders

A Board Committee under the chairmanship of non-executive director shall be formed to specifically look into the redressing of shareholders and investors' complaints like transfer of shares, non-receipt of Balance Sheet or declared dividends etc. This committee shall be designated as 'Shareholders / Investors Grievance Committee'.

(g) Report on Corporate Governance

There shall be a separate section on corporate governance in the Annual Report of the company, with a detailed report on corporate governance.

(h) Compliance

The company shall obtain a certificate from the auditors of the company regarding the compliance

of conditions of corporate governance. This certificate shall be annexed with the Directors' Report sent to shareholders and also sent to the stock exchange.

1.3.2.6 The Companies Act, 2013 and its Impact on Corporate Governance in India

The foundations of the comprehensive revision in the Companies Act, 1956 was laid in 2004 when the Government constituted the Irani Committee to conduct a comprehensive review of the Act. The Government of India has placed before the Parliament a new Companies Bill, 2011 that incorporates several significant provisions for improving corporate governance in Indian companies which, having gone through an extensive consultation process. The Bill was passed in the parliament and enacted as the Companies Act, 2013.

The Companies Act, 2013 contemplates structural and fundamental changes in the way companies would be governed in India and incorporates various lessons that have been learnt from the corporate scams of the recent years that highlighted the role and importance of good governance in organizations.

Significant corporate governance reforms, primarily aimed at improving the board oversight process, have been proposed in the Companies Act, 2013; for instance it has proposed, for the first time in Company Law, the concept of an Independent Director and all listed companies are required to appoint independent directors with at least one third of the Board of such companies comprising of independent directors.

The Companies Act, 2013 takes the concept of board independence to another level altogether. The definition of an Independent Director has been considerably tightened and the definition now defines positive attributes of independence and also requires every Independent Director to declare that he or she meets the criteria of independence.

In order to ensure that Independent Directors maintain their independence and do not become too familiar with the management and promoters, minimum tenure requirements have been prescribed. The initial term for an independent director is for five years, following which further appointment of the director would require a special resolution of the shareholders. However, the total tenure for an independent director is not allowed to exceed two consecutive terms.

The Companies Act, 2013 expressly disallows Independent Directors from obtaining stock options in companies to protect their independence.

The new guidelines which set out the role, functions and duties of Independent Directors and their appointment, resignation and evaluation introduce greater clarity in their role; however, in certain places they are prescriptive in nature and could end up making the role of Independent Directors quite onerous.

In order to balance the extensive nature of functions and obligations imposed on Independent Directors, the Companies Act, 2013 seeks to limit their liability to matters directly relatable to them and limits their liability to 'only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently'.

The Act also requires that all resolutions in a meeting convened with a shorter notice should be ratified by at least one independent director which gives them an element of veto power. Various other clauses such as those on directors' responsibility statements, statement of social responsibilities, and the directors' responsibilities over financial controls, fraud, etc, will create a more transparent system through better disclosures.

The Act also contemplates that any undue gain made by a director by abusing his position will be disgorged and returned to the company together with monetary fines.

1.3.2.7 Audit committee (Section 177)

Section 177 of the Act provides for Audit committee. According to this section:

(a) Formation of an Audit Committee: An audit committee shall be constituted by the Board of directors of:

(1) Every listed company, and

(2) Such other class or classes of companies as may be prescribed.

(b) Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014 have prescribed the following classes of companies that shall constitute Audit Committee:

(1) all public companies with a paid up capital of 10 crore rupees or more.

(2) all public companies having turnover of 100 crore rupees or more.

(3) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 50 crore rupees or more.

Explanation.- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

Provided that public companies covered under this rule which were not required to constitute Audit Committee under section 292A of the Companies Act, 1956 shall constitute their Audit Committee within one year from the commencement of these rules or appointment of independent directors by them, whichever is earlier:

Provided further that public companies covered under this rule shall constitute their Nomination and Remuneration Committee within one year from the commencement of these rules or appointment of independent directors by them, whichever is earlier.

(c) Composition of an Audit committee: According to sub section 2 of section 177, the Audit Committee shall consist of a minimum of 3 directors with independent directors forming a majority.

Provided that the majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement.

Disclosure of composition of Audit Committee [Section 177(8)]: The composition of the Audit Committee shall be disclosed in the Board's report under section 134(3) and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with reasons thereof.

Note: 'With Independent Directors forming a majority' is omitted in Section 177(2) for the Companies covered under Section 8 of the Companies Act, 2013 [Vide Notification G.S.R. 466(E)] dated 05th June, 2015].

(d) Transition period: Every Audit Committee of a company existing immediately before the commencement of this Act shall, within one year of such commencement, be reconstituted in accordance with the new composition of an Audit Committee as provided in sub section (2) above.

(e) Responsibilities of an Audit Committee: According to sub section (4) of section 177, every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include:

(1) the recommendation for appointment, remuneration and terms of appointment of auditors of the company.

Note: In case of Government companies, in this clause, for the word 'recommendation for

appointment, remuneration and of appointment' the words 'recommendation for remuneration' shall be substituted [Vide Notification no. G.S.R. 463(E), dated 5.6.15].

(2) review and monitor the auditor's independence and performance, and effectiveness of audit process.

(3) examination of the financial statement and the auditors' report thereon.

(4) approval or any subsequent modification of transactions of the company with related parties.

However, vide Companies (Amendment) Act, 2015 notified on 26th May, 2015 (but not yet brought into force), the Audit Committee may make omnibus approval for related party transactions proposed to be entered by the company subject to such conditions as may be prescribed.

(5) scrutiny of inter-corporate loans and investments.

(6) valuation of undertakings or assets of the company, wherever it is necessary.

(7) evaluation of internal financial controls and risk management systems.

(8) monitoring the end use of funds raised through public offers and related matters.

(f) Investigation by Audit Committee: According to sub section (6) of section 177, the Audit Committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.

(g) Role of auditor in Audit Committee:

(1) According to section 177 (5), the Audit Committee is empowered to:

a) call for the comments of the auditors about:

1) internal control systems,

2) the scope of audit, including the observations of the auditors,

3) review of financial statement before their submission to the Board,

b) discuss any related issues with the internal and statutory auditors and the management of the company.

(2) Right to be heard in the meeting of Audit Committee: According to section 177(7), the auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.

(h) Penalty for contravention [Section 178(8)]

(1) The company shall be punishable with fine which shall not be less than 1 lakh rupees but which may extend to 5 lakh rupees, and

(2) every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than 25,000 rupees but which may extend to 1 lakh rupees, or with both. Vigil mechanism

(i) Formation of vigil mechanism: According to section 177 (9), a Vigil mechanism shall be formed in:

1) Every listed company, and

2) Such other prescribed classed of companies.

(a) Rule 7 of the Companies (Meetings of Board and its Powers) Rules, 2014 has prescribed the following classes of companies that shall constitute Vigil mechanism:

1) the Companies which accept deposits from the public;

2) the Companies which have borrowed money from banks and public financial institutions in excess of 50 crore rupees.

(b) Objective of formation of vigil mechanism:

1) A vigil mechanism shall be formed for directors and employees to report genuine concerns in such manner as may be prescribed.

2) The vigil mechanism shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases. It is imperative for the company to disclose the details of the establishment of vigil mechanism on the website of the company and in Board's report.

3) According to the Companies (Meetings of Board and its Powers) Rules, 2014:

a. Persons who use such mechanism means employees and directors who avail the vigil mechanism.

b. The companies which are required to constitute an audit committee shall oversee the vigil mechanism through the committee and if any of the members of the committee have a conflict of interest in a given case, they should recuse themselves and the others on the committee would deal with the matter on hand.

c. In case of other companies, the Board of directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.

d. The employees and directors who avail of vigil mechanism may have direct access to the Chairperson of the Audit Committee or the director nominated to play the role of Audit Committee, as the case may be, in exceptional cases.

e. In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand.

(c) Penalty for contravention [Section 178 (8)]: Same as penalty mentioned supra in the topic of Audit Committee.

F : 1.4 NOMINATION AND REMUNERATION COMMITTEE

As per Section 178 of the Companies Act, 2013 read with Rule 6 of the Companies (Meetings of the Board and its power) Rules, 2014, the Board of Directors of every company and the following classes of companies are required to constitute a Nomination and Remuneration Committee of the Board:

(i) All public companies with a paid up capital of 10 crore rupees or more;

(ii) All public companies having turnover of 100 crore rupees or more;

(iii) All public companies having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 50 crore rupees or more.

Composition:

Nomination and Remuneration Committee consisting of 3 or more non-executive directors out of which not less than one-half shall be independent directors.

Functions:

(i) The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the board their appointment and removal and shall carry out evaluation of every director's performance[Section 178(2)].

(ii) The Committee shall formulate the criteria for determining qualifications, positive attributes and independence of a director, and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees [Section 178(3)]. Such policy shall be palced on the website such policy of the company and salient features of the policy, alongwith webaddressed shall be disclosed in board's report.

(iii) The Committee shall while formulating the policy under sub-section (3) ensure that-

(a) The level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

(b) Relationship of remuneration to performance is clear and meets appropriate performance benchmark; and

(c) Remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long term performance objectives

Such policy shall be disclosed in the Board's report [Section 178(4)].

Note:

Section 178(2), (3) and (4) shall not apply to Government Company except with regard to appointment of 'senior management' and other employees, vide notification no. G.S.R. 463(E) dated 5th June, 2015.

Explanation:

Senior Management means personnel of the company who are members of its core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads.

F : 1.5 STAKEHOLDERS RELATIONSHIP COMMITTEE

As per Section 178(5) of the Companies Act, 2013, the Board of Directors of the company which consists of more than 1000 shareholders, debenture holders, and any other security holders at any time during a financial year shall constitute a Stakeholder Relationship Committee.

Composition:

The Stakeholder shall consist of a Chairperson who shall be a non-executive director and such other members as may be decided by the Board.

Function:

The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company.

F : 1.6 CORPORATE SOCIAL RESPONSIBILITY COMMITTEE

Section 135(1) read with Rule 3 of the Companies (Corporate Social Responsibility Policy Rules, 2014, mandates every company having:

(a) Net worth of rupees 5 crores or more, or

(b) Turnover of rupees 1000 crores or more, or

(c) A net profit of rupees 5 crores or more

During any financial year to constitute a Corporate Social Responsibilty (CSR) Committee of the Board.

Composition:

Section 135 provides that CSR committee shall be constituted with 3 or more directors, out of which atleast one director shall be an independent director.

Function:

The CSR Committee shall:

(a) formulate and recommend to the Board, CSR Policy which shall indicate the activities undertaken by the Company as specified in Schedule VII.

(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a)

(c) monitor the CSR policy from time to time.

CSR Expenses:

The Board of every company refers in this Section, shall ensure that Company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceeding financial years, in pursuance of its CSR Policy.

Board's Report:

The Board's Report of the company covered under this Section, shall include an annual report on CSR. Moreover, if the company fails to spend CSR expenses, Board's report shall specify the reasons for not spending amount.

F : 1.7 DUTIES AND LIABILITIES OF DIRECTORS

Directors acting collectively i.e. Board of Directors are authorized to do what the company is authorized to do unless barred by restrictions on their powers by the provisions of the Companies Act, 2013, the Memorandum or Articles of the company.

The Act specifies certain powers to be exercised only at Board Meeting (Section 179) and, certain powers only with the consent of shareholders in general meeting (Section 180). The Act also casts certain duties upon the directors such as duty to disclose the interest in contracts, duty to attend Board meetings etc.

Except where express provisions are made that the powers of a company in respect of any matter are to be exercised by the company in general meeting, in all other cases the Board is entitled to exercise all its powers. The directors acting together are the authority for conducting the affairs of the company. They are authorised to do what the company is authorised to do, unless barred by restrictions on their powers by the provisions of the Companies Act, 2013, the memorandum or articles of the company (Section 179).

The directors shall exercise their powers bonafide and in interest of the company. The directors while exercising their powers do not act as agents for the majority or even all the members and so the members cannot by resolution passed by a majority or even unanimously supercede the director's powers, or instruct them how they shall exercise their powers. This sovereignty of the directors within the limits of the powers conferred on them by the articles, and within limit laid down by the Act was clearly expressed by Greer L.J. in [John Shaw & Sons (Salford) Ltd. v. Shaw (1935) 2 K.B. 113] in the following words:

'A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. The powers of management are vested in the directors. They and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles, in the directors, is by altering the articles, or if opportunity arises under the articles, by refusing to re-elect the directors whose action they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders'

In [Milan Sen v. Guardian Plasticate Ltd. (1998) 2 Comp L J 320], the directors passed a resolution for rights issue which was questioned by certain shareholders. The Calcutta High Court held that the question whether the company needed additional capital was a question which should primarily be decided by the directors of the company and if they were of the view that further capital in the form of rights issue was required, the Court would not be allowed to disturb the same unless there were extreme circumstances of malafides or breach of trust.

Thus, from the provisions of Section 179 and the exposition of the law stated above, it is clear that subject to the restrictions contained in the Act, Memorandum and Articles, the powers of directors are co-extensive with those of the company itself. The relationship of the Board of directors with the shareholders is more of federation than one of subordinates and superior. Some powers are specially reserved for the Board. On the other hand, some powers are exclusively reserved for the members in general meeting.

1.7.1 Duties of directors (section 166)

Duties of directors has been defined in the company Law for the first time under section 166 of the Companies Act, 2013.The following duties have been prescribed for a director under the said section:

(a) He shall act in accordance with the articles of the company, subject to the provisions of this Act.

(b) He shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

(c) He shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

(d) He shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

(e) He shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

(f) He shall not assign his office and if any assignment so made, it shall be void.

(g) If a director of the company contravenes the provisions of this section, such director shall be punishable with fine which shall not be less than ₹ 1,00,000 but which may extend to ₹ 5,00,000.

1.7.2 Liabilities of directors

The liabilities of the directors may be grouped under certain heads for convenience of consideration and discussion. They are:

1.7.2.1 Liability to outsiders

Directors of a company may personally become liable to outside parties in the following cases:

(a) When they enter into contracts on behalf of the company:

(1) if the contracts are ultra vires the company;

(2) if they act outside the scope of their own authority;

(3) if they act in their own name and not for and on behalf of the company;

(b) When they issue a prospectus; in violation of the provisions of the Companies Act, 2013 and the SEBI (ICDR) Regulations which contains mis-statements(s).

(c) When they are found guilty of fraud.

(d) When they allot shares in an irregular manner.

(e) When the Court orders that the directors are personally liable for all or any of the debts or liabilities of the company for fraudulent trading on the part of the company.

1.7.2.2 Liability to the company

The directors are liable to the company in the following cases:

(a) When they are negligent in the performance of their duty as directors and the company suffers loss, etc.

(b) When they commit an act which is ultra vires their powers or ultra vires the company.

(c) When any illegal act or breach of trust is committed by them.

1.7.2.3 Liability to the shareholders

The position of the directors in respect of the company's properties and the rights conferred upon them to be exercised as directors is that of a trustee. If they commit any breach of trust or indulge in wrongful uses of their rights and the company suffers loss, they have to make good the loss. Similarly, if shareholders suffer loss due to the negligence of the directors they are personally liable for the loss.

1.7.2.4 Liability for statutory defaults and violations.

Under the Companies Act, 2013 the directors are required to ensure compliance with the several provisions of the Act and penalties have been prescribed for defaults and/or non-compliance. The directors are liable for consequences.

F : 1.8 POWERS RELATED TO POLITICAL CONTRIBUTIONS

1.8.1 Section 182 of the Act provides for prohibitions and restrictions regarding political contributions. According to this section:

(a) Notwithstanding anything contained in any other provision of this Act, a company may contribute any amount directly or indirectly to any political party. Here, political party means a political party registered under section 29A of the Representation of the People Act, 1951.

(b) The following companies are not allowed to contribute to any political party:

(1) a Government company; and

(2) a company which has been in existence for less than three financial years.

(c) The aggregate of the amount which may be so contributed by the company in any financial year shall not exceed seven and a half per cent of its average net profits during the three immediately preceding financial years.

(d) No such contribution shall be made by a company unless a resolution authorising the making of such contribution is passed at a meeting of the Board of Directors and such resolution shall be deemed to be justification in law for the making and the acceptance of the contribution authorised by it.

(e) Without prejudice to the generality of the provisions of sub-section (1),

(1) a donation or subscription or payment caused to be given by a company on its behalf or on its account to a person who, to its knowledge, is carrying on any activity which, at the time at which such donation or subscription or payment was given or made, can reasonably be regarded as likely to affect public support for a political party shall also be deemed to be contribution of the amount of such donation, subscription or payment to such person for a political purpose.

(2) the amount of expenditure incurred, directly or indirectly, by a company on an advertisement in any publication, being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like, shall also be deemed:

a) where such publication is by or on behalf of a political party, to be a contribution of such amount to such political party, and

b) where such publication is not by or on behalf of, but for the advantage of a political party, to be a contribution for a political purpose.

(f) Every company shall disclose in its profit and loss account any amount or amounts contributed by it to any political party during the financial year to which that account relates. [Section 182(3)].

(g) If a company makes any contribution in contravention of the provisions of this section, the company shall be punishable with fine which may extend to five times the amount so contributed and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times the amount so contributed. [Section 182(4)].

Self Assessment Questions

1. What powers can be exercised by the Board with the consent of members in general meeting?
2. Discuss the liabilities of directors to the company and to outsiders for their acts.
3. Directors are not only agents but are also in some sense trustee of the company. Discuss.
4. What are the provisions of the Companies Act, in regard to the holding of a Board Meeting?
5. Write short notes on:

(i) Minutes.

(ii) Statutory Registers.

(iii) Quorum.

(iv) Audit Committee

(v) Board Meeting through video conferencing

(vi) Vigil Mechanism

6. What are the committees of Board, mandatorily to be constituted under the Companies Act, 2013?
7. Write key points for consideration for Board Meetings as per Secretarial Standards-1?
8. What are the powers of the Board of a company under the provisions of Companies Act, 2013?
9. What are the matters not to be dealt within a meeting of Board through video conferencing or other audio-visual means?
10. Can any Board of Directors of a company pass some resolutions through circulation? If yes, what are the Provisions and Rules in connection to it.
11. What are the duties of Directors under the provisions of Companies Act, 2013?
12. What are the Prohibitions and restrictions regarding political contributions under Section 182 of the Companies Act, 2013?

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Study Note - 1

THE COMPANIES ACT, 2013

PART - G : INSPECTION, INQUIRY AND INVESTIGATION

This Study Note includes:

G : 1.1 Power to call for information, inspect books and conduct inquiries [Section 206]
G : 1.2 Conduct of inspection and inquiry [Section 207]
G : 1.3 Report on inspection made [Section 208]
G : 1.4 Search and seizure [Section 209]
G : 1.5 Investigation into affairs of Company [Section 210]
G : 1.6 Establishment of Serious Fraud Investigation Office (SFIO) [Section 211]
G : 1.7 Investigation into affairs of Company by SFIO [Section 212]
G : 1.8 Investigation into Company's affairs in other cases [Section 213]
G : 1.9 Security for payment of costs and expenses of investigation [Section 214]
G : 1.10 Firm, body corporate or association not to be appointed as Inspector [Section 215]
G : 1.11 Investigation of ownership of company [Section 216]
G : 1.12 Procedure, powers, etc., of Inspectors [Section 217]
G : 1.13 Protection of employees during investigation [Section 218]
G : 1.14 Power of Inspector to conduct investigation into affairs of related companies, etc. [Section 219]
G : 1.15 Seizure of documents by Inspector [Section 220]
G : 1.16 Freezing of assets of Company on inquiry and investigation [Section 221]
G : 1.17 Imposition of restrictions upon securities [Section 222]
G : 1.18 Inspector's report [Section 223]
G : 1.19 Actions to be taken in pursuance of Inspector's report [Section 224]
G : 1.20 Expenses of investigation [Section 225]
G : 1.21 Voluntary winding up of company, etc., not to stop investigation proceedings [Section 226]
G : 1.22 Legal advisers and bankers not to disclose certain information [Section 227]
G : 1.23 Investigation etc. of foreign companies [Section 228]
G : 1.24 Penalty for furnishing false statement, mutilation, destruction of document [Section 229]

Before going into the topic, let us understand the meaning of the terms 'Inspection', 'Inquiry' and 'Investigation'. According to Cambridge English Dictionary:

(a) Inspection

'Inspection' means the act of looking at something carefully, or an official visit to a building or organization to check that everything is correct and legal.

Purpose

The purpose of an inspection is to confirm that the company, organization or individual is obeying the law.

(b) Inquiry

'Inquiry' is an official process or a judicial inquiry to discover the facts about something bad that has happened:

Purpose

An inquiry is any process that has the aim of augmenting knowledge, resolving doubt, or solving a problem.

(c) Investigation

'Investigation' means the act or process of examining a crime, problem, statement, etc. carefully, especially to discover the truth.

Purpose

The purpose of an investigation is to gather information and evidence to support the prosecution of a suspected violation. If the enforcement officer reasonably believes that there has been a violation of the law, then they have the authority to conduct an investigation.

Chapter XIV of the Companies Act, 2013 provides for Inspection, Inquiry and Investigation.

G : 1.1 POWER TO CALL FOR INFORMATION, INSPECT BOOKS AND CONDUCT INQUIRIES [SECTION 206]

A check on the performance of Companies is generally exercised by scrutiny of Balance Sheet and Profit and Loss Account and other returns filed by them with the Registrar who is empowered to call for information and explanation with respect to any matter to which such documents purport to relate.

The Companies Act explains the legal requirement for the companies in relation to maintenance of books of account. The object of inspection is not to keep a watch on the performance of companies but also to evaluate precisely the level of efficiency in the conduct of the company concerned.

Section 206 of the Act provides for the power to call for information, inspect books and conduct inquiries. According to this section:

(a) **Power of the Registrar to call for information, explanation or documents [Section 206(1)]**

According to section 206(1) of the Companies Act, 2013, where on a scrutiny of any document filed by a company or on any information received by him, the Registrar is of the opinion that any further information or explanation or any further documents relating to the company is necessary, he may by a written notice require the company :

(1) to furnish in writing such information or explanation; or

(2) to produce such documents, within such reasonable time, as may be specified in the notice.

(b) **Duty of the company and its officers [Section 206 (2)]**

On the receipt of a notice under sub-section (1) of section 206, it shall be the duty of the company and of its officers concerned to furnish such information or explanation to the best of their knowledge and power and to produce the documents to the Registrar within the time specified or extended by the Registrar.

(c) **Duty of past officers of the company [proviso to Section 206 (2)]**

According to the proviso to sub-section (2) of section 206, where such information or explanation relates to any past period, the officers who had been in the employment of the company for such period, if so called upon by the Registrar through a notice served on them in writing, shall also furnish such information or explanation to the best of their knowledge.

(d) **Additional written notice by the Registrar [Section 206 (3)]**

The Registrar may by another written notice call on the company to produce for his inspection such further books of account, books, papers and explanations as he may require at such place and at such time as he may specify in the notice:

(1) If no information or explanation is furnished to the Registrar within the time specified under Section 206 (1), or

(2) If the Registrar on an examination of the documents furnished is of the opinion that the information or explanation furnished is inadequate, or

(3) If the Registrar is satisfied on a scrutiny of the documents furnished that an unsatisfactory state of affairs exists in the company and the information or documents do not disclose a full and fair statement of the information required.

Provided that, before any notice is served under this sub-section, the Registrar shall record his reasons in writing for issuing such notice.

(e) **Inquiry by the Registrar [Section 206 (4)]**

(1) The Registrar may call on the company to furnish in writing any information or explanation on matters specified in the order within such time as he may specify therein and carry out such inquiry as he deems fit after providing the company a reasonable opportunity of being heard, if the Registrar is satisfied:

a) on the basis of information available with or furnished to him, or

b) on a representation made to him by any person that the business of a company is being carried on for a fraudulent or unlawful purpose or not in compliance with the provisions of this Act, or

c) the grievances of investors are not being addressed.

(2) Before calling the company to furnish in writing any information or explanations and carrying out inquiry, the Registrar has to inform the company of the allegations made against it by a written order.

(3) The Central Government may, if it is satisfied that the circumstances so warrant, direct the Registrar or an Inspector appointed by it for the purpose to carry out the inquiry under this sub-section.

(4) It is further provided that where business of a company has been or is being carried on for a fraudulent or unlawful purpose, every officer of the company who is in default shall be punishable for fraud in the manner as provided in section 447.

(f) **Inspection by Central Government [Section 206 (5)]**

Without prejudice to the foregoing provisions of this section, the Central Government may, if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by an Inspector appointed by it for the purpose.

(g) **Order to Carry out Inspection [Section 206 (6)]**

The Central Government may, having regard to the circumstances by general or special order, authorise any statutory authority to carry out the inspection of books of account of a company or class of companies.

(h) **Failure to furnish information [Section 206 (7)]**

If a company fails to furnish any information or explanation or produce any document required under this section, the company and every officer of the company, who is in default shall be punishable with a fine which may extend to 1 lakh rupees and in the case of a continuing failure, with an additional fine which may extend to 500 rupees for every day after the first during which the failure continues.

G : 1.2 CONDUCT OF INSPECTION AND INQUIRY [SECTION 207]

Section 207 of the Act provides for the conduct of inspection and inquiry as follows:

(a) **Duty of director, officer or employee [Section 207 (1)]**

Where a Registrar or Inspector calls for the books of account and other books and papers under section 206, it shall be the duty of every director, officer or other employee of the company:

(1) to produce all such documents to the Registrar or Inspector, and

(2) to furnish him with such statements, information or explanations in such form as the Registrar or Inspector may require, and

(3) to render all assistance to the Registrar or Inspector in connection with such inspection.

(b) **Powers of the Registrar or Inspector [Section 207 (2) & (3)]**

(1) The Registrar or Inspector making an inspection or inquiry under section 206 may, during the course of such inspection or inquiry, as the case may be:

a) make or cause to be made copies of books of account and other books and papers, or

b) place or cause to be placed any marks of identification in such books in token of the inspection having been made.

(2) Notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, the Registrar or Inspector making an inspection or inquiry shall have all the 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) the discovery and production of books of account and other documents, at such place and time as may be specified by such Registrar or Inspector making the inspection or inquiry,

b) summoning and enforcing the attendance of persons and examining them on oath, and

c) inspection of any books, registers and other documents of the company at any place.

(c) **Penalty for Contravention [Section 207 (4)]**

If any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to 1 year and with fine which shall not be less than 25,000 rupees but which may extend to 1 lakh rupees.

If a director or an officer of the company has been convicted of an offence under this section, the director or the officer 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 from holding an office in any company.

G : 1.3 REPORT ON INSPECTION MADE [SECTION 208]

Section 208 of the Act provides for the submission of the report on inspection made. According to this section:

The Registrar or Inspector shall, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, submit a report in writing to the Central Government along with such documents, if any and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

G : 1.4 SEARCH AND SEIZURE [SECTION 209]

Search means, an examination of public records to determine and confirm a property's legal ownership, and find out what claims are on the property.

Seizure is the forcible taking of property by a government law enforcement official from a person who is suspected of violating, or is known to have violated, the law.

Search and seizure is a procedure used in many civil law and common law legal systems by which police or other authorities and their agents, who suspect that a crime has been committed, do a search of a person's property and confiscate any relevant evidence to the crime.

Section 209 of the Act provides for Search and seizure. According to this section:

(a) **Circumstances for seizure [Section 209 (1)]**

Where, upon information in his possession or otherwise, the Registrar or inspector has reasonable ground to believe that the books and papers of a company, or relating to:

(1) the key managerial personnel or

(2) any director or

(3) auditor or

(4) company secretary in practice if the company has not appointed a company secretary,

are likely to be destroyed, mutilated, altered, falsified or secreted, he may, after obtaining an order from the Special Court for the seizure of such books and papers:

a) enter, with such assistance as may be required, and search, the place or places where such books or papers are kept, and

b) seize such books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books or papers at its cost.

(b) **Period of seizure [Section 209 (2)]**

(1) Original period of seizure: The Registrar or Inspector shall return the books and papers seized under sub-section (1), as soon as may be, and in any case not later than 180th day after such seizure, to the company from whose custody or power such books or papers were seized.

(2) Further period of seizure: The books and papers may be called for by the Registrar or Inspector for a further period of 180 days by an order in writing if they are needed again.

(c) **Taking of copies, placing identification marks [second proviso to Section 209 (2)]**

The Registrar or Inspector may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

(d) **Applicability of the provisions of the Code of Criminal Procedure, 1973 [Section209 (3)]**

The provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures shall apply, 'mutatis mutandis', to every search and seizure made under this section.

G : 1.5 INVESTIGATION INTO AFFAIRS OF COMPANY [SECTION 210]

Sections 210 to 229 of the Companies Act, 2013 contain provisions relating to investigation of the affairs of company. Investigation within the meaning of the relevant provisions of the Act is a form of probe; a deeper probe; into the affairs of a company. It is a fact finding exercise. The main object of investigation is to collect evidence and to see if any illegal acts or offences are disclosed and then decide the action to be taken. Section 210 of the Act provides:

(a) **Investigation in the opinion of Central Government [Section 210 (1)]**

Where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company:

(1) on the receipt of a report of the Registrar or Inspector under section 208.

(2) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated, or

[Every special resolution is required to be filed in Form No. MGT-14 as per Section 117(3)(a)].

(3) in public interest, it may order an investigation into the affairs of the company.

(b) **Investigation on the order by a court or the Tribunal [Section 210 (2)]**

Where an order is passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated, the Central Government shall order an investigation into the affairs of that company.

(c) **Appointment of Inspectors [Section 210 (3)]**

For the purposes of this section, the Central Government may appoint one or more persons as Inspectors to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct.

G : 1.6 ESTABLISHMENT OF SERIOUS FRAUD INVESTIGATION OFFICE (SFIO) [SECTION 211]

Section 211 of the Act provides for the establishment of Serious Fraud Investigation Office as under:

(a) **Setting up of Serious Fraud Investigation Office (SFIO) [Section 211 (1)]**

The Central Government shall, by notification, establish an office to be called the Serious Fraud Investigation Office (SFIO) to investigate frauds relating to a company. MCA vide Notification No. S.O.2005(E) dated 21st July, 2015 established under Section 211 of the Companies Act, 2013.

(b) **Continuation of earlier SFIO**

Earlier, the Serious Fraud Investigation Office was set-up by the Central Government in terms of the Government of India's Resolution No. 45011/16/2003-Adm-I, dated 2nd July, 2003 to carry out the functions of SFIO.

(c) **Composition of SFIO [Section 211 (2)]**

The SFIO shall be:

(1) Headed by a Director, and

(2) Consist of such number of experts from the following fields to be appointed by the Central Government from amongst persons of ability, integrity and experience in:

a) banking;

b) corporate affairs;

c) taxation;

d) forensic audit;

e) capital market;

f) information technology;

g) law; or

h) such other fields as may be prescribed.

(d) **Appointment of a Director in SFIO**

The Central Government shall, by notification, appoint a Director in the SFIO, who shall be an officer not below the rank of a Joint Secretary to the Government of India having knowledge and experience in dealing with matters relating to corporate affairs [Section 211 (3)].

(e) **Appointment of Experts**

The Central Government may appoint of such experts and other officers and employees in the SFIO as it considers necessary for the efficient discharge of its functions under this Act [Section 211 (4)].

(f) **Terms and conditions of service**

The terms and conditions of service of Director, experts, and other officers and employees of the SFIO shall be such as may be prescribed [Section 211 (5)].

The terms and conditions of service of the above mentioned officers have been laid down in the Companies (Inspections, Investigations and Inquiry) Rules, 2014.

G : 1.7 INVESTIGATION INTO AFFAIRS OF COMPANY BY SFIO [SECTION 212]

Section 212 of the Act provides for Investigation into affairs of Company by the Serious Fraud Investigation Office (SFIO). According to this section:

(a) Without prejudice to the provisions of section 210, where the Central Government :

(1) on receipt of a report of the Registrar or Inspector under section 208;

(2) on intimation of a special resolution passed by a company that its affairs are required to be investigated;

[Every special resolution is required to be filed in Form No. MGT-14 as per Section 117(3)(a)]

(3) in the public interest, or

(4) on request from any Department of the Central Government or a State Government,

is of the opinion that it is necessary to investigate into the affairs of a company by the SFIO, the Central Government may, by order, assign the investigation into the affairs of the said company to the SFIO.

On receipt of such order, the Director, SFIO may designate such number of Inspectors, as he may consider necessary for the purpose of such investigation.

(b) Where any case has been assigned by the Central Government to the SFIO for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation

in such case in respect of any offence under this Act. In case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to SFIO [Sub section (2)].

(c) Where the investigation into the affairs of a company have been assigned by the Central Government to SFIO, it shall conduct the investigation in the manner and follow the procedure provided in this Chapter (Chapter XIV, Inspection, Inquiry and Investigation) and submit its report to the Central Government within such period as may be specified in the order [Sub section (3)].

(d) The Director, SFIO shall cause the affairs of the company to be investigated by an Investigating Officer who shall have the power of the Inspector under section 217 [Sub section (4)].

(e) The company and its officers and employees, who are or have been in employment of the company shall be responsible to provide all information, explanation, documents and assistance to the Investigating Officer as he may require for conduct of the investigation [Sub section (5)].

(f) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, offences covered under section 447 of this Act shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond unless:

(1) the Public Prosecutor has been given an opportunity to oppose the application for such release, and

(2) 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 [Sub section (6)].

However, 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 referred in point (f) except upon a complaint in writing made by:

a) the Director, SFIO, or

b) any officer of the Central Government authorised, by a general or special order in writing in this behalf by that Government.

(g) The limitation on granting of bail specified in sub section (6) above is in addition to the limitations under the Code of Criminal Procedure, 1973 or any other law for the time being in force on granting of bail [Sub section (7)].

(h) The SFIO shall submit an interim report to the Central Government, if the Central Government so directs [Sub section (11)].

(i) The SFIO shall submit the investigation report to the Central Government on completion of the investigation [sub-section (12)].

(j) Notwithstanding anything contained in the Companies Act, 2013 or in any other law for the time being in force, a copy of the investigation report may be obtained by any person concerned by making an application in this regard to the court [Sub section (13)].

(k) On receipt of the investigation report, the Central Government may, after examination of the report (and after taking such legal advice, as it may think fit) direct the SFIO to initiate prosecution against the company and its officers or employees, who are or have been in employment of the company or any other person directly or indirectly connected with the affairs of the company [Sub section (14)].

(l) Notwithstanding anything contained in this Act or in any other law for the time being in force, the investigation report filed with the Special Court for framing of charges shall be deemed to be a report filed by a police officer under section 173 of the Code of Criminal Procedure, 1973 [Sub section (15)].

(m) Notwithstanding anything contained in this Act, any investigation or other action taken or initiated by SFIO under the provisions of the Companies Act, 1956 shall continue to be proceeded with under that Act as if this Act had not been passed [Sub section (16)].

(n) In case SFIO has been investigating any offence under this Act, any other investigating agency, State Government, police authority, income-tax authorities having any information or documents in respect of such offence shall provide all such information or documents available with it to the SFIO [Sub section (17) (a)].

(o) The SFIO shall share any information or documents available with it, with any investigating agency, State Government, police authority or income tax authorities, which may be relevant or useful for such investigating agency, State Government, police authority or income-tax authorities in respect of any offence or matter being investigated or examined by it under any other law [Sub section (17) (b)].

G : 1.8 INVESTIGATION INTO COMPANY'S AFFAIRS IN OTHER CASES [SECTION 213]

The Tribunal may:

(a) on an application made by:

(1) not less than one hundred members or members holding not less than one-tenth of the total voting power, in the case of a company having a share capital, or

(2) not less than one-fifth of the persons on the company's register of members, in the case of a company having no share capital,

and supported by such evidence as may be necessary for the purpose of showing that the applicants have good reasons for seeking an order for conducting an investigation into the affairs of the company; or

(b) on an application made to it by any other person or otherwise, if it is satisfied that there are circumstances suggesting that:

(1) the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose.

(2) 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 towards any of its members, or

(3) 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,

order, after giving a reasonable opportunity of being heard to the parties concerned, that the affairs of the company ought to be investigated by an inspector or inspectors appointed by the Central Government and where such an order is passed, the Central Government shall appoint one or more competent persons as inspectors to investigate into the affairs of the company in respect of such matters and to report thereupon to it in such manner as the Central Government may direct:

Provided that if after investigation it is proved that:

(1) 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 that the company was formed for any fraudulent or unlawful purpose, or

(2) any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud,

then, every officer of the company who is in default and the person or persons concerned in the formation of the company or the management of its affairs shall be punishable for fraud in the manner as provided in section 447.

G : 1.9 SECURITY FOR PAYMENT OF COSTS AND EXPENSES OF INVESTIGATION [SECTION 214]

Section 214 of the Act provides for security for payment of costs and expenses of investigation as under:

Where an investigation is ordered by the Central Government in pursuance of clause (b) of sub-section (1) of section 210, or in pursuance of an order made by the Tribunal under section 213, the Central Government may before appointing an Inspector under sub-section (3) of section 210 or clause (b) of section 213, require the applicant to give such security not exceeding 25,000 rupees as may be prescribed, as it may think fit, for payment of the costs and expenses of the investigation. Such security shall be refunded to the applicant if the investigation results in prosecution.

G : 1.10 FIRM, BODY CORPORATE OR ASSOCIATION NOT TO BE APPOINTED AS INSPECTOR [SECTION 215]

Section 215 of the Act provides that no firm, body corporate or other association shall be appointed as an Inspector.

G : 1.11 INVESTIGATION OF OWNERSHIP OF COMPANY [SECTION 216]

Section 216 of the Act provides for Investigation of ownership of company as under:

(a) As per Section 216 (1), where it appears to the Central Government that there is a reason so to do, it may appoint one or more Inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons:

(1) who are or have been financially interested in the success or failure, whether real or apparent, of the company, or

(2) who are or have been able to control or to materially influence the policy of the company or

(3) who have or had beneficial interest in shares of a company or have been significant beneficial owner of the company.

(b) While appointing an Inspector under sub-section (1), the Central Government may define the scope of the investigation, whether as respects the matters or the period to which it is to extend or otherwise, and in particular, may limit the investigation to matters connected with particular shares or debentures [Sub section (3)].

(c) Subject to the terms of appointment of an Inspector, his powers shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding, is or was observed or is likely to be observed in practice and which is relevant for the purposes of his investigation [Sub section (4)].

G : 1.12 PROCEDURE, POWERS, ETC., OF INSPECTORS [SECTION 217]

Section 217 of the Act provides for procedure, powers, etc., of Inspectors as under:

(a) As per sub- section (1), it shall be the duty of all officers and other employees and agents including the former officers, employees and agents of a company which is under investigation in accordance with the provisions contained in this Chapter XIV, and where the affairs of any other body corporate or a person are investigated under section 219, of all officers and other employees and agents including former officers, employees and agents of such body corporate or a person:

(1) to preserve and to produce to an Inspector or any person authorised by him in this behalf all books and papers of, or relating to, the company or, as the case may be, relating to the other body corporate or the person, which are in their custody or power, and

(2) otherwise to give to the Inspector all assistance in connection with the investigation which they are reasonably able to give.

(b) The Inspector may require any body corporate, other than a body corporate referred in point (a) to furnish such information to, or produce such books and papers before him or any person authorised by him in this behalf as he may consider necessary, if the furnishing of such information or the production of such books and papers is relevant or necessary for the purposes of his investigation [Sub section (2)].

(c) The Inspector shall not keep in his custody any books and papers produced under point (a) or point (b) for more than 180 days and return the same to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced [Sub section (3)].

However, the books and papers may be called for by the Inspector if they are needed again for a further period of 180 days by an order in writing.

(d) As per sub-section (4), an Inspector may examine on oath:

(1) any of the persons referred to in point (a), and

(2) any other person with the prior approval of the Central Government, in relation to the affairs of the company, or other body corporate or person, as the case may be, and for that purpose may require any of those persons to appear before him personally.

However, in case of an investigation under section 212, the prior approval of Director, Serious Fraud Investigation Office shall be sufficient under point (2) above (instead of the Central Govt.).

(e) As per sub- section (5), notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, the Inspector, being an officer of the Central Government making an investigation under this chapter, shall have all the 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:

(1) the discovery and production of books of account and other documents, at such place and time as may be specified by such person.

(2) summoning and enforcing the attendance of persons and examining them on oath, and

(3) inspection of any books, registers and other documents of the company at any place.

(f) If any director or officer of the company disobeys the direction issued by the Registrar or the Inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than 25,000 rupees but which may extend to ` 1 lakh [Sub section (6) (i)].

If a director or an officer of the company has been convicted of an offence under this section, the director or the officer 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 from holding an office in any company [Sub section (6) (ii)].

(g) The notes of any examination under sub section (4) referred under (d) above, 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 [Sub section (7)].

(h) As per sub-section (8), if any person fails without reasonable cause or refuses:

(1) to produce to an Inspector or any person authorised by him in this behalf any book or paper which is his duty under point (a) or point (b) to produce;

(2) to furnish any information which is his duty under point (b) to furnish.

(3) to appear before the Inspector personally when required to do so under point (d) or to answer any question which is put to him by the Inspector in pursuance of that point, or

(4) to sign the notes of any examination referred to in sub section (7) above, he shall be punishable with imprisonment for a term which may extend to 6 months and with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 1 lakh, and also with a further fine which may extend to ₹ 2,000 for every day after the first during which the failure or refusal continues.

(i) The officers of the Central Government, State Government, police or statutory authority shall provide assistance to the Inspector for the purpose of inspection, inquiry or investigation, which the Inspector may, with the prior approval of the Central Government, require [Sub section (9)].

(j) The Central Government may enter into an agreement with the Government of a foreign State for reciprocal arrangements to assist in any inspection, inquiry or investigation under this Act or under the corresponding law in force in that State and may, by notification, render the application of this Chapter in relation to a foreign State with which reciprocal arrangements have been made subject to such modifications, exceptions, conditions and qualifications as may be deemed expedient for implementing the agreement with that State [Sub section (10)].

(k) Notwithstanding anything contained in this Act or in the Code of Criminal Procedure, 1973 if, in the course of an investigation into the affairs of the company, an application is made to the competent court in India by the Inspector stating that evidence is, or may be, available in a country or place outside India, such court may issue a letter of request to a court or an authority in such country or place, competent to deal with such request, to examine orally, or otherwise, any person, supposed to be acquainted with the facts and circumstances of the case, to record his statement made in the course of such examination and also to require such person or any other person to produce any document or thing, which may be in his possession pertaining to the case, and to forward all the evidence so taken or collected or the authenticated copies thereof or the things so collected to the court in India which had issued such letter of request [Sub section (11)].

Provided that, the letter of request shall be transmitted in such manner as the Central Government may specify in this behalf. Provided further that every statement recorded or document or thing received under this sub-section shall be deemed to be the evidence collected during the course of investigation.

(l) Upon receipt of a letter of request from a court or an authority in a country or place outside India, competent to issue such letter in that country or place for the examination of any person or production of any document or thing in relation to affairs of a company under investigation in that country or place, the Central Government may, if it thinks fit, forward such letter of request to the court concerned, which shall thereupon summon the person before it and record his statement or cause any document or thing to be produced, or send the letter to any Inspector for investigation, who shall thereupon investigate into the affairs of company in the same manner as the affairs of a company are investigated under this Act and the Inspector shall submit the report to such court within 30 days or such extended time as the court may allow for further action [Sub section (12)].

Provided that the evidence taken or collected as above or authenticated copies thereof or the things so collected shall be forwarded by the court, to the Central Government for transmission, in such manner as the Central Government may deem fit, to the court or the authority in country or place outside India which had issued the letter of request.

G : 1.13 PROTECTION OF EMPLOYEES DURING INVESTIGATION [SECTION 218]

(a) Notwithstanding anything contained in any other law for the time being in force, if:

(1) during the course of any investigation of the affairs and other matters of o relating to a company, other body corporate or person under section 210, section 212 section 213 or section 219 or of the membership and other matters of or relating to a company, or the ownership of shares in or debentures of a company

or body corporate, or the affairs and other matters of or relating to a company, other body corporate or person, under section 216, or

(2) during the pendency of any proceeding against any person concerned in the conduct and management of the affairs of a company under Chapter XVI,

such company, other body corporate or person proposes:

a) to discharge or suspend any employee; or

b) to punish him, whether by dismissal, removal, reduction in rank or otherwise; or

c) to change the terms of employment to his disadvantage,

the company, other body corporate or person, as the case may be, shall obtain approval of the Tribunal of the action proposed against the employee and if the Tribunal has any objection to the action proposed, it shall send by post notice thereof in writing to the company, other body corporate or person concerned.

(b) If the company, other body corporate or person concerned does not receive within thirty days of making of application under point (a), the approval of the Tribunal, then and only then, the company, other body corporate or person concerned may proceed to take against the employee, the action proposed.

(c) If the company, other body corporate or person concerned is dissatisfied with the objection raised by the Tribunal, it may, within a period of thirty days of the receipt of the notice of the objection, prefer an appeal to the Appellate Tribunal in such manner and on payment of such fees as may be prescribed.

(d) The decision of the Appellate Tribunal on such appeal shall be final and binding on the Tribunal and on the company, other body corporate or person concerned.

(e) For the removal of doubts, it is hereby declared that the provisions of this section shall have effect without prejudice to the provisions of any other law for the time being in force.

G : 1.14 POWER OF INSPECTOR TO CONDUCT INVESTIGATION INTO AFFAIRS OF RELATED COMPANIES, ETC. [SECTION 219]

Section 219 of the Act provides for power of Inspector to conduct investigation into affairs of related companies, etc. as under:

(a) Investigation into affairs of related companies: If an Inspector appointed under section 210 or section 212 or section 213 to investigate into the affairs of a company considers it necessary for the purposes of the investigation, can also investigate the affairs of:

(1) any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company.

(2) 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, the managing director or the manager of the company.

(3) any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors, or

(4) any person who is or has at any relevant time been the company's managing director or manager or employee.

(b) Report of Inspector: The Inspector shall, subject to the prior approval of the Central Government, investigate

into and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed.

G : 1.15 SEIZURE OF DOCUMENTS BY INSPECTOR [SECTION 220]

Section 220 of the Act provides for seizure of documents by Inspector as under:

(a) Seizure of books and papers [Sub section (1)]: Where in the course of an investigation under this Chapter, the Inspector has reasonable grounds to believe that the books and papers of, or relating to, any company or other body corporate or managing director or manager of such company are likely to be destroyed, mutilated, altered, falsified or secreted, the Inspector may:

(1) enter, with such assistance as may be required, the place or places where such books and papers are kept in such manner as may be required, and

(2) seize books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books and papers at its cost for the purposes of his investigation.

(b) Time period for keeping books and papers [Sub section (2)]: The Inspector shall keep in his custody the books and papers seized under this section for such a period not later than the conclusion of the investigation as he 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.

(c) Extracts of books and papers: The Inspector may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such manner as he considers necessary.

(d) Application of provisions of Cr.P.C: The provisions of the Code of Criminal Procedure, 1973, relating to searches or seizures shall apply 'mutatis mutandis' to every search or seizure made under this section.

G : 1.16 FREEZING OF ASSETS OF COMPANY ON INQUIRY AND INVESTIGATION [SECTION 221]

(a) Where it appears to the Tribunal, on a reference made to it by the Central Government or in connection with any inquiry or investigation into the affairs of a company under this Chapter or on any complaint made by such number of members as specified under sub section (1) of section 244 or a creditor having one lakh amount outstanding against the company or any other person having a reasonable ground to believe that the removal, transfer or disposal of funds, assets, properties of the company is likely to take place in a manner that is prejudicial to the interests of the company or its shareholders or creditors or in public interest, it may by order direct that such transfer, removal or disposal shall not take place during such period not exceeding three years as may be specified in the order or may take place subject to such conditions and restrictions as the Tribunal may deem fit.

(b) In case of any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal under sub-section (1), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

G : 1.17 IMPOSITION OF RESTRICTIONS UPON SECURITIES [SECTION 222]

(a) Where it appears to the Tribunal, in connection with any investigation under section 216 or on a complaint made by any person in this behalf, that there is good reason to find out the relevant facts about any securities

issued or to be issued by a company and the Tribunal is of the opinion that such facts cannot be found out unless certain restrictions, as it may deem fit, are imposed, the Tribunal may, by order, direct that the securities shall be subject to such restrictions as it may deem fit for such period not exceeding three years as may be specified in the order.

(b) Where securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under point (a), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

G : 1.18 INSPECTOR'S REPORT [SECTION 223]

Section 223 of the Act lays down the following provisions in respect of the Inspector's report on investigation conducted under the Chapter XIV:

(a) Submission of interim report and final report [Sub section (1)]: An Inspector appointed under the Chapter (Chapter XIV- Inspection, Inquiry and Investigation) may, and if so directed by the Central Government shall, submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report to the Central Government.

(b) Report to be in writing or printed [Sub section (2)]: Every report made under sub section (1) above, shall be in writing or printed as the Central Government may direct.

(c) Obtaining copy of report [Sub section (3)]: A copy of the above report may be obtained by making an application in this regard to the Central Government.

(d) Authentication of report [Sub section (4)]: The report of any Inspector appointed under this Chapter shall be authenticated either:

(1) by the seal, if any, of the company whose affairs have been investigated; or

(2) by a certificate of a public officer having the custody of the report, as provided under section 76 of the Indian Evidence Act, 1872, and such report shall be admissible in any legal proceeding as evidence in relation to any matter contained in the report.

(e) Exceptions [Sub section (5)]: Nothing in this section shall apply to the report referred to in section 212 of the Companies Act, 2013.

G : 1.19 ACTIONS TO BE TAKEN IN PURSUANCE OF INSPECTOR'S REPORT [SECTION 224]

Section 224 of the Act provides the following provisions in respect of the actions to be taken in pursuance of Inspector's report:

(a) If, from an Inspector's report, made under section 223, it appears to the Central Government that any person has, in relation to the company or in relation to any other body corporate or other person whose affairs have been investigated under this Chapter been guilty of any offence for which he is criminally liable, the Central Government may prosecute such person for the offence and it shall be the duty of all officers and other employees of the company or body corporate to give the Central Government the necessary assistance in connection with the prosecution [Sub section (1)].

(b) As per sub-section (3), if from any such report as aforesaid, it appears to the Central Government that proceedings ought, in the public interest, to be brought by the company or anybody corporate whose affairs

have been investigated under this Chapter:

(1) for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation, or the management of the affairs, of such company or body corporate, or

(2) for the recovery of any property of such company or body corporate which has been misapplied or wrongfully retained, the Central Government may itself bring proceedings for winding up in the name of such company or body corporate.

(c) The Central Government, shall be indemnified by such company or body corporate against any costs or expenses incurred by it in, or in connection with, any proceedings brought by virtue of sub-section (3) [Sub section (4)].

G : 1.20 EXPENSES OF INVESTIGATION [SECTION 225]

Section 225 of the Act lays down the following provisions in respect of expenses of investigation:

(a) As per sub-section (1), the expenses of, and incidental to, an investigation by an Inspector appointed by the Central Government under this Chapter XIV, (Inspection, Inquiry and Investigation) other than expenses of inspection under section 214 (Security for payment of costs and expenses of investigation) shall be defrayed in the first instance by the Central Government, but shall be reimbursed by the following persons to the extent mentioned below, namely:

(1) any person who is convicted on a prosecution instituted, or who is ordered to pay damages or restore any property in proceedings brought, under section 224, to the extent that he may in the same proceedings be ordered to pay the said expenses as may be specified by the court convicting such person, or ordering him to pay such damages or restore such property, as the case may be.

(2) any company or body corporate in whose name proceedings are brought as aforesaid, to the extent of the amount or value of any sums or property recovered by it as a result of such proceedings.

(3) unless, as a result of the investigation, a prosecution is instituted under section 224:

a) any company, body corporate, managing director or manager dealt with by the report of the Inspector, and

b) the applicants for the investigation, where the Inspector was appointed under section 213, to such extent as the Central Government may direct.

(b) As per sub-section (2), any amount for which a company or body corporate is liable under clause (2) above shall be a first charge on the sums or property mentioned in that clause.

G : 1.21 VOLUNTARY WINDING UP OF COMPANY, ETC., NOT TO STOP INVESTIGATION PROCEEDINGS [SECTION 226]

An investigation under this Chapter XIV may be initiated notwithstanding, and no such investigation shall be stopped or suspended by reason only of, the fact that:

(a) an application has been made under section 241.

(b) the company has passed a special resolution for voluntary winding up, or

(c) any other proceeding for the winding up of the company is pending before the Tribunal:

Provided that where a winding up order is passed by the Tribunal in a proceeding referred to in clause (c), the inspector shall inform the Tribunal about the pendency of the investigation proceedings before him and the Tribunal shall pass such order as it may deem fit:

Provided further that nothing in the winding up order shall absolve any director or other employee of the company from participating in the proceedings before the inspector or any liability as a result of the finding by the inspector.

G : 1.22 LEGAL ADVISERS AND BANKERS NOT TO DISCLOSE CERTAIN INFORMATION [SECTION 227]

Nothing in this Chapter shall require the disclosure to the Tribunal or to the Central Government or to the Registrar or to an inspector appointed by the Central Government:

(a) by a legal adviser, of any privileged communication made to him in that capacity, except as respects the name and address of his client, or

(b) by the bankers of any company, body corporate, or other person, of any information as to the affairs of any of their customers, other than such company, body corporate, or person.

G : 1.23 INVESTIGATION ETC. OF FOREIGN COMPANIES [SECTION 228]

Section 228 of the Act provides that the provisions of this Chapter XIV shall apply 'mutatis mutandis' to inspection, inquiry or investigation in relation to foreign companies.

G : 1.24 PENALTY FOR FURNISHING FALSE STATEMENT, MUTILATION, DESTRUCTION OF DOCUMENT [SECTION 229]

Section 229 of the Companies Act, 2013 lays down the following penalty for furnishing false statement, mutilation, destruction of documents:

Where a person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation:

(a) destroys, mutilates or falsifies, or conceals or tampers or unauthorisedly removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company or the body corporate.

(b) makes, or is a party to the making of, a false entry in any document concerning the company or body corporate, or

(c) provides an explanation which is false or which he knows to be false,

he shall be punishable for fraud in the manner as provided in section 447 of the Act.

[**Note** : Some of the provisions of this chapter are yet to be notified.]

Self Assessment Questions

(1) Explain the provisions of Companies Act, 2013 with respect to investigation of the affairs of company by the Central Government.

(2) What are the powers of Inspectors appointed under Section 210 or 212 of the Companies Act, 2013?

(3) Discuss the provisions of Companies Act, 2013 which protects the employees of company during investigation.

(4) Discuss the powers of Registrar to call for information or explanation under Chapter XIV.

(5) Explain the provisions relating to Investigation into affairs of Company by the Serious Fraud Investigation Office (SFIO).

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Study Note - 1

THE COMPANIES ACT, 2013

PART - H : COMPROMISES, ARRANGEMENTS AND AMALGAMATIONS

This Study Note includes:

H : 1.1 Power to compromise or make arrangements with creditors and members [Section 230]

H : 1.2 Power of Tribunal to enforce compromise or arrangement [Section 231]

H : 1.3 Merger and amalgamation of companies [Section 232]

H : 1.4 Merger or amalgamation of certain companies [Section 233]

H : 1.5 Merger or amalgamation of company with foreign company [Section 234]

H : 1.6 Power to acquire shares of shareholders dissenting from scheme or contract approved by majority [Section 235]

H : 1.7 Purchase of minority shareholding [Section 236]

H : 1.8 Power of Central Government to provide for amalgamation of companies in public interest [Section 237]

H : 1.9 Registration of offer of schemes involving transfer of shares [Section 238]

H : 1.10 Preservation of books and papers of amalgamated companies [Section 239]

H : 1.11 Liability of officers in respect of offences committed prior to merger, amalgamation, etc [Section 240]

Chapter XV of the Companies Act, 2013 (Section 230 to Section 240) provides for Compromises, Arrangements and Amalgamations.

Introduction

Corporate restructuring is one of the method to achieve this objective. Mergers, demerger, amalgamation, compromise and arrangements are the different modes of corporate restructuring. The Companies Act provides the power to the Court for sanctioning schemes of compromise and arrangement.

Compromise

'Compromise' is a term which implies the existence of a dispute such as relating to rights. It means settlement or adjustment of claims in dispute by mutual concessions. If the members have to gave up their rights entirely. It will not be compromise [NFU Development Trust Ltd., Re (1973) 1 All E.R. 135]

There can be no 'compromise' unless there is first a dispute [Guardian Assurance Co., Re(1917) 1 Ch. 431].

Arrangement

The term 'arrangement' is of very wide import. It includes a reorganization of the share capital of a company by the consolidation of shares of different classes, or by the division of share into shares of different classes or by both these methods. All modes of reorganising the share capital, including interference with preferential and other special rights attached to shares, can properly form part of an arrangement with members [Investment Corp. of India Ltd., Re (1987) 61 Comp. Cas.92 (Bom)].

Amalgamation

'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 and as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of new company or the amalgamated company.

The shareholders of each amalgamating company become the shareholders in the amalgamated company. To give a simple example of amalgamation, we may say X Ltd. and Y Ltd. form Z Ltd. and merge their legal identities into Z Ltd. It may be said in another way that X Ltd. + Y Ltd. = Z. Ltd.

The word amalgamation is not defined anywhere in the Companies Act, 2013.

H : 1.1 POWER TO COMPROMISE OR MAKE ARRANGEMENTS WITH CREDITORS AND MEMBERS [SECTION 230]

(a) Where a compromise or arrangement is proposed:

(1) between a company and its creditors or any class of them, or

(2) between a company and its members or any class of them, the Tribunal may, on the application of the,

a) company or

b) of any creditor or

c) member of the company, or

d) 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 Tribunal directs.

[Resolution is required to be filed in Form No. MGT-14 as per Section 117(3)(d)]

(b) The application to the tribunal to disclose by affidavit:

(1) 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 and the pendency of any investigation or proceedings against the company.

(2) reduction of share capital of the company, if any, included in the compromise or arrangement.

(3) any scheme of corporate debt restructuring consented to by not less than seventy-five per cent. of the secured creditors in value, including:

a) a creditor's responsibility statement in the prescribed form;

b) safeguards for the protection of other secured and unsecured creditors;

c) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

d) where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and

e) a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

(c) Notice of the meeting called in pursuant to the order of the tribunal shall be sent to all the creditors or class of creditors and to all the members or class of members and the debenture-holders of the company, individually at the address registered with the company which shall be accompanied by:

(1) a statement disclosing the details of the compromise or arrangement,

(2) a copy of the valuation report, if any, and

(3) explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture holders, and

(4) the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and

(5) such other matters as may be prescribed:

Such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as may be prescribed:

When the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

(d) Procedural aspects relating to notice under Rule 15.3

Rule 15.3 states that the notice of the meeting pursuant to the order of the Tribunal to be given in Form No. 15.3, and shall be sent individually specifying therein,

(1) disclosure of nature and extent of interest and effect of compromise or arrangement on such interest of:

a) key managerial personnel.

b) directors.

c) promoters.

d) non-promoter members.

e) depositors.

f) creditors.

g) debenture holders.

h) deposit and debenture trustee(s).

i) promoters, directors, and key managerial personnel of holding company, subsidiary and associate companies.

j) employees of the company stating clearly that the changes, if any, in the terms and conditions of employment are not detrimental to the interest of the employees.

(2) where there is no interest or there is no effect on such interest of any promoter, director or key managerial personnel, a statement to the effect that there is no interest or there is no effect of the scheme of compromise or arrangement on such interests of such persons.

(3) investigation proceedings, if any, pending against the company or against any promoter, director or key managerial personnel of such company.

(4) details of shareholding of directors, key managerial personnel and promoters of the company as on the date of making this statement and change in their shareholding in the last six months including the date on which and price at which change took place.

(5) details of any No-objection(s), approvals or sanctions, if already received from the concerned authorities for the compromise or arrangement.

(6) details of the availability of the following documents for obtaining extract from or for making copies of or for inspection by the members and creditors, namely:

a) latest audited financial statements of the company including consolidated financial statements.

b) copy of the order of Tribunal in pursuance of which the meeting is to be convened.

c) copy of scheme of compromise or arrangement.

d) contracts or agreements material to the compromise or arrangement, And

e) such other information/documents as the Board/ Management believes necessary and relevant for making decision for / against the scheme.

(7) declaration to the effect that the scheme is in the best interests of the employees, creditors, debenture holders, members particularly non-promoter members and minority shareholders of the company, as detailed in the scheme.

(8) Status of approval(s) of regulatory or any other authority(ies), required, if any in connection with compromise or arrangement.

(9) The notice shall provide for the information required under sub Section (4) of Section 230 of the Act.

(e) Notice to provide for voting by themselves or through proxy or through postal ballot Sub-Section (4) of Section 230 states that a notice under Sub-Section (3) shall provide that the persons to whom the notice is sent may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice:

(f) Any objection to the compromise or arrangement shall be made only by persons holding not less than ten per cent of the shareholding or having outstanding debt amounting to not less than five per cent of the total outstanding debt as per the latest audited financial statement.

(g) Notice to be sent to the regulators seeking their representations Section 230(5) states that a notice under Sub-Section (3) along with all the documents in such form as may be prescribed shall also be sent to the Central Government, the income-tax authorities, the Reserve Bank of India, the Securities and Exchange Board, the Registrar, the respective stock exchanges, the Official Liquidator, the Competition Commission of India established under Sub-Section (1) of Section 7 of the Competition Act, 2002, if necessary, and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement and shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals.

(h) Approval and sanction of the scheme

Section 230 (6) states that when at a meeting held in pursuance of Sub-Section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator and the contributories of the company.

(i) Order of the tribunal sanctioning the scheme to provide for the Certain matters

An order made by the Tribunal shall provide for all or any of the following matters, namely:

(1) where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable.

(2) the protection of any class of creditors.

(3) if the compromise or arrangement results in the variation of the shareholders' rights, it shall be given effect to under the provisions of Section 48.

(4) if the compromise or arrangement is agreed to by the creditors under Sub-Section (6), any proceedings pending before the Board for Industrial and Financial Reconstruction established under Section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate.

(5) such other matters including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement:

(j) Compromise or arrangement is to be in conformity with the accounting standards

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under Section 133.

(k) Order of tribunal to be filed with the Registrar Section 230 (8) states that the order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.

(l) Tribunal may dispense with calling of meeting of creditors Section 230 (9) states that the Tribunal may dispense with calling of a meeting of creditor or class of creditors where such creditors or class of creditors, having at least ninety per cent value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.

(m) Compromise in respect of buy back is to be in compliance with Section 68 As per Section 230 (10), no compromise or arrangement in respect of any buy-back of securities under this Section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of Section 68.

(n) Compromise includes takeover

Section 230 (11) states that any compromise or arrangement may include takeover offer made in such manner as may be prescribed. In case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board.

H : 1.2 POWER OF TRIBUNAL TO ENFORCE COMPROMISE OR ARRANGEMENT [SECTION 231]

As per Section 231 (1) when the Tribunal makes an order under Section 230 sanctioning a compromise or an arrangement in respect of a company, it:

(a) shall have power to supervise the implementation 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 implementation of the compromise or arrangement.

Sub-Section (2) states that if the Tribunal is satisfied that the compromise or arrangement sanctioned under Section 230 cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding up the company and such an order shall be deemed to be an order made under Section 273.

H : 1.3 MERGER AND AMALGAMATION OF COMPANIES [SECTION 232]

(a) Tribunal's power to call meeting of creditors or members, with respect to merger or amalgamation of companies Section 232 (1) states that when an application is made to the Tribunal under Section 230 for the sanctioning of a compromise or an arrangement proposed between a company and any such persons as are mentioned in that Section, and it is shown to the Tribunal:

(1) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the amalgamation of any two or more companies, and

(2) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies, the Tribunal may on such application, order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal may direct and the provisions of Sub-Sections (3) to (6) of Section 230 shall apply mutatis mutandis.

(b) Circulation of documents for members/creditors meeting Section 232 (2) states that when an order has been made by the Tribunal under Sub-Section (1), merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following for the meeting so ordered by the Tribunal, namely:

(1) the draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company.

(2) confirmation that a copy of the draft scheme has been filed with the Registrar.

(3) a report adopted by the directors of the merging companies explaining effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties.

(4) the report of the expert with regard to valuation, if any.

(5) a supplementary accounting statement if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme.

(c) Sanctioning of scheme by tribunal:

Section 232 (3) states that the Tribunal, after satisfying itself that the procedure specified in Sub-Sections (1) and (2) has been complied with, may, by order, sanction the compromise or arrangement or by a subsequent order, make provision for the following matters, namely:

(1) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company from a date to be determined by the parties unless the Tribunal, for reasons to be recorded by it in writing, decides otherwise.

(2) the allotment or appropriation by the transferee company of any shares, debentures, policies or other like instruments in the company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person:

No transferee company can hold shares in its own name or under any trust.

A transferee company shall not, as a result of the compromise or arrangement, hold any shares in its own name or in the name of any trust whether on its behalf or on behalf of any of its subsidiary or associate companies and any such shares shall be cancelled or extinguished.

(3) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company on the date of transfer.

(4) dissolution, without winding-up, of any transferor company.

(5) the provision to be made for any persons who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement.

(6) where share capital is held by any non-resident shareholder under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force, the allotment of shares of the transferee company to such shareholder shall be in the manner specified in the order.

(7) the transfer of the employees of the transferor company to the transferee company.

(8) when the transferor company is a listed company and the transferee company is an unlisted company:

a) the transferee company shall remain an unlisted company until it becomes a listed company.

b) if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal:

The amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board under any regulations framed by it.

(9) where the transferor company is dissolved, the fee, if any, paid by the transferor company on its authorised capital shall be set-off against any fees payable by the transferee company on its authorised capital subsequent to the amalgamation, and

(10) such incidental, consequential and supplemental matters as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out:

(d) Auditor's certificate as to conformity with accounting standard

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under Section 133.

(e) Transfer of property or liabilities

Sub-Section (4) stares that an order under this Section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to the transferee company and the liabilities shall e transferred to and become the liabilities of the transferee company and any property may, if the order so directs, be freed from any charge which shall by virtue of the compromise or arrangement, cease to have effect.

(f) Certified copy of the order to be filed with the registrar Section 232(5) states that every company in relation to which the order is made shall cause a certified copy of the order to be filed with the Registrar for registration within thirty days of the receipt of certified copy of the order.

(g) Effective date of the scheme

Section 232 (6) states that the scheme under this Section shall clearly indicate an appointed date from which it shall be effective and the scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date.

(h) Annual statement certified by CA/CS/CWA to be filed with registrar every year until the completion of the scheme

Section 232 (7) states that every company in relation to which the order is made shall, until the completion of the scheme, file a statement in such form and within such time as may be prescribed with the Registrar every year duly certified by a chartered accountant or a cost accountant or a company secretary in practice indicating whether the scheme is being complied with in accordance with the orders of the Tribunal or not.

(i) Punishment

Section 232 (8) states that if a transferor company or a transferee company contravenes the provisions of this Section, the transferor company or the transferee company, as the case may be, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of such transferor or transferee company who is in default, shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

(j) Compromise or arrangement includes 'demerger'

(1) Rule 15.31 of the Rules made under Chapter XV states that For the purpose of Chapter XV of the Act, 'demerger' in relation to companies means transfer, pursuant to scheme of arrangement by a 'demerged company' of its one or more undertakings to any 'resulting company' in such a manner as provided in Section 2 (19AA) of the Income Tax Act, 1961, subject to fulfilling the conditions stipulated in Section 2 (19AA) of the Income Tax Act and shares have been allotted by the 'resulting company' to the share holders of the .demerged company' against the transfer of assets and liabilities.

(2) For the purpose of the compromise in the nature of 'demerger' till the Accounting Standards is prescribed for the purpose of 'demerger', the Accounting Treatment shall be in accordance with the conditions stipulated in Section 2 (19AA) of the Income Tax Act, 1961 and

a) in the books of the 'demerged company':

1) Assets and liabilities shall be transferred at the same value appearing in the books, without considering any revaluation or writing off of assets carried out during the preceding two financial years, and

2) The difference between the value of assets and liabilities shall be credited to capital reserve or debited to good will.

b) In the books of 'resulting company:

1) Assets and liabilities of 'demerged company' transferred shall be recorded at the same value appearing in the books of the 'demerged company' without considering any revaluation or writing off of assets carried out during the preceding two financial years.

2) Shares issued shall be credited to the share capital account, and

3) The excess or deficit, if any, remaining after recording the aforesaid entries shall be credited to capital reserve or debited to good will as the case may be.

A certificate from a Chartered Accountant is to be submitted to the Tribunal to the effect that both 'demerged company' and 'resulting company' have complied with conditions as above and accounting treatment prescribed in this rule.

H : 1.4 MERGER OR AMALGAMATION OF CERTAIN COMPANIES [SECTION 233]

Section 233 prescribes simplified procedure for Merger or amalgamation of

(a) two or more small companies or

(b) between a holding company and its wholly-owned subsidiary company or

(c) such other class or classes of companies as may be prescribed.

1.4.1 What is a holding company?

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

1.4.2 What is a small company?

As per Section 2 (85) ''small company'' means a company, other than a public company:

(a) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees, or

(b) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees:

Provided that nothing in this clause shall apply to:

(1) a holding company or a subsidiary company.

(2) a company registered under Section 8. or

(3) a company or body corporate governed by any special Act.

1.4.3 What is a subsidiary company?

As per 2 (87) 'subsidiary company' or 'subsidiary', in relation to any other company (that is to say the holding company), means a company in which the holding company:

(a) controls the composition of the Board of Directors, or

(b) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation: For the purposes of this clause:

(1) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause:

a) or sub-clause

b) is of another subsidiary company of the holding company.

(2) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors.

(3) the expression 'company' includes any body corporate.

(4) 'layer' in relation to a holding company means its subsidiary or subsidiaries.

1.4.4 Merger of small companies/holding and subsidiary companies [Section 233]

Accordingly Sub-Section (1) of Section 233 states that notwithstanding the provisions of Section 230 and Section 232, a scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as may be prescribed, subject to the following, namely:

(a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and

Official Liquidators where registered office of the respective companies are situated or persons affected by the scheme within thirty days is issued by the transferor company or companies and the transferee company;

(b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety per cent. of the total number of shares;

(c) each of the companies involved in the merger files a declaration of solvency, in the prescribed form, with the Registrar of the place where the registered office of the company is situated; and

(d) the scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

1.4.5 Rule 15.25 states as follows with respect to Section 233(1)

(a) For the purposes of Sub-Section (1) of Section 233, a company shall be deemed to be 'wholly owned subsidiary' only if hundred per cent of share capital is held by the holding company except the shares held by the nominee or nominees to ensure that the number of members of subsidiary company is not reduced below the statutory limit as provided in Section 187.

(b) For the purposes of clause (c) of Sub-Section (1) of Section 233, the declaration of solvency shall be filed by the each of the companies involved in a scheme of compromise or arrangement involving merger in Form No. 15.12 along with such fee as provided in Annexure 'B 'before convening the meeting of members and creditors for approval of the scheme.

(c) For the purposes of clause (b) and (d) of Sub-Section (1) of Section 233, the notice of the meeting to the members and creditors shall be accompanied by:

(1) a statement, as far as applicable, referred to in Sub-Section (3) of Section 230.

(2) the declaration of solvency made in pursuance of clause (c) of Sub-Section (1) of Section 233.

(3) a copy of the scheme.

1.4.6 Transferee Company to file a copy of scheme approved

Section 233 (2) states that the transferee company shall file a copy of the scheme so approved in the manner as may be prescribed, with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.

1.4.7 Central Government to issue confirmation order, where there are no objections or suggestions from registrar or official liquidator

Section 233 (3) states that on the receipt of the scheme, if the Registrar or the Official Liquidator has no objections or suggestions to the scheme, the Central Government shall register the same and issue a confirmation thereof to the companies.

1.4.8 Objections if any by the registrar or official liquidator to be communicated to the central government

Section 233 (4) states that if the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days. If no such communication is made, it shall be presumed that he has no objection to the scheme.

1.4.9 Application by Central Government to the Tribunal

Section 233 (5) states that if the Central Government after receiving the objections or suggestions or for

any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application before the Tribunal within a period of sixty days of the receipt of the scheme under Sub-Section (2) stating its objections and requesting that the Tribunal may consider the scheme under Section 232.

1.4.10 Tribunal's Action to Central Government's application

Section 233 (6) states that on receipt of an application from the Central Government or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down in Section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it deems fit:

If the Central Government does not have any objection to the scheme or it does not file any application under this Section before the Tribunal, it shall be deemed that it has no objection to the scheme.

1.4.11 Registrar having jurisdiction over transferee company has to be communicated

Section 233 (7) states that a copy of the order under Sub-Section (6) confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

1.4.12 Effect of registration of the scheme

Section (8) states that the registration of the scheme under subSection (3) or Sub-Section (7) shall be deemed to have the effect of dissolution of the transferor company without process of winding up.

Section 233 (9) states that the registration of the scheme shall have the following effects, namely:

(a) transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company.

(b) the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company.

(c) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company, and

(d) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

1.4.13 Transferee Company not to hold any share in its own name or trust and all such shares are to be cancelled or extinguished

Section 233 (10) states that a transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

1.4.14 Transferee Company to file an application with Registrar along with the scheme registered

Section 233 (11) The transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital. The fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

H : 1.5 MERGER OR AMALGAMATION OF COMPANY WITH FOREIGN COMPANY [SECTION 234]

Section 234 (2) Subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.

For the purposes of Sub-Section (2), the expression 'foreign company' means any company or body corporate incorporated outside India whether having a place of business in India or not. Section 234 (1) states that the provisions of this Chapter unless otherwise provided under any other law for the time being in force, shall apply mutatis mutandis to schemes of mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government. The Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this Section.

H : 1.6 POWER TO ACQUIRE SHARES OF SHAREHOLDERS DISSENTING FROM SCHEME OR CONTRACT APPROVED BY MAJORITY [SECTION 235]

Section 235 of the Companies Act 2013 prescribes the manner of acquisition of shares of shareholders dissenting from the scheme or contract approved by the majority shareholders holding not less than nine tenth in value of the shares, whose transfer is involved. It includes notice to dissenting shareholders, application to dissenting shareholders to tribunal, deposit of consideration received by the transferor company in a separate bank account etc.,

H : 1.7 PURCHASE OF MINORITY SHAREHOLDING [SECTION 236]

Further Section 236 prescribes the manner of notification by the acquirer(majority) to the company, offer to minority for burying their shares, deposit an amount equal to the value of shares to be acquired, valuation of shares by registered valuer etc.,

Further Section 230 (7) (e) provides that the order made by the National Company Law Tribunal may provide for exit offer to dissenting shareholders, if any as are in the opinion of the tribunal necessary to effectively implement the terms of the compromise or arrangement.

Section 232 (3) (h) (B) provides exit route for the shareholders of unlisted transferor company.

H : 1.8 POWER OF CENTRAL GOVERNMENT TO PROVIDE FOR AMALGAMATION OF COMPANIES IN PUBLIC INTEREST [SECTION 237]

Section 237 (1) states that when the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order.

Continuation of legal proceedings Section 237 (2) states that the order under Sub-Section (1) may also provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

Interest or rights of members, creditors, debenture holders not to be affected As per Section 237 (3), every member or creditor, including a debenture holder, of each of the transferor companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the transferee company as he had in the company of which he was originally a member or creditor, and in case the interest or rights of such member or creditor in or against the transferee company are less than his interest in or rights against the original company, he shall be entitled to compensation to that extent, which shall be assessed by such authority as may be prescribed and every such assessment shall be published in the Official Gazette, and the compensation so assessed shall be paid to the member or creditor concerned by the transferee company.

1.8.1 Appeal to tribunal

As per Section 237 (4) Any person aggrieved by any assessment of compensation made by the prescribed authority under Sub-Section (3) may, within a period of thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Tribunal and thereupon the assessment of the compensation shall be made by the Tribunal.

1.8.2 Conditions for order under Section 237

As per Section 237 (5) No order shall be made under this Section unless:

(a) a copy of the proposed order has been sent in draft to each of the companies concerned;

(b) the time for preferring an appeal under Sub-Section (4) has expired, or where any such appeal has been preferred, the appeal has been finally disposed off; and

(c) the Central Government has considered, and made such modifications, if any, in the draft order as it may deem fit in the light of suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof.

1.8.3 Copies of order to be laid before each house of parliament

As per Section 237 (6) the copies of every order made under this Section shall, as soon as may be after it has been made, be laid before each House of Parliament.

H : 1.9 REGISTRATION OF OFFER OF SCHEMES INVOLVING TRANSFER OF SHARES [SECTION 238]

Section 238 (1) states that 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 under Section 235:

(a) every circular containing such offer and recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information and in such manner as may be prescribed.

(b) 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, and

(c) every such circular shall be presented to the Registrar for registration and no such circular shall be issued until it is so registered: Provided that the Registrar may refuse, for reasons to be recorded in writing, to register any such circular which does not contain the information required to be given under clause (a) or which sets out such information in a manner likely to give a false impression, and communicate such refusal to the parties within thirty days of the application.

Section 238 (2) states that an appeal shall lie to the Tribunal against an order of the Registrar refusing to register any circular under Sub-Section (1).

Section 238 (3) states that the director who issues a circular which has not been presented for registration and registered under clause (c) of Sub-Section (1), shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

H : 1.10 PRESERVATION OF BOOKS AND PAPERS OF AMALGAMATED COMPANIES [SECTION 239]

As per Section 239, the books and papers of a company which has been amalgamated with, or whose shares have been acquired by, another company under this Chapter shall not be disposed of without the prior permission of the Central Government and before granting such permission, that Government may appoint a person to examine the books and papers or any of them for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation, or the management of the affairs, of the transferor company or its amalgamation or the acquisition of its shares.

H : 1.11 LIABILITY OF OFFICERS IN RESPECT OF OFFENCES COMMITTED PRIOR TO MERGER, AMALGAMATION, ETC [SECTION 240]

As per Section 240, notwithstanding anything in any other law for the time being in force, the liability in respect of offences committed under this Act by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

Self Assessment Questions

(1) Explain the powers of the Tribunal to enforce comprise or arrangement under Section 231 of the Companies Act, 2013.

(2) Explain the meaning of the term 'Compromise'. What procedure should a company adopt to give effect a compromise, when such a company is a going concern?

(3) Explain the stepwise procedure for merger and amalgamation under the Companies Act, 2013.

(4) Explain the provisions under Section 236 of the Companies Act, 2013 as to purchase of minority share holding.

(5) Discuss the powers of Central Government to provide for amalgamation in the public interest.

(6) Write short notes on the following :

(a) Fast Track Merger and amalgamation under Section 233.

(b) Preservation of books and papers of amalgamated companies under Section 239 of the Companies Act, 2013.

(c) Merger or amalgamation of company with foreign company under Section 234 of the Companies Act, 2013.

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Study Note - 1

THE COMPANIES ACT, 2013

PART - I : PREVENTION OF OPPRESSION AND MISMANAGEMENT

This Study Note includes:

I : 1.1 Majority Rule but Minority Protection

I : 1.2 Prevention of Oppression and Mismanagement

Introduction

The concept of shareholders' democracy in the present day corporate world denotes the shareholders' supremacy in the governance of the business and affairs of corporate sector either directly or through their elected representatives. Democracy means the rule of people, by people and for people. In that context the shareholders democracy means the rule of shareholders, by the shareholders, and for the shareholders in the corporate enterprise, to which the shareholders belong. Precisely it is a right to speak, congregates and communicates with co-shareholders and to learn about what is going on in the company.

Under the Companies Act, the powers have been divided between two segments: one is the Board of Directors and the other is of shareholders. The directors exercise their powers through meetings of Board of directors and shareholders exercise their powers through General Meetings. Although constitutionally all the acts relating to the company can be performed in General Meetings but most of the powers in regard thereto are delegated to the Board of directors by virtue of the constitutional documents of the company viz. the Memorandum of Association and Articles of Association.

Under Section 179 of the Companies Act, 2013 a general power has been conferred on the Board of directors. The Section 179 (1) provides that 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, in exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting. Further that the Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting.

This Section further restricts the power of the Board of directors to do things which are specifically required to be done by shareholders in the General Meetings under the provisions of Companies Act or Memorandum of Association or the Articles of Association. Thus the Companies Act demarcates the area of control of directors as well as that of shareholders. All the business to be transacted at the meetings of shareholders is by means of an ordinary resolution or a special resolution.

I : 1.1 MAJORITY RULE BUT MINORITY PROTECTION

In the day-to-day working of a company, certain decisions need to be taken regarding the management of the company and these decisions are generally taken by the majority members. In this process of decision-making, there may arise certain occasions wherein the interests of the majority shareholders may come in conflict with that of the minority shareholders. In such a case, if the decisions taken, are not in the larger interest of the company as a whole, but only caters to the interest of one particular group, the minority group whose interest may have been violated can raise its voice against such an action.

The protection of minority shareholders within the domain of corporate activity constitutes one of the most difficult problems facing modern company law. The aim must be to strike a balance between the effective control of the company and the interest of the small individual shareholders.

Palmer has stated with respect to rights of shareholders:

"A proper balance of the rights of majority and minority shareholders is essential for the smooth functioning of the company."

It is only right to expect that in matters of a company, any decisions that are taken are done so in keeping with principles of natural justice and fair play. In case of failure to do so, it is important that the interest of minority shareholders be protected.

1.1.1 Powers of Majority

According to Section 47 of the Companies Act, 2013, every member of a company, which is limited by shares, holding any equity shares shall have a right to vote in respect of such capital on every resolution placed before the company. Member's right to vote is recognised as right of property and the shareholder may exercise it as he thinks fit according to his choice and interest. However, this rule is modified by the Act in certain cases. A special resolution, for instance, requires a majority of 3/4th of those voting at the meeting and therefore, where the Act or the Articles require a special resolution for any purpose, a three fourth majority is necessary and a simple majority is not enough [Edwards v. Halliwell, (1950) 2 All. E.R.1064]. The resolution of a majority of shareholders, passed at a duly convened and held general meeting, upon any question with which the company is legally competent to deal, is binding upon the minority and consequently upon the company [North-West Transportation Co. v. Beatty (1887) L.R. 12 A.C. 589].

Thus, the majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs. But this is subject to two very important limitations. Firstly, the powers of the majority of members is subject to the provisions of the Company's memorandum and articles of association. Secondly, the resolution of a majority must not be inconsistent with the provisions of the Act or any other statute, or constitute a fraud on minority depriving it of its legitimate rights.

1.1.2 The Principle of Non-interference (Rule in Foss v. Harbottle)

The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members the issue is decided by a vote of the majority. The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of Foss v. Harbottle 67 E.R. 189. (1843) 2 Hare 461 that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

1.1.3 Justification and Advantages of the Rule in Foss v. Harbottle

The justification for the rule laid down in Foss v. Harbottle is that the will of the majority prevails. On becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder.

Moreover, a company is a person at law and the action is vested in it and cannot be brought by a single shareholder. Where there is a corporate body capable of filing a suit for itself to recover property either from its directors or officers or from any other person then that corporate body is the proper plaintiff and the only proper plaintiff [Gray v. Lewis, (1873) 8 Ch. Appl. 1035].

The main advantages that flow from the Rule in Foss v. Harbottle are of a purely practical nature and are as follows:

1. Recognition of the separate legal personality of company**:** If a company has suffered some injury, and not the individual members, it is the company itself that should seek to redress.

2. Need to preserve right of majority to decide: The principle in Foss v. Harbottle preserves the right of majority to decide how the affairs of the company shall be conducted. It is fair that the wishes of the majority should prevail.

3. Multiplicity of futile suits avoided**:** Clearly, if every individual member were permitted to sue anyone who had injured the company through a breach of duty, there could be as many suits as there are shareholders. Legal proceedings would never cease, and there would be enormous wastage of time and money.

4. Litigation at suit of a minority futile if majority does not wish it: If the irregularity complained of is one which can be subsequently ratified by the majority it is futile to have litigation about it except with the consent of the majority in a general meeting.

1.1.4 Exceptions to the Rule in Foss v. Harbottle - Protection of Minority Rights and shareholders remedies

The rule in Foss v. Harbottle is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

(a) the common law. and

(b) the provisions of the Companies Act, 2013.

1.1.5 Actions by Shareholders in Common Law

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in Foss v. Harbottle and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases.

(a) **Ultra Vires Acts**

Where the directors representing the majority of shareholders perform an illegal or ultra vires act for the company, an individual shareholder has right to bring an action. The majority of shareholders have no right to confirm an illegal or ultra vires transaction of the company. In such case a shareholder has the right to restrain the company by an order or injunction of the court from carrying out an ultra vires act.

(b) **Fraud on Minority**

Where an act done by the majority amounts to a fraud on the minority. an action can be brought by an individual shareholder. This principle was laid down as an exception to the rule in Foss v. Harbottle in a number of cases. In Menier v. Hooper's Telegraph Works, (1874) L.R. 9 Ch. App. 350, it was observed that it would be a shocking thing if the majority of shareholders are allowed to put something into their pockets at the expenses of the minority. In this case, the majority of members of company 'A' were also members of company 'B', and at a meeting of company 'A' they passed a resolution to compromise an action against company 'B', in a manner alleged to be favourable to company 'B', but unfavourable to company 'A'. Held, the minority shareholders of company 'A' could bring an action to have the compromise set aside.

(c) **Wrongdoers in Control**

If the wrongdoers are in control of the company, the minority shareholders' representative action for fraud on the minority will be entertained by the court [Cf. Birch v. Sullivan, (1957) 1 W.L.R. 1274]. The reason for it is that if the minority shareholders are denied the right of action, their grievances in such case would never reach the court, for the wrongdoers themselves, being in control, will never allow the company to sue [Par Jenkins L.J. in Edwards v. Halliwell, (1950) 2 All E.R. 1064, 1067].

In Glass v. Atkin (1967) 65 D.L.R. (2d) 501, a company was controlled equally by the two defendants and the two plaintiff. The plaintiff brought an action against defendants alleging that they had fraudulently converted the assets of the company for their own private use. The Court allowed the action and observed. While the general principle was for the company itself to bring an action, where it had an interest, since the two defendants controlled the company in the sense that they would prevent the company from taking action.

(d) **Resolution requiring Special Majority but is passed by a simple majority**

A shareholder can sue if an act requires a special majority but is passed by a simple majority. Simple or rigid, formalities are to be observed if the majority wants to give validity to an act which purports to impede the interest of minority. An individual shareholder has the right of action to restrain the company from acting on a special resolution to which the insufficient notice is served [Baillie v. Oriental Telephone and Electric Co. Ltd., (1915) 1 Ch. 503 (C.A.) and Nagappa Chettiar v. Madras Race Club, 1 M.L.J. 662].

(e) **Personal Actions**

Individual membership rights cannot be invaded by the majority of shareholders. He is entitled to all the rights and privileges according to his status as a member. An individual shareholder can insist on the strict compliance with the legal rules, statutory provisions. Provisions in the memorandum and the articles are mandatory in nature and cannot be waived by a bare majority of shareholders [Salmon v. Quin and Aztens, (1909) A.C. 442]. In Nagappa Chettiar v. Madras Race Club, (1949) 1 M.L.J. 662 at 667, it was observed by the Court that 'An individual shareholder is entitled to enforce his individual rights against the company, such as, his right to vote, the right to have his vote recorded, or his right to stand as a director of a company at an election'.

Where the candidature of a shareholder for directorship is rejected by the Chairman, it is an individual wrong in respect of which a suit is maintainable [Joseph v. Jos, (1964) 1 Comp LJ 105].

(f) **Breach of Duty**

The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company.

In Daniels v. Daniels, (1978) 2 W.L.R. 73, the plaintiff, who were minority shareholders of a company, brought an action against the two directors of the company and the company itself. In their statement of the claim they alleged that the company, on the instruction of the two directors who were majority shareholders, sold the company's land to one of the directors (who was the wife of the other) for £ 4,250 and the directors knew or ought to have known that the sale was at an under value. Four years after the sale, she sold the same land for £ 1,20,000. The directors applied for the statement of claim to be disclosed on reasonable cause of action or otherwise as an abuse of the process of the Court.

(g) **Prevention of Oppression and Mismanagement**

The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement.

It should be noted that the ordinary civil courts are not deprived of the jurisdiction to decide the matters except where the Companies Act expressly excludes it such as matters relating to winding up [Panipat Woollen & General Mills Co. Ltd. v. R.L. Kaushik, (1969) 39 Com Cases 249 (Punj & Har)].

1.1.6 **Statutory Remedies under the Companies Act**

Though the shareholders' democracy is supreme, the Companies Act, 1956 & 2013 and the decided cases suggest that the majority shall not be allowed to act in an unfair, fraudulent, or oppressive way against the interests of the minority shareholders. Further, under Section 163 of the Companies Act, 2013 a company may adopt principle of proportional representation. The Companies Act, 2013, extends protection to minority by granting various rights to minority shareholders.

I : 1.2 PREVENTION OF OPPRESSION AND MISMANAGEMENT

Chapter XVI [Section 241 to 246] of the Companies Act, 2013 deals with Prevention of Oppression and Mismanagement. However, only Section 241, 242[except clause (b) of sub-section (1), clause (c) & (g) of sub-section (2)], 243, 244 and 245 has come into force with effect from 1st June, 2016 vide Notification No. S.O.1934(E).

As explained in the preceding topic that one of the exceptions to the majority rule laid down in Foss v. Harbottle is the right of the oppressed minority to get relief against the wrongful conduct of the majority. This protection to the oppressed minority is also statutorily provided under Sections 241 and 242 of the Companies Act, 2013. This statutory protection for prevention of oppression and mismanagement is an alternative remedy for winding up of the affairs of the company. The reason is that the oppressed minority may file application with the NCLT to wind up the company. However, the company may be a sound and profitable concern.

1.2.1 Meaning of Oppression

The words 'Oppression' and 'mismanagement' are not defined in the Act. The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense.

The meaning of the term 'oppression' as explained by Lord Cooper in the Scottish case of Elder v. elder & Western Ltd. [(1952) Scottish Cases 49], which has been cited with approval by Wanchoo. J (afterwards C.J.) of the Supreme Court in Shanti Prasad v. Kalinga Tubes [(1965) 1 Comp L.J. 193 at 204], is as under:

'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 fair dealing, on which every shareholders 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. [Lord Simonds in Scottish Co-operative Wholesale Society v. Meyer (1959) AC 324 at p. 342] 'A persistent course of unjust conduct must be shown' [In Re. H.R. Harmer Ltd . [(1958) 3 All ER 689]]. 'The result of application under Section 210 of English Companies Act, 1948, in different cases must depend on the particular facts of each case, the circumstances in which oppression may arise being infinitely various that it is impossible to define them with precision.'

An attempt to force new and more risky objects upon an unwilling minority may in circumstances amount to oppression. This was held in Re. Hindustan Co-operative Insurance Society Ltd, [AIR. 1961 Cal. 443] wherein the life Insurance business of a company was acquired in 1956 by the Life Insurance Corporation of India on payment of compensation. The directors, who had the majority voting power, refused to distribute this amount among shareholders, rather they passed a special resolution changing the objects of the company to utilize the compensation money for the new objects, and this was held to be 'Oppression'. The court observed: 'The majority exercised their authority wrongfully, in a manner burdensome, harsh and wrongful. They attempted to force the minority shareholders to invest their money in different kind of business against their will. The minority had invested their money in a life insurance business with all its safeguards and statutory protections. But they were being forced to invest where there would be no such protections or safeguards.'

1.2.2 Application to Tribunal for relief in cases of oppression, etc (Section 241).

Section 241 of the Act provides the relief in case of oppression and mismanagement. Further, the Central Government may also file application to the Tribunal, if it is satisfied that the affairs of the company are being conducted in a manner prejudicial to the public interest. According to this Section:

(a) Any member of a company who complains that:

(1) the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company, or

(2) the 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 or control of the company, whether by an alteration in the 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, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members, may apply to the Tribunal, provided such member has a right

to apply under Section 244, for an order under this Chapter.

(b) The Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order under this Chapter.

1.2.3 Powers of Tribunal (Section 242)

Section 242 of the Act deals with the Powers of the Tribunal. This Section provides more powers to the Tribunal for the purpose of bringing to an end the oppression or mismanagement in a company.

Under Section 242 (2) (k) of the Act the Tribunal may appoint such number of persons as directors, who may be required to report to the Tribunal on such matters as the Tribunal may direct. There are no overriding provisions governing this appointment.

According to this Section:

(a) If, on any application made under Section 241, the Tribunal is of the opinion:

(1) that the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company, and

(2) 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 Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

(b) Without prejudice to the generality of the powers under Sub-Section (1), an order under that Sub-Section may provide for:

(1) the regulation of conduct of affairs of the company in future.

(2) the purchase of shares or interests of any members of the company by other members thereof or by the company.

(3) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital.

(4) restrictions on the transfer or allotment of the shares of the company.

(5) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case.

(6) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (5):

Provided that no such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned.

(7) 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 this Section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference.

(8) removal of the managing director, manager or any of the directors of the company.

(9) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims.

(10) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (8).

(11) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct.

(12) imposition of costs as may be deemed fit by the Tribunal.

(13) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.

(c) Further, Sub-Section (1) provides that, a certified copy of the order of the Tribunal shall be filed by the company with the Registrar within thirty days of the order of the Tribunal. [Sub-Section 3]

(d) The Tribunal may, on the application of any party to the proceeding, 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. [Sub-Section 4]

(e) Where an order of the Tribunal under Sub-Section (1) makes any alteration in the memorandum or articles of a company, then, notwithstanding any other provision of this Act, the company shall not have power, except to the extent, if any, permitted in the order, to make, without the leave of the Tribunal, any alteration whatsoever which is inconsistent with the order, either in the memorandum or in the articles. [Sub-Section 5]

(f) Subject to the provisions of Sub-Section (1), the alterations made by the order in the memorandum or articles of a company shall, in all respects, have the same effect as if they had been duly made by the company in accordance with the provisions of this Act and the said provisions shall apply accordingly to the memorandum or articles so altered. [Sub-Section 6]

(g) A certified copy of every order altering, or giving leave to alter, a company's memorandum or articles, shall within thirty days after the making thereof, be filed by the company with the Registrar who shall register the same. [Sub-Section 7]

(h) If a company contravenes the provisions of Sub-Section (5), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both. [Sub-Section 8]

1.2.4 Consequence of termination or modification of certain agreements (Section 243)

This Section deals with the situations arising out of termination/modification of certain agreements. According to this Section:

(a) Where an order made under Section 242 terminates, sets aside or modifies an agreement such as is referred to in Sub-Section (2) of that Section:

(1) such order shall not give rise to any claims whatever against the company by any person for damages or for compensation for loss of office or in any other respect either in pursuance of the agreement or otherwise;

(2) no managing director or other director or manager whose agreement is so terminated or set aside shall, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal, be appointed, or act, as the managing director or other director or manager of the company:

Provided that the Tribunal shall not grant leave under this clause unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given a reasonable opportunity of being heard in the matter.

(b) Any person who knowingly acts as a managing director or other director or manager of a company

in contravention of clause (b) of Sub-Section (1), and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five lakh rupees, or with both.

1.2.5 Right to apply (Section 244)

Under this Section members shall have right to apply under Section 241 of the Act. Accordingly:

(a) The following members of a company shall have the right to apply under Section 241, namely:

(1) in the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(2) in the case of a company not having a share capital, not less than one-fifth of the total number of its members:

Provided that the Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b) so as to enable the members to apply under Section 241.

Explanation: For the purposes of this Sub-Section, where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

(b) Where any members of a company are entitled to make an application under 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.

1.2.6 Class action (Section 245)

The conception of Class Action Suit is one of the many improvements introduced in the Companies Act, 2013 under Section 245. It is relevant to mention here that, the 'class action' suit first time came to the highlight in the context of securities market was when the Satyam scam broke out in year of 2009. According to this Section:

(a) Such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in Sub-Section (2) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders, namely:

(1) to restrain the company from committing an act which is ultra vires the articles or memorandum of the company.

(2) to restrain the company from committing breach of any provision of the company's memorandum or articles.

(3) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors.

(4) to restrain the company and its directors from acting on such resolution.

(5) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force.

(6) to restrain the company from taking action contrary to any resolution passed by the members.

(7) to claim damages or compensation or demand any other suitable action from or against:

a) the company or its directors for any fraudulent, unlawful or wrongful act or omission or

conduct or any likely act or omission or conduct on its or their part.

b) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct, or

c) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part.

(8) to seek any other remedy as the Tribunal may deem fit.

(b) Where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.

(c) The requisite number of members provided in Sub-Section (1) shall be as under:

(1) in the case of a company having a share capital, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares.

(2) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.

(3) The requisite number of depositors provided in Sub-Section (1) shall not be less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever less or any depositor is or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

(d) In considering an application under Sub-Section (1), the Tribunal shall take into account, in particular:

(1) whether the member or depositor is acting in good faith in making the application for seeking an order.

(2) any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a) to (f) of Sub-Section (1).

(3) whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this Section.

(4) any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this Section.

(5) where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be:

a) authorised by the company before it occurs. or

b) ratified by the company after it occurs.

(6) where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.

(e) If an application filed under Sub-Section (1) is admitted, then the Tribunal shall have regard to the following, namely:

(1) public notice shall be served on admission of the application to all the members or depositors of the class in such manner as may be prescribed.

(2) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant's side.

(3) two class action applications for the same cause of action shall not be allowed.

(4) the cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

(f) Any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company.

(g) Any company which fails to comply with an order passed by the Tribunal under this Section shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

(h) Where any application filed before the Tribunal is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, reject the application and make an order that the applicant shall pay to the opposite party such cost, not exceeding one lakh rupees, as may be specified in the order.

(i) Nothing contained in this Section shall apply to a banking company.

(j) Subject to the compliance of this Section, an application may be filed or any other action may be taken under this Section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in Sub-Section (1).

1.2.7 Application of certain provisions to proceedings under Section 241 or Section 245 (Section 246).

In terms of the Section 246, the provisions of Sections 337 to 341 (both inclusive) shall apply 'mutatis mutandis', in relation to an application made to the Tribunal under Section 241 or Section 245.

Self Assessment Questions

(1) Discuss the rule in Foss v. Harbottle.

(2) Discuss the majority rule and minority rights. State the remedies available to minority shareholders.

(3) Briefly state the 'rule of majority' and its exceptions.

(4) What are the powers of the NCLT to prevent Oppression and Mismanagement? Under what circumstances these powers can be exercised?

(5) The conception of Class Action Suit is one of the many improvements introduced in the Companies Act, 2013 under Section 245. Discuss.

(6) What are the powers of Central Government to prevent Oppression and Mismanagement?

(7) State the procedure for applying to NCLT regarding prevention of oppression and mismanagement.

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STUDY NOTE : 1

THE COMPANIES ACT, 2013

PART – J : REVIVAL AND REHABILITATION OF SICK INDUSTRIAL COMPANIES

This Study Note Includes:

J : 1.1	Determination of sickness
J : 1.2	Application for revival and rehabilitation
J : 1.3	Exclusion of certain time in computing period of limitation
J : 1.4	Appointment of interim administrator
J : 1.5	Committee of creditors
J : 1.6	Order of Tribunal
J : 1.7	Appointment of administrator
J : 1.8	Powers and duties of company administrator
J : 1.9	Scheme of revival and rehabilitation
J : 1.10	Sanction of scheme
J : 1.11	Scheme to be binding
J : 1.12	Implementation of scheme
J : 1.13	Winding up of company on report of company administrator

These provisions are no longer applicable. Students are advised to follow the Insolvency & Bankruptcy Code, 2016, in Annexure - I.

STUDY NOTE : 1

THE COMPANIES ACT, 2013

PART – K : CORPORATE WINDING UP AND DISSOLUTION

This Study Note Includes:

K : 1.1 Modes of Winding Up
K : 1.2 Winding up by the Tribunal
K : 1.3 Voluntary Winding Up
K : 1.4 Provisions applicable to every mode of winding up
K : 1.5 Official Liquidators

Chapter XX of the Companies Act, 2013 deals with Corporate Winding-Up. Under this Chapter, Part -I deals with Winding-Up by the Tribunal; Part-II deals with Voluntary Winding-Up; Part-III contains the provisions applicable to every mode of winding up and Part- IV deals with Official Liquidators.

CORPORATE WINDING UP AND DISSOLUTION

The Companies Act, 2013, provides various strategies to deal with such business failures such as arrangement, reconstruction, amalgamation and winding-up. Winding-up of a company is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such dissolution its assets are collected, its debts are paid off out of the assets of the company or from contributions by its members, if necessary. If any surplus is left, it is distributed among the members in accordance with their rights.

Winding up of a company is the stage, whereby the company takes its last breath. It is a process by which business of the company is wound up, and the company ceases to exist anymore. All the assets of the company are sold, and the proceedings collected are used to discharge the liabilities on a priority basis.

Winding-up is the process by which management of a company's affairs is taken out of its directors' hands, its assets are realized by a liquidator and its debts are realized and liabilities are discharged out of proceeds of realization and any surplus of assets remaining is returned to its members or shareholders. At the end of the winding up the company will have no assets or liabilities and it 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.

The main purpose of winding up of a company is to realize the assets and pay the debts of the company expeditiously and fairly in accordance with the law. However, the purpose must not be exploited for the benefit or advantage of any class or person entitled to submit petition for winding up of a company. It may be noted that on winding up, the company does not cease to exist as such except when it is dissolved. The administrative machinery of the company gets changed as the administration is transferred in the hands of the liquidator. Even after commencement of the winding-up, the property and assets of the company belong to the company until dissolution takes place. On dissolution the company ceases to exist as a separate entity and becomes incapable of keeping property, suing or being sued. Thus in between the winding up and dissolution, the legal status of the company continues and it can be sued in the court of law.

Chapter XX Sections 270 to 365 of the Companies Act, 2013 deals with the provisions of winding up.

K : 1.1 MODES OF WINDING UP (SECTION 270)

Under Companies Act 2013, the Company may be wound up in any of the following modes:

(a) By National Company Law Tribunal (the Tribunal).

(b) Voluntary winding up

K : 1.2 WINDING UP BY THE TRIBUNAL (SECTIONS 271 TO 303)

1.2.1 Circumstances in which company may be wound up by Tribunal (Section 271)

Grounds on which a Company may be wound up by the Tribunal A company under Section 271(1) may be wound up by the tribunal if:

(a) if the company is unable to pay its debts.

(b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal.

(c) 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.

(d) if the Tribunal has ordered the winding up of the company under Chapter XIX(i.e., Revival and Rehabilitation of Sick Companies).

(e) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.

(f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years, or

(g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

1.2.2 Inability to pay debts (Section 271(2)

A company shall be deemed to be unable to pay its debts:

(a) if a creditor, by assignment or otherwise, to whom the company is indebted for an amount exceeding one lakh rupees then due, has served on the company, by causing it to be delivered at its registered office, by registered post or otherwise, a demand requiring the company to pay the amount so due and the company has failed to pay the sum within twenty one days after the receipt of such demand or to provide adequate security or re-structure or compound the debt to the reasonable satisfaction of the creditor.

(b) if any execution or other process issued on a decree or order of any court or tribunal in favour of a creditor of the company is returned unsatisfied in whole or in part, or

(c) if it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the company.

Case Law :

In Shakti Agencies v. Manshuk Bhai Industries Ltd. [(2007), 74 SCL 332 (RAJ), decided on 14.8.2006, Petitioner firm filed a winding up petition against the respondent company for the recovery of a debt which was disputed by the respondent company. The Petition was dismissed.

The instant case was of bona fide disputed debt. Even from the petition for winding up, it was evident that for the payment of ` 10,50,000, the petitioner firm agreed to purchase shares of the respondent company. In the additional affidavit filed by the respondent company, it was stated that application form was signed by the proprietor of petitioner with a sole view to settle the outstanding account pursuant to which the respondent proceeded to allot 70,000 shares to the petitioner and the certificates were dispatched, which were received by the representative of petitioner. The respondent disputed the debt and it could

not be held that it neglected to pay the debt. The winding up petition is not a legitimate means of seeking to enforce payment of debt, which is bona fide disputed by the company. The principles, on which the Court should act is disposing of winding up petition, may be deduced thus:

(i) if the debt is not disputed on some substantial ground, the Court may make the order.

(ii) if the debt is bona fide dispatched, there cannot be 'neglect to pay' and petition for winding up is not maintainable.

(iii) dispute with regard to payment of interest is not a bona fide dispute.

(iv) the defense of respondent company should be in good faith, one of substance and likely to succeed in point of law.

1.2.3 Petition for winding up (Section 272)

An application for the winding up of a company has to be made by way of petition to the Court. A petition may be presented under Section 272 by any of the following persons:

(a) the company, or

(b) any creditor or creditors, including any contingent or prospective creditor or creditors.

(c) any contributory or contributories.

(d) all or any of the parties specified above in clauses (a), (b), (c) together

(e) the Registrar.

(f) any person authorized by the Central Government in that behalf.

(g) by the Central Government or State Government in case falling under clause (c) of Section 271 (1) i.e., Company acing against the interest of the sovereignty and integrity of India.

1.2.3.1 Petition by the Company

The company may make a petition through its directors with the authority of a special resolution passed at a general meeting. A petition by the Company for winding up before the tribunal will be admitted only it is accompanied by the statement of affairs, prescribed in form 4 and shall state the facts upto the date which shall not be a date more than fifteen days prior to the date of making the statement. This statement shall be certified by a Chartered Accountant. (Section 272 (5) read with Rule 5 made under Chapter XX of the Companies Act 2013.

Every contributory or creditor of the company shall be entitled to be furnished, by the petitioner or his authorized representative, with a copy of a petition. The contributory may seek an electronic copy from the registry of tribunal on payment of prescribed fee. (Rule 5 (4) of the rules made under Chapter XX of the Companies Act, 201.

1.2.3.2 Petition by Creditor

A creditor or creditors (including any contingent or prospective creditor) may make petition before the tribunal would make a winding up order on such petition if the creditor proves that the claims are undisputed debt.

(a) Contingent or prospective Creditor

Section 272(6) states that before a petition for winding up of a company presented by a contingent or prospective creditor is admitted, the leave of the Tribunal shall be obtained for the admission of the petition and such leave shall not be granted, unless in the opinion of the Tribunal there is a prima facie case for the winding up of the company and until such security for costs has been given as the Tribunal thinks reasonable.

(b) Creditor

The expression 'creditors' includes the assignee of debt, a decree holder, a secured creditor, a debenture holder or the trustee for debenture holders. But a creditor whose debt is unliquidated cannot apply for Corporate Restructuring & Insolvency winding up order. A contingent or prospective creditor can present petition on giving security for costs and showing that a prima facie case has arisen. A petition by a secured creditor for winding up may not be allowed by the Court where the security is ample and the petition is not supported by the other creditors.

In the case of State of Andhra Pradesh V Hyderabad Vegetable Products Co Ltd (1962) 32 Comp. Cases 64 (AP), the term creditor as occurring in Section 439 (1) (b) of the 1956 Act (Presently Section 27 2(1) (b) is not limited to one to whom a debt is due at the date of the petition and who can demand immediate payment. Every person having a pecuniary claim, whether actual or contingent is a creditor. As per Section 272 (2), a secured creditor, the holder of any debentures, whether or not any trustee or trustees have been appointed in respect of such and other like debentures, and the trustee for the holders of debentures shall be deemed to be creditors.

1.2.3.3 Petition by Contributory

Section 2 (26) defines 'contributory' means a person liable to contribute towards the assets of the company in the event of its being wound up. For the purposes of this clause, it is hereby clarified that a person holding fully paid-up shares in a company shall be considered as a contributory but shall have no liabilities of a contributory under the Act whilst retaining rights of such a contributory.

Section 273 (2) states that a contributory shall be entitled to present a petition for the winding up of a company, notwithstanding that he may be the holder of fully paid-up shares, or that the company may have no assets at all or may have no surplus assets left for distribution among the shareholders after the satisfaction of its liabilities, and shares in respect of which he is a contributory or some of them were either originally allotted to him or have been held by him, and registered in his name, for at least six months during the eighteen months immediately before the commencement of the winding up or have devolved on him through the death of a former holder.

1.2.3.4 Petition by Registrar

(a) The Registrar shall be entitled to present a petition for winding up under sub- Section (1) on any of the grounds specified in Sub-Section (1) of Section 271, except on the grounds specified in clause (b), clause (d) or clause (g) of that Sub-Section.

Accordingly the registrar can present a petition on the following grounds.

(1) if the company is unable to pay its debts.

(2) 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.

(3) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.

(4) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years.

The Registrar shall not present a petition on the ground that the company is unable to pay its debts unless it appears to him either from the financial condition of the company as disclosed in its balance sheet or from the report of an inspector appointed under Section 210 that the

company is unable to pay its debts:

The Registrar shall obtain the previous sanction of the Central Government to the presentation of a petition: The Central Government shall not accord its sanction unless the company has been given a reasonable opportunity of making representations.

(b) Filing a copy of petition with the registrar

A copy of the petition made under this Section shall also be filed with the Registrar and the Registrar shall, without prejudice to any other provisions, submit his views to the Tribunal within sixty days of receipt of such petition.

(c) Powers of Tribunal on receipt of petition

According to Section 273, the Tribunal may, on receipt of a petition for winding up under Section 272 pass any of the following orders, namely:

(a) dismiss it, with or without costs.

(b) make any interim order as it thinks fit.

(c) appoint a provisional liquidator of the company till the making of a winding up order.

(d) make an order for the winding up of the company with or without costs, or

(e) any other order as it thinks fit:

An order under this Sub-Section shall be made within ninety days from the date of presentation of the petition.

Before appointing a provisional liquidator under clause (c), the Tribunal shall give notice to the company and afford a reasonable opportunity to it to make its representations, if any, unless for special reasons to be recorded in writing, the Tribunal thinks fit to dispense with such notice.

The Tribunal shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged for an amount equal to or in excess of those assets, or that the company has no assets.

Section 273 (2) states that if a 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 the other remedy.

(d) Directions for statement of affairs if the petition is filed by a person other than a company (Section 274)

Accordingly to Section 274(1) read with the rules made under Chapter XX, when a petition for winding up is filed before the Tribunal by any person other than the company, the Tribunal shall, if satisfied that a prima facie case for winding up of the company is made out, by an order direct the company to file its objections along with a statement of its affairs within thirty days of the order in the prescribed form. The Tribunal may allow a further period of thirty days in a situation of contingency or special circumstances:

Section 274(2) states that a company, which fails to file the statement of affairs as referred to in Sub-Section (1), shall forfeit the right to oppose the petition and such directors and officers of the company as found responsible for such non-compliance, shall be liable for punishment under Sub-Section (4). As per Section 274(4), if any director or officer of the company contravenes the provisions of this Section, the director or the officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

Section 274 (3) read with Rules 7 (2) of Rules made under Chapter XX, states that the directors and other officers of the company, in respect of which an order for winding up is passed by the Tribunal under clause (d) of Sub-Section (1) of Section 273 (i.e., make an order for the winding up of the company with or without costs) shall, within a period of thirty days of such order, submit, at the cost of the company, the books of account of the company completed and audited up to the date of the order, to such liquidator and in the manner specified by the Tribunal.

Section 274 (5) states that the complaint may be filed in this behalf before the Special Court by Registrar, provisional liquidator, Company Liquidator or any person authorised by the Tribunal.

(e) Appointment of Company Liquidators (Section 275)

Section 275(1) States that, for the purposes of winding up of a company by the Tribunal, the Tribunal at the time of the passing of the order of winding up, shall appoint an Official Liquidator or a liquidator from the panel maintained under Sub-Section (2) as the Company Liquidator.

Section 275 (2) states that the provisional liquidator or the Company Liquidator, as the case may be, shall be appointed from a panel maintained by the Central Government consisting of the names of Chartered Accountants, Advocates, Company Secretaries, Cost Accountants or firms or bodies corporate having such Chartered Accountants, Advocates, Company Secretaries, Cost Accountants and such other professionals as may be notified by the Central Government or from a firm or a body corporate of persons having a combination of such professionals as may be prescribed and having at least ten years' experience in company matters.

Section 275 (3) states that if a provisional liquidator is appointed by the Tribunal, the Tribunal may limit and restrict his powers by the order appointing him or it or by a subsequent order, but otherwise he shall have the same powers as a liquidator.

Section 275 (4) enables the Central Government may remove the name of any person or firm or body corporate from the panel maintained under Sub-Section (2) on the grounds of misconduct, fraud, misfeasance, breach of duties or professional incompetence. However, the Central Government before removing him or it from the panel shall give him or it a reasonable opportunity of being heard.

As per Section 275 (5) the terms and conditions of appointment of a provisional liquidator or Company Liquidator and the fee payable to him or it shall be specified by the Tribunal on the basis of task required to be performed, experience, qualification of such liquidator and size of the company.

As per Section 275 (6) On appointment as provisional liquidator or Company Liquidator, as the case may be, such liquidator shall file a declaration within seven days from the date of appointment in the prescribed form disclosing conflict of interest or lack of independence in respect of his appointment, if any, with the Tribunal and such obligation shall continue throughout the term of his appointment. As per Section 275 (7) while passing a winding up order, the Tribunal may appoint a provisional liquidator, if any, appointed under clause (c) of Sub-Section (1) of Section 273, as the Company Liquidator for the conduct of the proceedings for the winding up of the company.

(f) Removal and replacement of liquidator (Section 276)

As per Section 276(1) The Tribunal may, on a reasonable cause being shown and for reasons to be recorded in writing, remove the provisional liquidator or the Company Liquidator, as the case may be, as liquidator of the company on any of the following grounds, namely:

(a) misconduct.

(b) fraud or misfeasance.

(c) professional incompetence or failure to exercise due care and diligence in performance of the powers and functions.

(d) inability to act as provisional liquidator or as the case may be,

(e) Liquidator.

(f) conflict of interest or lack of independence during the term of his appointment that would justify removal.

As per Section 276(2) in the event of death, resignation or removal of the provisional liquidator or as the case may be, Company

Liquidator, the Tribunal may transfer the work assigned to him or it to another Company Liquidator for reasons to be recorded in writing. As per Section 276 (3) if the Tribunal is of the opinion that any liquidator is responsible for causing any loss or damage to the company due to fraud or misfeasance or failure to exercise due care and diligence in the performance of his or its powers and functions, the Tribunal may recover or cause to be recovered such loss or damage from the liquidator and pass such other orders as it may think fit.

As per Section 276(4) The Tribunal shall, before passing any order under this Section, provide a reasonable opportunity of being heard to the provisional liquidator or, as the case may be, Company Liquidator. Order of winding up/order of appointment of liquidator to be communicated to the company liquidator and the registrar.

(g) Intimation to Company Liquidator, provisional liquidator and Registrar (Section 277)

Section 277(1) states that Where the Tribunal makes an order for appointment of provisional liquidator or for the winding up of a company, it shall, within a period not exceeding seven days from the date of passing of the order, cause intimation thereof to be sent to the Company Liquidator or provisional liquidator, as the case may be, and the Registrar.

(h) Advertisement of Winding up order

As per Rule 7(3) of winding up rules 2013,

(a) At the time of making the winding-up order, or at any time thereafter, the Tribunal shall give directions as to the advertisement of the order and the persons, if any, on whom the order shall be served and the persons, if any, to whom notice shall be given of the further proceedings in the liquidation, and such further directions as may be necessary.

(b) Save as otherwise ordered by the Tribunal, every order for the winding up of a company by the Tribunal, shall within fourteen days of the date of making the order, be advertised by the petitioner in English and Vernacular language in one issue of a newspaper in the English language and a newspaper in the principal regional language respectively circulating in the State or the Union Territory concerned and shall be served by the petitioner upon such person, if any, and in such manner as the Tribunal may direct including publication on the website of the Tribunal if any or MCA 21 portal.

(i) Registrar's action on receipt of order of winding up or order appointing company liquidator

Section 277(2) states that On receipt of the copy of order of appointment of provisional liquidator or winding up order, the Registrar shall make an endorsement to that effect in his records relating to the company and notify in the Official Gazette that such an order has been made and in the case of a listed company, the Registrar shall intimate about such appointment or order, as the case may be, to the stock exchange or exchanges where the securities of the company are listed.

(j) Winding up order shall be deemed to be a notice

Section 277(3) states that the winding up order shall be deemed to be a notice of discharge to the officers, employees and workmen of the company, except when the business of the company is

continued.

(k) Constitution of winding up committee

Section 277(4) states that within three weeks from the date of passing of winding up order, the Company Liquidator shall make an application to the Tribunal for constitution of a winding up committee to assist and monitor the progress of liquidation proceedings by the Company Liquidator in carrying out the function as provided in Sub-Section (5) and such winding up committee shall comprise of the following persons, namely:

(a) Official Liquidator attached to the Tribunal.

(b) nominee of secured creditors. and

(c) a professional nominated by the Tribunal.

(l) Functions of winding up committee

Section 277(5) states that the Company Liquidator shall be the convener of the meetings of the winding up committee which shall assist and monitor the liquidation proceedings in following areas of liquidation functions, namely:

(a) taking over assets.

(b) examination of the statement of affairs.

(c) recovery of property, cash or any other assets of the company including

(d) benefits derived therefrom.

(e) review of audit reports and accounts of the company.

(f) sale of assets.

(g) finalization of list of creditors and contributories.

(h) compromise, abandonment and settlement of claims.

(i) payment of dividends, if any. and

(j) any other function, as the Tribunal may direct from time to time.

(m) Report and minutes of the meeting of the winding up committee

As per Section 277 (6) the Company Liquidator shall place before the Tribunal a report along with minutes of the meetings of the committee on monthly basis duly signed by the members present in the meeting for consideration till the final report for dissolution of the company is submitted before the Tribunal.

As per 277 (7), the Company Liquidator shall prepare the draft final report for consideration and approval of the winding up committee. As per 277 (8), the final report so approved by the winding up committee shall be submitted by the Company Liquidator before the Tribunal for passing of a dissolution order in respect of the company.

(n) Effect of Winding up order (Section 278)

Section 278 states that the order for the winding up of a company shall operate in favour of all the creditors and all contributories of the company as if it had been made out on the joint petition of creditors and contributories.

(o) Stay of suits, etc., on winding up order (Section 279)

As per Section 279 (1) when a winding up order has been passed or a provisional liquidator has been appointed, no suit or other legal proceeding shall be commenced, or if pending at the date of the

winding up order, shall be proceeded with, by or against the company, except with the leave of the Tribunal and subject to such terms as the Tribunal may impose. Any application to the Tribunal seeking leave under this Section shall be disposed of by the Tribunal within sixty days. Section 279 (2) states that nothing in Sub-Section (1) shall apply to any proceeding pending in appeal before the Supreme Court or a High Court.

(p) Jurisdiction of Tribunal (Section 280)

As per Section 280, The Tribunal 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 233.

(d) any scheme submitted under Section 262.

(e) any question of priorities or any other question whatsoever, whether of law or facts, including those relating to assets, business, actions, rights, entitlements, privileges, benefits, duties, responsibilities, obligations or in any matter arising out of, or in relation to 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 or such scheme has been submitted, or is submitted, before or after the order for the winding up of the company is made.

Case Law:

1. In GTC Industries Ltd. v. Parasrampuria Trading (1999) 34 CLA 380 (All HC), it was held that only High Court where the registered office is situated has jurisdiction in winding up, even if there was agreement between parties that dispute between parties will be resolved before High Court where registered office is not situated. Regardless of where agreement is executed, Company Court having jurisdiction over the place where the registered office is situated, will have the jurisdiction to entertain a petition for winding up.

2. LKP Merchant Financing v. Arwin Liquid Gases (2001) 103 Comp. Cas. 211 (Guj.). For the purposes of jurisdiction to wind up companies, the expression 'Registered Office' means the place which has longest been the registered office of the company during the six months immediately preceding the presentation of the petition for winding up.

3. In Kalpana Trading v. N.C.L. Industries Ltd. [(1996) 1 Comp. LJ 152], the Orissa High Court refused to entertain the petition for winding up as the Company had its place of Registered Office at Hyderabad.

(q) Submission of report by Company liquidator (Section 281)

Section 281 (1) states that when the Tribunal has made a winding up order or appointed a Company Liquidator, such liquidator shall, within sixty days from the order, submit to the Tribunal, a report containing the following particulars, namely:

(a) the nature and details of the assets of the company including their location and value, stating separately the cash balance in hand and in the bank, if any, and the negotiable securities, if any, held by the company. The valuation of the assets shall be obtained from registered valuers for this purpose.

(b) amount of capital issued, subscribed and paid-up.

(c) the existing and contingent liabilities of the company including names, addresses and occupations of its creditors, stating separately the amount of secured and unsecured debts, and in the case of

secured debts, particulars of the securities given, whether by the company or an officer thereof, their value and the dates on which they were given.

(d) the debts due to the company and the names, addresses and occupations of the persons from whom they are due and the amount likely to be realized on account thereof.

(e) guarantees, if any, extended by the company.

(f) list of contributories and dues, if any, payable by them and details of any unpaid call.

(g) details of trademarks and intellectual properties, if any, owned by the company.

(h) details of subsisting contracts, joint ventures and collaborations, if any.

(i) details of holding and subsidiary companies, if any.

(j) details of legal cases filed by or against the company. and

(k) any other information which the Tribunal may direct or the company Liquidator may consider necessary to include.

Section 281 (2) states that the Company Liquidator shall include in his report the manner in which the company was promoted or formed and whether in his opinion any fraud has been committed by any person in its promotion or formation or by any officer of the company in relation to the company since the formation thereof and any other matters which, in his opinion, it is desirable to bring to the notice of the Tribunal.

As per Section 281 (3) , the Company Liquidator shall also make a report on the viability of the business of the company or the steps which, in his opinion, are necessary for maximising the value of the assets of the company.

As per Section 281 (4), the Company Liquidator may also, if he thinks fit, make any further report or reports.

As per Section 281 (5), any person describing himself in writing to be a creditor or a contributory of the company shall be entitled by himself or by his agent at all reasonable times to inspect the report submitted in accordance with this Section and take copies thereof or extracts there from on payment of the prescribed fees.

(r) Directions of Tribunal on report of Company Liquidator (Section 282)

Section 282 (1) states that the Tribunal shall, on consideration of the report of the Company Liquidator, fix a time limit within which the entire proceedings shall be completed and the company be dissolved.

The Tribunal may, if it is of the opinion, at any stage of the proceedings, or on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, that it will not be advantageous or economical to continue the proceedings, revise the time limit within which the entire proceedings shall be completed and the company be dissolved.

Section 282 (2) states that the Tribunal may, on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, order sale of the company as a going concern or its assets or part thereof. The Tribunal may, where it considers fit, appoint a sale committee comprising such creditors, promoters and officers of the company as the Tribunal may decide to assist the Company Liquidator in sale under this Sub-Section.

Section 282 (3) states that when a report is received from the Company Liquidator or the Central Government or any person that a fraud has been committed in respect of the company, the Tribunal shall, without prejudice to the process of winding up, order for investigation under Section 210, and on consideration of the report of such investigation it may pass order and give directions under Sections

339 to 342 or direct the Company Liquidator to file a criminal complaint against persons who were involved in the commission of fraud.

Section 283 (4) states that the Tribunal may order for taking such steps and measures, as may be necessary, to protect, preserve or enhance the value of the assets of the company.

(s) Custody of Company's properties (Section 283)

According to Section 283 (1) when a winding up order has been made or where a provisional liquidator has been appointed, the Company Liquidator or the provisional liquidator, as the case may be, shall, on the order of the Tribunal, forthwith take into his or its custody or control all the property, effects and actionable claims to which the company is or appears to be entitled to and take such steps and measures, as may be necessary, to protect and preserve the properties of the company.

According Section 283 (2), all the property and effects of the company shall be deemed to be in the custody of the Tribunal from the date of the order for the winding up of the company, notwithstanding to anything contained in Sub-Section (1).

According to Section 283 (3) on an application by the Company Liquidator or otherwise, the Tribunal may, at any time after the making of a winding up order, require any contributory for the time being on the list of contributories, and any trustee, receiver, banker, agent, officer or other employee of the company, to pay, deliver, surrender or transfer forthwith, or within such time as the Tribunal directs, to the Company Liquidator, any money, property or books and papers in his custody or under his control to which the company is or appears to be entitled.

(t) Settlement of list of contributories and application of assets (Section 285)

(a) Section 285 (1) states that as soon as, may be after the passing of a winding up order by the Tribunal, the Tribunal shall settle a list of contributories, cause rectification of register of members in all cases where rectification is required in pursuance of this Act and shall cause the assets of the company to be applied for the discharge of its liability.

If it appears to the Tribunal that it would not be necessary to make calls on or adjust the rights of contributories, the Tribunal may dispense with the settlement of a list of contributories. Sub-Section(2) of Section 285, states that in settling the list of contributories, the Tribunal shall distinguish between those who are contributories in their own right and those who are contributories as being representatives of, or liable for the debts of, others.

Rule 10 of Companies (Winding up Rules) 2013 states that:

(1) For the purposes of Sub-Section (1) of Section 285, unless the Tribunal dispenses with the settlement of a list of contributories, the Company Liquidator shall prepare and file in the Tribunal not later than twenty one days after the date of the winding up order a provisional list of contributories in Form No. 18.

(2) The Company Liquidator shall obtain date from the Tribunal for settlement of the list of contributories and shall give notice of the date appointed to every person included in such list. Such notice shall be in Form No. 19, and shall be sent by Registered AD or other recognized modes of service as per Section 20 of the Act for acknowledgment to every person included in the list so as to reach him in the ordinary course of post not less than fourteen days before the date fixed for the settlement.

(3) An affidavit in Form No. 20 relating to the dispatch of notice, shall be filed in the Tribunal not later than two days before the date fixed for the settlement of the list.

(4) On the date appointed for the settlement of the list, the Tribunal shall hear any person who objects to being settled as a contributory or as a contributory in such character or for such

number of shares as is mentioned in the list, and after such hearing, shall finally settle the list in accordance with Sub-Section (1) of Section 285. The list when settled shall be certified by the Tribunal under its seal and shall be in Form No. 21.

(5) Upon the settlement of the list of contributories, the Company Liquidator shall forthwith give notice to every person placed on the list of contributories as finally settled, stating in what character and for what number of shares he has been placed on the list, what amount has been called up and what amount paid up in respect of such shares and in the notice he shall inform such person that any application for the removal of his name from the list or for a variation of the list, must be made to the Tribunal within fifteen days from the date of service on the contributory of such notice. Such notice shall be in Form No. 22, and shall be sent to each person settled on the list by Registered AD or other recognized modes of service as per Section 20 of the Act for acknowledgment at the address mentioned in the list as settled.

(6) In affidavit of service relating to the dispatch of the notices to the contributories under this Rule shall be filed in the Tribunal within seven days of the settlement of the list of contributories by the Tribunal. Such affidavit shall be in Form No. 23.

(b) Section 285 (2) states that in settling the list of contributories, the Tribunal shall distinguish between those who are contributories in their own right and those who are contributories as being representatives of, or liable for the debts of, others.

Section 285 (3) states that while settling the list of contributories, the Tribunal shall include every person, who is or has been a member, who shall be liable to contribute to the assets of the company an amount sufficient for payment of the debts and liabilities and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves, subject to the following conditions, namely:

(1) a person who has been a member shall not be liable to contribute if he has ceased to be a member for the preceding one year or more before the commencement of the winding up.

(2) a person who has been a member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member.

(3) no person who has been a member shall be liable to contribute unless it appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them in pursuance of this Act.

(4) in the case of a company limited by shares, no contribution shall be required from any person, who is or has been a member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as such member.

(5) in the case of a company limited by guarantee, no contribution shall be required from any person, who is or has been a member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up but if the company has a share capital, such member shall be liable to contribute to the extent of any sum unpaid on any shares held by him as if the company were a company limited by shares.

(u) Obligations of directors and managers (Section 286)

Any person who is or has been a director or manager, whose liability is unlimited under the provisions of this Act, shall, in addition to his liability, if any, to contribute as an ordinary member, be liable to make a further contribution as if he were at the commencement of winding up, a member of an unlimited company.

(v) Advisory Committee (Section 287)

Tribunal may direct constitution of advisory committee while passing winding up order:

(1) Section 287 (1) states that the Tribunal may, while passing an order of winding up of a company, direct that there shall be, an advisory committee to advise the Company Liquidator and to report to the Tribunal on such matters as the Tribunal may direct.

a) Members of Advisory committee

Section 287 (2) states that the advisory committee appointed by the Tribunal shall consist of not more than twelve members, being creditors and contributories of the company or such other persons in such proportion as the Tribunal may, keeping in view the circumstances of the company under liquidation, direct.

Meeting of creditors and contributories to identify the members of advisory committee

Section 287 (3) states that The Company Liquidator shall convene a meeting of creditors and contributories, as ascertained from the books and documents, of the company within thirty days from the date of order of winding up for enabling the Tribunal to determine the persons who may be members of the advisory committee.

Advisory Committee may inspect the books of account and other documents Section 287 (4) states that the advisory committee shall have the right to inspect the books of account and other documents, assets and properties of the company under liquidation at a reasonable time.

b) Procedure for convening the meeting

The provisions relating to the convening of the meetings, the procedure to be followed thereat and other matters relating to conduct of business by the advisory committee shall be such as may be prescribed.

(2) Rule 11 (6) of Companies (Winding up) Rules 2013 states the following procedure to be followed in this regard.

a) The advisory committee shall meet at such times as it may from time to time appoint and the Company liquidator or any member of the committee may also call a meeting of the committee as and when he thinks necessary.

b) The quorum for a meeting of the advisory committee shall be one third of the total number of the members, or two, whichever is higher.

c) The advisory committee may act by a majority of its members present at a meeting, but shall not act unless a quorum is present.

d) A member of the advisory committee may resign by notice in writing signed by him and delivered to the Company Liquidator.

e) If a member of the advisory 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.

f) A member of the advisory committee except the Official Liquidator or his nominee appointed as committee member 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.

Company Liquidator to chair the meeting of advisory committee.

Section 287 (6) states that the meeting of advisory committee shall be chaired by the Company Liquidator.

(w) Submission of periodic reports to the tribunal (Section 288)

Section 288 (1) requires the Company Liquidator to make periodical reports to the Tribunal and in any case make a report at the end of each quarter with respect to the progress of the winding up of the company in such form and manner as may be prescribed. Sub-Section (2) states that the Tribunal may, on an application by the Company Liquidator, review the orders made by it and make such modifications as it thinks fit.

(x) Power of Tribunal on application for stay of winding up (Section 289)

As per 289 (1), the Tribunal may, at any time after making a winding up order, on an application of promoter, shareholders or creditors or any other interested person, if satisfied, make an order that it is just and fair that an opportunity to revive and rehabilitate the company be provided staying the proceedings for such time but not exceeding one hundred and eighty days and on such terms and conditions as it thinks fit. An order under this Sub-Section shall be made by the Tribunal only when the application is accompanied with a scheme for rehabilitation.

As per Sub-Section (2) The Tribunal may, while passing the order under Sub-Section (1), require the applicant to furnish such security as to costs as it considers fit.

As per Sub-Section (3) if an order under Sub-Section (1) is passed by the Tribunal, the provisions of Chapter XIX shall be followed in respect of the consideration and sanction of the scheme of revival of the company.

As per Sub-Section (4) Without prejudice to the provisions of Sub-Section (1), the Tribunal may at any time after making a winding up order, on an application of the Company Liquidator, make an order staying the winding up proceedings or any part thereof, for such time and on such terms and conditions as it thinks fit.

As per Sub-Section (5) The Tribunal may, before making an order, under this Section, require the Company Liquidator to furnish to it a report with respect to any facts or matters which are in his opinion relevant to the application.

As per Sub-Section (6) a copy of every order made under this Section shall forthwith be forwarded by the Company Liquidator to the Registrar who shall make an endorsement of the order in his books and records relating to the company.

Rule 16 of Companies (Winding up) Rules 2013 states that the order by the tribunal staying winding up proceedings shall be filed with the Registrar of Companies within 15 days of passing such order.

(y) Powers and duties of company liquidator (Section 290)

Section 290 (1) states that Subject to directions by the Tribunal, if any, in this regard, the Company Liquidator, in a winding up of a company by the Tribunal, shall have the power :

(1) to carry on the business of the company so far as may be necessary for the beneficial winding up of the company.

(2) to do all acts and to execute, in the name and on behalf of the company, all deeds, receipts and other documents, and for that purpose, to use, when necessary, the company's seal.

(3) to sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels.

(4) to sell the whole of the undertaking of the company as a going concern.

(5) to raise any money required on the security of the assets of the company.

(6) to institute or defend any suit, prosecution or other legal proceeding, civil or criminal, in the name and on behalf of the company.

(7) to invite and settle claim of creditors, employees or any other claimant and distribute sale proceeds in accordance with priorities established under this Act.

(8) to inspect the records and returns of the company on the files of the Registrar or any other authority.

(9) to prove rank and claim in the insolvency of any contributory for any balance against his estate, and to receive dividends in the insolvency, in respect of that balance, as a separate debt due from the insolvent, and ratably with the other separate creditors.

(10) to draw, accept, make and endorse any negotiable instruments including cheque, bill of exchange, hundi or promissory note in the name and on behalf of the company, with the same effect with respect to the liability of the company as if such instruments had been drawn, accepted, made or endorsed by or on behalf of the company in the course of its business.

(11) to take out, in his official name, letters of administration to any deceased contributory, and to do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate which cannot be conveniently done in the name of the company, and in all such cases, the money due shall, for the purpose of enabling the Company Liquidator to take out the letters of administration or recover the money, be deemed to be due to the Company Liquidator himself.

(12) to obtain any professional assistance from any person or appoint any professional, in discharge of his duties, obligations and responsibilities and for protection of the assets of the company, appoint an agent to do any business which the Company Liquidator is unable to do himself.

(13) to take all such actions, steps, or to sign, execute and verify any paper, deed, document, application, petition, affidavit, bond or instrument as may be necessary:

a) for winding up of the company.

b) for distribution of assets.

c) in discharge of his duties and obligations and functions as Company Liquidator. and

(14) to apply to the Tribunal for such orders or directions as may be necessary for the winding up of the company.

Sub-Section (2) states that the exercise of powers by the Company Liquidator under Sub-Section (1) shall be subject to the overall control of the Tribunal.

Sub-Section (3) states that notwithstanding the provisions of Sub-Section (1), the Company Liquidator shall perform such other duties as the Tribunal may specify in this behalf.

(z) Provision for professional assistance to Company Liquidator (Section 291)

As per 291 (1), the Company Liquidator may, with the sanction of the Tribunal, appoint one or more Chartered Accountants or Company Secretaries or Cost Accountants or legal practitioners or such other professionals on such terms and conditions, as may be necessary, to assist him in the performance of his duties and functions under this Act. Sub-Section (2) states that any person appointed under this Section shall disclose forthwith to the Tribunal in the prescribed form any conflict of interest or lack of independence in respect of his appointment.

(aa) Exercise and control of company liquidators' powers (Section 292)

Section 292 (1) states that subject to the provisions of this Act, the Company Liquidator shall, in the administration of the assets of the company and the distribution thereof among its creditors, have regard to any directions which may be given by the resolution of the creditors or contributories at any general meeting or by the advisory committee.

As per Sub-Section (2) any directions given by the creditors or contributories at any general meeting shall, in case of conflict, be deemed to override any directions given by the advisory committee.

As per Sub-Section (3) the Company Liquidator:

(1) may summon meetings of the creditors or contributories, whenever he thinks fit, for the purpose of ascertaining their wishes, and

(2) shall summon such meetings at such times, as the creditors or contributories, as the case may be, may, by resolution, direct, or whenever requested in writing to do so by not less than one tenth in value of the creditors or contributories, as the case may be.

As per Sub-Section (4) Any person aggrieved by any act or decision of the Company Liquidator may apply to the Tribunal, and the Tribunal may confirm, reverse or modify the act or decision complained of and make such further order as it thinks just and proper in the circumstances.

(bb) Books to be kept by Company Liquidator (Section 293)

For the purpose of Sub-Section (1) of Section 293 and Sub-Section (1) of Section 294, the company liquidator shall maintain the following books, so far as may be applicable, in respect of the company under winding up. This is prescribed under rule 20 of Companies (Winding up Rules) 2013.

(1) Register of Liquidations in Form No. 41-A.

(2) Central Cash Book in Form No.41-B

(3) Company's Cash Book in Form No. 41-C.

(4) General Ledger in Form No. 41-D.

(5) Cashier's Cash Book in Form No. 41-E

(6) Bank Ledger in Form No. 41-F.

(7) Register of Assets in Form No. 41-G

(8) Securities and Investment Register in Form No. 41-H.

(9) Register of Book Debts and Outstanding in Form No. 41-I.

(10) Tenants Ledger in Form No. 41-J.

(11) Suits Register in Form No. 41-K.

(12) Decree Register in Form No. 41-L.

(13) Sales Register in Form No. 41-M.

(14) Register of Claims and Dividends in Form No. 41-N.

(15) Contributories Ledger in Form No. 41-O.

(16) Dividends Paid Register in Form No. 41-P.

(17) Commission Register in Form No. 41-Q.

(18) Suspense Register in Form No. 41-R.

(19) Documents Register in Form No. 41-S.

(20) Books Register in Form No. 41-T.

(21) Register of unpaid dividends and undistributed assets, deposited into the Company Liquidation Dividend and Undistributed Assets Account in a scheduled bank, in Form No. 41-U and

(cc) Audit of Company Liquidator's accounts (Section 294)

A Record Book for each company in which shall be entered all minutes of proceedings and the resolutions passed at any meeting of the creditors or contributories or of the Advisory Committee, the substance of all orders passed by the Court in the liquidation proceedings, and all such matters other than matters of account as may be necessary to furnish a correct view of the administration of the company's affairs. Filing of Half-yearly accounts with the Tribunal Section 294(2) states that the Company Liquidator shall, at such times as may be prescribed but not less than twice in each year during his tenure of office, present to the Tribunal an account of the receipts and payments as such liquidator in the prescribed form in duplicate, which shall be verified by a declaration in such form and manner as may be prescribed.

Rule 21 of the Companies (winding up) Rules, 2013 states that for the purpose of Sub-Section (2) of Section 294, unless otherwise ordered by the Tribunal, the Company Liquidator shall file his accounts in the Tribunal twice a year. Such accounts shall be made up to the 31st of March and 30th of September every year, the account for the period ending 31st March being filed not later than the 30th of June following, and account for the period ending 30th September, not later than the 31st of December following. The account shall be a statement of receipts and payments in Form No. 42 and shall be prepared in accordance with the instructions contained therein. Three copies thereof shall be filed, and the account shall be verified by an affidavit of the Company

If the Company Liquidator has not during the period of account received or paid any sum of money on account of the assets of the company, he shall file an affidavit of no receipts or payments on the date on which he shall have to file his accounts for the period. As soon as the accounts are filed, the Registrar of Tribunal shall forward to the auditor one copy thereof within 15 days for purposes of audit with a requisition in Form No. 45 requesting that the accounts may be audited and a certificate of audit submitted to the Tribunal not later than one month from the date of receipt of the copy of the account as required under Sub-Section (4) of Section 294. However, the accounts need not be got audited where the transaction during the period is for rupees five thousand or less.

Audit of company liquidator's accounts: Section 294 (3) states that the Tribunal shall cause the accounts to be audited in such manner as it thinks fit, and for the purpose of the audit, the Company Liquidator shall furnish to the Tribunal with such vouchers and information as the Tribunal may require, and the Tribunal may, at any time, require the production of, and inspect, any books of account kept by the Company Liquidator.

Section 294 (4) states that when the accounts of the company have been audited, one copy thereof shall be filed by the Company Liquidator with the Tribunal, and the other copy shall be delivered to the Registrar which shall be open to inspection by any creditor, contributory or person interested.

Rule 21 (5) of Companies (Winding up Rules) 2013 states that the accounts shall be audited by one or more Chartered Accountants appointed by the Tribunal. The audit shall be a complete check of the accounts of the Company Liquidator. The Company Liquidator shall produce before the auditor all his books and vouchers for the purposes of the audit, and shall give the auditor all such explanations, information and assistance as may be required of him in respect of the accounts.

Rule 21 (6) state that after the audit of the accounts of the Company Liquidator filed in Tribunal,

the auditor shall forward to the Registrar a certificate of audit relating to the account with his observations and comments, if any, on the account, together with a copy thereof and shall forward another copy to the Company Liquidator in accordance with Sub-Section (4) of Section 294. The Registrar shall file the original certificate with the records and forward the copy to the Registrar of Companies together with a copy of the account to which it relates.

Rules 21 (8) states that for the purposes of Sub-Section (4) of Section 294, any creditor or contributory or person interested shall be entitled to inspect the accounts and the auditor's certificate in the office of the Registrar of Companies on payment of such fee and to obtain a copy thereof on payment of prescribed fees.

Section 294 (6) states that (6) the Company Liquidator shall cause the accounts when audited, or a summary thereof, to be printed, and shall send a printed copy of the accounts or summary thereof by post to every creditor and every contributory.

Section 294 (5) states that where an account referred to in Sub-Section (4) relates to a Government company, the Company Liquidator shall forward a copy thereof:

(1) to the Central Government, if that Government is a member of the Government company, or

(2) to any State Government, if that Government is a member of the Government company, or

(3) to the Central Government and any State Government, if both the Governments are members of the Government company.

Rule 21 (9) states that, upon the audit of the account, the Registrar of Tribunal shall place the statement of account and the auditor's certificate before the Bench for its consideration and orders.

(dd) Payment of debt by the Contributory and the extent of set off (Section 295)

As per Section 295 (1) the Tribunal may, at any time after passing of a winding up order, pass an order requiring any contributory for the time being on the list of contributories to pay, in the manner directed by the order, any money due to the company, from him or from the estate of the person whom he represents, exclusive of any money payable by him or the estate by virtue of any call in pursuance of this Act.

According to Sub-Section (2) the Tribunal, in making an order, under Sub-Section (1), may:

(1) in the case of an unlimited company, allow to the contributory, by way of setoff, any money due to him or to the estate which he represents, from the company, on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit, and

(2) in the case of a limited company, allow to any director or manager whose liability is unlimited, or to his estate, such setoff.

As per Sub-Section (3) in the case of any company, whether limited or unlimited, when all the creditors have been paid in full, any money due on any account whatever to a contributory from the company may be allowed to him by way of set-off against any subsequent call.

(ee) Power of the Tribunal to make calls (Section 296)

As per Section 296, the Tribunal may, at any time after the passing of a winding up order, and either before or after it has ascertained the sufficiency of the assets of the company; 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 make an order for payment

of any calls so made.

(ff) Adjustment of rights of contributories (Section 297)

As per Section 297 the Tribunal shall adjust the rights of the contributories among themselves and distribute any surplus among the persons entitled thereto.

(gg) Power to order costs (Section 298)

The Tribunal may, in the event of the assets of a company being insufficient to satisfy its liabilities, make an order for the payment out of the assets, of the costs, charges and expenses incurred in the winding up

(hh) Power to summon persons suspected of having property of company, etc. (Section 299)

As per 299 (1) The Tribunal may, at any time after the appointment of a provisional liquidator or the passing of a winding up order, summon before it any officer of the company or person known or suspected to have in his possession any property or books or papers, of the company, or known or suspected to be indebted to the company, or any person whom the Tribunal thinks to be capable of giving information concerning the promotion, formation, trade, dealings, property, books or papers, or affairs of the company. As per 299 (2) The Tribunal may examine any officer or person so summoned on oath concerning the matters aforesaid, either by word of mouth or on written interrogatories or on affidavit and may, in the first case, reduce his answers to writing and require him to sign them. As per 299 (3) The Tribunal may require any officer or person so summoned to produce any books and papers relating to the company in his custody or power, but, where he claims any lien on books or papers produced by him, the production shall be without prejudice to such lien, and the Tribunal shall have power to determine all questions relating to that lien.

As per 299 (4) The Tribunal may direct the liquidator to file before it a report in respect of debt or property of the company in possession of other persons.

As per 299 (5) If the Tribunal finds that :

(1) a person is indebted to the company, the Tribunal may order him to pay to the provisional liquidator or, as the case may be, the liquidator at such time and in such manner as the Tribunal may consider just, the amount in which he is indebted, or any part thereof, either in full discharge of the whole amount or not, as the Tribunal thinks fit, with or without costs of the examination.

(2) a person is in possession of any property belonging to the company, the Tribunal may order him to deliver to the provisional liquidator or, as the case may be, the liquidator, that property or any part thereof, at such time, in such manner and on such terms as the Tribunal may consider just.

As per 299 (6) If any officer or person so summoned fails to appear before the Tribunal at the time appointed without a reasonable cause, the Tribunal may impose an appropriate cost.

As per 299 (7) every order made under Sub-Section (5) shall be executed in the same manner as decrees for the payment of money or for the delivery of property under the Code of Civil Procedure, 1908.

As per 299 (8) Any person making any payment or delivery in pursuance of an order made under Sub-Section (5) shall by such payment or delivery be, unless otherwise directed by such order, discharged from all liability whatsoever in respect of such debt or property

1.2.3.5 Draft Rules under Winding up Chapter of Companies Act, 2013

An application for the examination of a person under Section 299 may be made ex-parte, provided that where the application is made by any person other than the Company Liquidator, notice of the

application shall be given to the Company Liquidator. The application shall be in Form No. 46 and, where the application is by the Company Liquidator, it shall be accompanied by a statement signed by him setting forth the facts on which the application is based. Where the application is made by a person other than the Company Liquidator, the application shall be supported by an affidavit of the applicant setting forth the matters in respect of which the examination is sought and the grounds, relied on in support of the application.

The summons issued in pursuance of the order shall be in Form No. 47 and shall be served by Registered AD or other recognized modes of service as per Section 20 of the Act on the person to be examined not less than seven days before the date fixed for the examination. The Tribunal at its discretion may give a reasonable sum towards expenses to such person for appearing before the Tribunal, if it deems to be justifiable.

The Company Liquidator shall have the conduct of an examination under Section 299, provided that the Tribunal may, if for any reasons it thinks fit to do so, entrust the conduct of the examination to any contributory or creditors. Where the conduct of the examination is entrusted to any person other than the Company Liquidator, the Company Liquidator shall nevertheless be entitled to be present at the examination in person or by authorized representative, and may take notes of the examination for his own use and put such questions to the person examined as the Tribunal may allow.

(a) **Power to order examination of promoters, directors, etc., (Section 300)**

As per Section 300 (1), when an order has been made for the winding up of a company by the Tribunal, and the Company Liquidator has made a report to the Tribunal under this Act, stating that in his opinion a fraud has been committed by any person in the promotion, formation, business or conduct of affairs of the company since its formation, the Tribunal may, after considering the report, direct that such person or officer shall attend before the Tribunal on a day appointed by it for that purpose, and be examined as to the promotion or formation or the conduct of the business of the company or as to his conduct and dealings as an officer thereof.

As per Section 300 (2), the Company Liquidator shall take part in the examination, and for that purpose he or it may, if specially authorized by the Tribunal in that behalf, employ such legal assistance as may be sanctioned by the Tribunal.

As per Section 300 (3), the person shall be examined on oath and shall answer all such questions as the Tribunal may put, or allow to be put, to him.

As per Section 300 (4), a person ordered to be examined under this Section:

(1) shall, before his examination, be furnished at his own cost with a copy of the report of the Company Liquidator. And Corporate Restructuring & Insolvency.

(2) may at his own cost employ Chartered Accountants or Company Secretaries or Cost Accountants or legal practitioners entitled to appear before the Tribunal under Section 432, who shall be at liberty to put to him such questions as the Tribunal may consider just for the purpose of enabling him to explain or qualify any answers given by him.

As per Section 300 (5), if any such person applies to the Tribunal to be exculpated from any charges made or suggested against him, it shall be the duty of the Company Liquidator to appear on the hearing of such application and call the attention of the Tribunal to any matters which appear to the Company Liquidator to be relevant.

As per Section 300 (6), if the Tribunal, after considering any evidence given or hearing witnesses called by the Company Liquidator, allows the application made under Sub-Section (5), the Tribunal may order payment to the applicant of such costs as it may think fit.

As per Section 300 (7), notes of the examination shall be taken down in writing, and shall be

read over to or by, and signed by, the person examined, a copy be supplied to him and may thereafter be used in evidence against him, and shall be open to inspection by any creditor or contributory at all reasonable times.

As per Rule 22 of Companies (Winding up) Rules 2013, where an order is made for the examination of any person or persons under Section 300, the examination shall be held before the Bench. The Bench may direct that the whole or any part of the examination of any such person or persons be held before any of the officers mentioned in Sub-Section (9) of the said Section as may be mentioned in the order. If the date of the examination has not been fixed by the order, the Company Liquidator shall take an appointment from the Bench, or officer before whom the examination is to be held as to the date of the examination. The order directing a public examination shall be in Form No. 48. The Bench may, if it thinks fit, either in the order for examination or by any subsequent order, give directions as to the specific matters on which such person is to be examined.

Not less than seven clear days before the date fixed for the examination, the Company Liquidator shall give notice thereof to the creditors and contributories of the company of advertisement in Form No. 49 in such newspapers as the Bench shall direct, and shall within the same period, serve, either personally or by Registered AD or other recognized modes of service as per Section 20 of the Act, on the person or persons to be examined, a notice in Form No. 50 of the date and hour fixed for the examination and the officer before whom it is to be held, together with a copy of the order directing the examination.

Where a public examination is adjourned, it shall not be necessary to advertise the adjournment or serve notice thereof unless otherwise ordered.

(b) **Arrest of person trying to leave India or abscond (Section 301)**

At any time either before or after passing a winding up order, if the Tribunal is satisfied that a contributory or a person having property, accounts or papers of the company in his possession is about to leave India or otherwise to abscond.

The Tribunal may cause:

(i) the contributory to be detained until such time as the Tribunal may order, and

(ii) his books and papers and movable property to be seized and safely kept until such time as the Tribunal may order.

(c) **Dissolution of company by Tribunal (Section 302)**

As per 302 (1), when the affairs of a company have been completely wound up, the Company Liquidator shall make an application to the Tribunal for dissolution of such company:

As per 302 (2), the Tribunal shall on an application filed by the Company Liquidator under Sub-Section (1) or when the Tribunal is of the opinion that it is just and reasonable in the circumstances of the case that an order for the dissolution of the company should be made, make an order that the company be dissolved from the date of the order, and the company shall be dissolved accordingly.

As per 302 (3), a copy of the order shall, within thirty days from the date thereof, be forwarded by the Company Liquidator to the Registrar who shall record in the register relating to the company a minute of the dissolution of the company.

As per 302 (4), if the Company Liquidator makes a default in forwarding a copy of the order within the period specified in Sub-Section (3), the Company Liquidator shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues.

K : 1.3 VOLUNTARY WINDING UP (SECTION 304 TO 323)

These part is no longer applicable after the introduction of Insolvency & Bankruptcy Code.

K : 1.4 PROVISIONS APPLICABLE TO EVERY MODE OF WINDING UP (SECTIONS 324 TO 358)

(a) As per Section 325 (1) in the winding up of an insolvent company, the same rules shall prevail and be observed with regard to :

(1) debts provable.

(2) the valuation of annuities and future and contingent liabilities, and

(3) the respective rights of secured and unsecured creditors, as are in force for the time being under the law of insolvency with respect to the estates of persons adjudged insolvent:

(a) The security of every secured creditor shall be deemed to be subject to a pari passu charge in favour of the workmen to the extent of the workmen's portion therein, and, where a secured creditor, instead of relinquishing his security and proving his debts, opts to realize his security:

(1) the liquidator shall be entitled to represent the workmen and enforce such charge.

(2) any amount realised by the liquidator by way of enforcement of such charge shall be applied ratably for the discharge of workmen's dues, and

(3) so much of the debts due to such secured creditor as could not be realized by him or the amount of the workmen's portion in his security, whichever is less, shall rank pari passu with the workmen's dues for the purposes of Section 326.

1.4.1 Overriding preferential payments (Section 326)

Section 326(1) notwithstanding anything contained in this Act or any other law for the time being in force, in the winding up of a company:

(a) workmen's dues, and

(b) debts due to secured creditors to the extent such debts rank under clause (iii) of the proviso to Section (1) of Section 325 pari passu with such dues, shall be paid in priority to all other debts.

In case of the winding up of a company, the sums towards wages or salary referred to in sub-clause (i) of clause (b) of Sub-Section (3) of Section 325, which are payable for a period of two years preceding the winding up order or such other period as may be prescribed, shall be paid in priority to all other debts (including debts due to secured creditors), within a period of thirty days of sale of assets and shall be subject to such charge over the security of secured creditors as may be prescribed.

Sub-Section (2) states that the debts payable under the proviso to Sub-Section (1) shall be paid in full before any payment is made to secured creditors and thereafter debts payable under that Sub-Section shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions Preferential payments

1.4.2 Priority to all other debts

(a) As per Section 327 (1) in a winding up, subject to the provisions of Section 326 (i.e., overriding preferential payments), the following shall be paid in priority to all other debts:

(1) all revenues, taxes, cess and rates due from the company to the Central Government or a State Government or to a local authority at the relevant date, and having become due and payable within the twelve months immediately before that date.

(2) all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any employee in respect of services rendered to the company and due for a period not exceeding four months within the twelve months immediately before the relevant date, subject to the condition that the amount payable under this clause to any workman shall not exceed such amount as may be notified.

(3) all accrued holiday remuneration becoming payable to any employee, or in the case of his death, to any other person claiming under him, on the termination of his employment before, or by the winding up order, or, as the case may be, the dissolution of the company.

(4) unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company, all amount due in respect of contributions payable during the period of twelve months immediately before the relevant date by the company as the employer of persons under the Employees' State Insurance Act, 1948 or any other law for the time being in force.

(5) unless the company has, at the commencement of winding up, under such a contract with any insurer as is mentioned in Section 14 of the Workmen's Compensation Act, 1923, rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any employee of the company: when any compensation under the said Act is a weekly payment, the amount payable under this clause shall be taken to be the amount of the lump sum for which such weekly payment could, if redeemable, be redeemed, if the employer has made an application under that Act.

(6) all sums due to any employee from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the employees, maintained by the company, and

(7) the expenses of any investigation held in pursuance of Sections 213 and 216, in so far as they are payable by the company.

(b) Sub-Section (2) states that when any payment has been made to any employee of a company on account of wages or salary or accrued holiday remuneration, himself or, in the case of his death, to any other person claiming through him, out of money advanced by some person for that purpose, the person by whom the money was advanced shall, in a winding up, have a right of priority in respect of the money so advanced and paid-up to the amount by which the sum in respect of which the employee or other person in his right would have been entitled to priority in the winding up has been reduced by reason of the payment having been made.

(c) As per Sub-Section (3) the debts enumerated in this Section shall:

(1) 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, and

(2) so far as the assets of the company available for payment to general creditors are insufficient to meet them, have priority over the claims of holders of debentures under any floating charge created by the company, and be paid accordingly out of any property comprised in or subject to that charge.

(d) Sub-Section (4) states that subject to the retention of such sums as may be necessary for the costs and expenses of the winding up, the debts under this Section shall be discharged forthwith so far as the assets are sufficient to meet them, and in the case of the debts to which priority is given under clause (d) of Sub-Section (1), formal proof thereof shall not be required except in so far as may be otherwise prescribed.

(e) Sub-Section (5) states that in the event of a landlord or other person distaining or having distained on any goods or effects of the company within three months immediately before the date of a winding up order, the debts to which priority is given under this Section shall be a first charge on the goods or effects so distained on or the proceeds of the sale thereof:

Provided that, in respect of any money paid under any such charge, the landlord or other person shall have the same rights of priority as the person to whom the payment is made.

(f) Sub-Section (6) any remuneration in respect of a period of holiday or of absence from work on medical grounds through sickness or other good cause shall be deemed to be wages in respect of services rendered to the company during that period.

(g) For the purpose of Section 327

'Accrued holiday remuneration' includes, in relation to any person, all sums which, by virtue either of his contract of employment or of any enactment including any order made or direction given thereunder, are payable on account of the remuneration which would, in the ordinary course, have become payable to him in respect of a period of holiday, had his employment with the company continued until he became entitled to be allowed the holiday.

'Employee' does not include a workman. And

'Relevant date' means:

(1) in the case of a company being wound up by the Tribunal, the date of appointment or first appointment of a provisional liquidator, or if no such appointment was made, the date of the winding up order, unless, in either case, the company had commenced to be wound up voluntarily before that date, and

(2) in any other case, the date of the passing of the resolution for the voluntary winding up of the company.

1.4.3 Fraudulent Preference (Section 328)

The expression 'fraudulent preference' may be described to mean the giving of an improper benefit to a few in preference to others, leading to inequality between them [Official Liquidator Vs. Victonj Hire Purchasing Co. (Pvt.) Ltd. [1982] 52 Compo Cas. 88].

The term 'fraudulent preference' has been borrowed from the law of insolvency. According to that law, any transfer of property or payment made by a person who is unable to pay his debts in favour of a creditor with a view to giving him a preference over other creditors is regarded as fraudulent preference.

Section 328 (1) states that when a company has given preference to a person who is one of the creditors of the company or a surety or guarantor for any of the debts or other liabilities of the company, and the company does anything or suffers anything done which has the effect of putting that person into a position which, in the event of the company going into liquidation, will be better than the position he would have been in if that thing had not been done prior to six months of making winding up application, the Tribunal, if satisfied that, such transaction is a fraudulent preference may order as it may think fit for restoring the position to what it would have been if the company had not given that preference.

Sub-Section (2) states that if the Tribunal is satisfied that there is a preference transfer of property, movable or immovable, or any delivery of goods, payment, execution made, taken or done by or against a company within six months before making winding up application, the Tribunal may order as it may think fit and may declare such transaction invalid and restore the position.

1.4.4 Liabilities and rights of certain persons fraudulently preferred (Section 331)

Section 331 (1) states that when a company is being wound up and anything made, taken or done

after the commencement of this Act is invalid under Section 328 as a fraudulent preference of a person interested in property mortgaged or charged to secure the company's debt, then, without prejudice to any rights or liabilities arising, apart from this provision, the person preferred shall be subject to the same liabilities, and shall have the same rights, as if he had undertaken to be personally liable as a surety for the debt, to the extent of the mortgage or charge on the property or the value of his interest, whichever is less.

As per Sub-Section (2), the value of the interest of the person preferred under Sub-Section (1) shall be determined as at the date of the transaction constituting the fraudulent preference, as if the interest were free of all encumbrances other than those to which the mortgage or charge for the debt of the company was then subject.

Sub-Section (3) states that on an application made to the Tribunal with respect to any payment on the ground that the payment was a fraudulent preference of a surety or guarantor, the Tribunal shall have jurisdiction to determine any questions with respect to the payment arising between the person to whom the payment was made and the surety or guarantor and to grant relief in respect thereof, notwithstanding that it is not necessary so to do for the purposes of the winding up, and for that purpose, may give leave to bring in the surety or guarantor as a third party as in the case of a suit for the recovery of the sum paid.

Sub-Section(4)states that the provisions of Sub-Section (3) shall apply mutatis mutandis in relation to transactions other than payment of money.

1.4. 5 Effect of floating charge (Section 332)

As per Section 332, when a company is being wound up, a floating charge on the undertaking or property of the company created within the twelve months immediately preceding the commencement of the winding up, shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except for the amount of any cash paid to the company at the time of, or subsequent to the creation of, and in consideration for, the charge, together with interest on that amount at the rate of five per cent. per annum or such other rate as may be notified by the Central Government in this behalf.

1.4.6 Offences by officers of companies in liquidation (Section 336)

For the purposes of Section 336, the expression 'officer' includes any person in accordance with whose directions or instructions the directors of the company have been accustomed to act.

Section 336 (1) states that if any person, who is or has been an officer of a company which, at the time of the commission of the alleged offence, is being wound up, whether by the Tribunal or voluntarily, or which is subsequently ordered to be wound up by the Tribunal or which subsequently passes a resolution for voluntary winding up :

(a) does not, to the best of his knowledge and belief, fully and truly disclose to the Company Liquidator all the property, movable and immovable, of the company, and how and to whom and for what consideration and when the company disposed of any part thereof, except such part as has been disposed of in the ordinary course of the business of the company.

(b) does not deliver up to the Company Liquidator, or as he directs, all such part of the movable and immovable property of the company as is in his custody or under his control and which he is required by law to deliver up.

(c) does not deliver up to the Company Liquidator, or as he directs, all such books and papers of the company as are in his custody or under his control and which he is required by law to deliver up.

(d) within the twelve months immediately before the commencement of the winding up or at any time thereafter:

    (i) conceals any part of the property of the company to the value of one thousand rupees or more, or conceals any debt due to or from the company.

(ii) fraudulently removes any part of the property of the company to the value of one thousand rupees or more.

(iii) conceals, destroys, mutilates or falsifies, or is privy to the concealment, destruction, mutilation or falsification of, any book or paper affecting or relating to, the property or affairs of the company.

(iv) makes, or is privy to the making of, any false entry in any book or paper affecting or relating to, the property or affairs of the company.

(v) fraudulently parts with, alters or makes any omission in, or is privy to the fraudulent parting with, altering or making of any omission in, any book or paper affecting or relating to the property or affairs of the company.

(vi) by any false representation or other fraud, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for.

(vii) under the false pretense that the company is carrying on its business, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for, or

(viii) pawns, pledges or disposes of any property of the company which has been obtained on credit and has not been paid for, unless such pawning, pledging or disposing of the property is in the ordinary course of business of the company.

(e) makes any material omission in any statement relating to the affairs of the company.

(f) knowing or believing that a false debt has been proved by any person under the winding up, fails for a period of one month to inform the Company Liquidator thereof.

(g) after the commencement of the winding up, prevents the production of any book or paper affecting or relating to the property or affairs of the company.

(h) after the commencement of the winding up or at any meeting of the creditors of the company within the twelve months next before the commencement of the winding up, attempts to account for any part of the property of the company by fictitious losses or expenses, or

(i) is guilty of any false representation or fraud for the purpose of obtaining the consent of the creditors of the company or any of them, to an agreement with reference to the affairs of the company or to the winding up, he shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees: Provided that it shall be a good defense if the accused proves that he had no intent to defraud or to conceal the true state of affairs of the company or to defeat the law.

Sub-Section (2) states that when any person pawns, pledges or disposes of any property in circumstances which amount to an offence under sub-clause (viii) of clause (d) of Sub-Section (1), every person who takes in pawn or pledge or otherwise receives the property, knowing it to be pawned, pledged, or disposed of in such circumstances as aforesaid, shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to five years and with fine which shall not be less than three lakh rupees but which may extend to five lakh rupees.

1.4.7 Power of tribunal to assess damages against delinquent directors etc (Section 340)

Section 340 (1) states that 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 person, who is or has been a director, manager, Company 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 Company Liquidator, or of any creditor or contributory, made within the period specified in that behalf in Sub-Section (2), inquire into the conduct of the person, director, manager, Company Liquidator or officer aforesaid, and order him to repay or restore the money or property or any part thereof respectively, with interest at such rate as the Tribunal considers just and proper, 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 considers just and proper.

Sub-Section (2) states that an application under Sub-Section (1) shall be made within five years from the date of the winding up order, or of the first appointment of the Company 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.

Case Law

1. In the matter of Ajay G Podar v. Official Liquidator of JS & WM & Ors. (2008) 85 CLA 398 (SC), Hon'ble Supreme Court has held that section 543(2) of the Companies Act, 1956 [Section 340 under the Companies Act, 2013] deals with the limitation of applications/claims including misfeasance proceedings and prescribes five (5) years period of limitation from the date of the winding up order for filing an application under section 543 (1). However, section 458A of the Companies Act, 1956 [Section 358 under the Companies Act, 2013] provides for the concept of computation of the limitation period. Section 458A being a non obstante clause exclude the period starting from commencement of winding up proceedings till the date on which winding up order is passed and a period of one (1) year thereafter. In view of the above, misfeasance proceedings filed by the OL are well within limitation period.

2. In L.K. Prabhu v. S.M. Ameerul Millath (2002) 40 SCL 385 (Ker HC), it was held that application under Section 543 (for damages for misapplication or misfeasance) [Section 340 under the Companies Act, 2013] is maintainable against Official Liquidator also, as 'liquidator' includes 'Official Liquidator'. Moreover he is 'Officer' of the company as defined in Section 2(30), even if not specifically mentioned in the definition. However there should be prima facie case against him and there is substance in the allegations. If Official Liquidator has acted in good faith, he is entitled to protection under Section 635A [Section 456 under the Companies Act, 2013].

3. In Official Liquidator v. Ashok Kumar, (1976) 46 Comp. Cas. 575 (Pat), it was held that a director who has not been duly elected and has taken his qualification shares shall be liable if he has acted as such. In other words, where a director continued to act de facto without being validly elected, he shall be liable for misfeasance.

4. The extent of liability of the Legal Representative: In the case of death of the director, it was held by the Supreme Court that the proceedings commenced against the delinquent director of a liquidated company can be continued against his legal representatives and the amount declared to be due in such misfeasance proceeding can be realized from the estate of the deceased on the hands of his legal representatives. The Court further held that the legal representatives would not, however, be liable for any sum beyond the value of the estate of the deceased in their hands [Official Liquidator, Supreme Bank Ltd. V.P.A. Tendolkar (1973) 43 Comp. (Case 382)] and [Official Liquidator vs. Parthasarthy Sinha (1983) 53. Comp. Case (SC) (3c)].

Hence, the misfeasance proceeding can be continued against the legal representatives of deceased Director.

1.4.8 Prosecution of delinquent officers and members of company (Section 342)

Section 342 (1) states that if it appears to the Tribunal in the course of a winding up by the Tribunal, that any person, who is or has been an officer, or any member, of the company has been guilty of any offence in relation to the company, the Tribunal may, either on the application of any person interested in the winding up or suo motu, direct the liquidator to prosecute the offender or to refer the matter to the Registrar

Sub-Section (2) further states that if it appears to the Company Liquidator in the course of a voluntary winding up that any person, who is or has been an officer, or any member, of the company has been guilty of any offence in relation to the company under this Act, he shall forthwith report the matter to the Registrar and shall furnish to him such information and give to him such access to and facilities for inspecting and taking copies of any books and papers, being information or books and papers in the possession or under the control of the Company Liquidator and relating to the matter in question, as the Registrar may require.

Sub-Section (3) states that when any report is made under Sub-Section (2) to the Registrar:

(a) if he thinks fit, he may apply to the Central Government for an order to make further inquiry into the affairs of the company by any person designated by him and for conferring on such person all the powers of investigation as are provided under this Act.

(b) if he considers that the case is one in which a prosecution ought to be instituted, he shall report the matter to the Central Government, and that Government may, after taking such legal advice as it thinks fit, direct the Registrar to institute prosecution: Provided that no report shall be made by the Registrar under this clause without first giving the accused person a reasonable opportunity of making a statement in writing to the Registrar and of being heard thereon.

Sub-Section (4) states that if it appears to the Tribunal in the course of a voluntary winding up that any person, who is or has been an officer, or any member, of the company has been guilty as aforesaid, and that no report with respect to the matter has been made by the Company Liquidator to the Registrar under Sub-Section (2), the Tribunal may, on the application of any person interested in the winding up or 'suo motu', direct the Company Liquidator to make such a report, and on a report being made, the provisions of this Section shall have effect as though the report had been made in pursuance of the provisions of Sub-Section (2).

Sub-Section (5) states that when any prosecution is instituted under this Section, it shall be the duty of the liquidator and of every person, who is or has been an officer and agent of the company to give all assistance in connection with the prosecution which he is reasonably able to give.

Explanation: For the purposes of this Sub-Section, the expression 'agent', in relation to a company, shall include any banker or legal adviser of the company and any person employed by the company as auditor.

Sub-Section(6) states that if a person fails or neglects to give assistance required by Sub-Section (5), he shall be liable to pay fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

1.4.9 Disposal of books and papers of the company (Section 347)

(a) Section 347 (1) states that when the affairs of a company have been completely wound up and it is about to be dissolved, its books and papers and those of the Company Liquidator may be disposed of as follows:

(1) in the case of winding up by the Tribunal, in such manner as the Tribunal directs, and

(2) in the case of voluntary winding up, in such manner as the company by special resolution with the prior approval of the creditors direct.

(b) Sub-Section (2) states that after the expiry of five years from the dissolution of the company, no responsibility shall devolve on the company, the Company Liquidator, or any person to whom the custody of the books and papers has been entrusted, by reason of any book or paper not being forthcoming to any person claiming to be interested therein.

(c) As per Sub-Section (3), the Central Government may, by rules:

(1) prevent for such period as it thinks proper the destruction of the books and papers of a company which has been wound up and of its Company Liquidator, and

(2) enable any creditor or contributory of the company to make representations to the Central Government in respect of the matters specified in clause (a) and to appeal to the Tribunal from any order which may be made by the Central Government in the matter.

(d) As per Sub-Section (4) if any person acts in contravention of any rule framed or an order made under Sub-Section (3), he shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to fifty thousand rupees, or with both.

1.4.10 Information as to pending liquidations (Section 348)

(a) Section 348 (1) states that if the winding up of a company is not concluded within one year after its commencement, the Company Liquidator shall, unless he is exempted from so doing either wholly or in part by the Central Government, within two months of the expiry of such year and thereafter until the winding up is concluded, at intervals of not more than one year or at such shorter intervals, if any, as may be prescribed, file a statement in such form containing such particulars as may be prescribed, duly audited, by a person qualified to act as auditor of the company, with respect to the proceedings in, and position of, the liquidation :

(1) in the case of a winding up by the Tribunal, with the Tribunal, and

(2) in the case of a voluntary winding up, with the Registrar:

However, (Audit of company liquidators' account under winding up by tribunal) no such audit as is referred to in this Sub-Section shall be necessary where the provisions of Section 294 apply.

(b) Rule 31 of companies (winding up) Rules 2013 states that the winding-up of a company shall, for the purposes of Section 348, be deemed to be concluded-

(1) in the case of a company wound-up by order of the Tribunal, at the date on which the order dissolving the company has been reported by the Company Liquidator to the Registrar of Companies.

(2) in the case of a company wound-up voluntarily, at the date of the dissolution of the company, unless any fund or assets of the company remaining unclaimed or undistributed in the hands or under the control of the Company Liquidator, shall be distributed or paid into the Company Liquidation Dividend and Undistributed Assets Account as provided in Section 352 of the Act.

K : 1.5 OFFICIAL LIQUIDATORS (SECTIONS 359 TO 365)

1.5.1 Appointment of official liquidator (Section 359)

Section 359 (1) the Central Government may appoint as many Official Liquidators, Joint, Deputy or Assistant Official Liquidators as it may consider necessary to discharge the functions of the Official Liquidator. Sub-Section (2) states that the liquidators appointed under Sub-Section (1) shall be whole-time officers of the Central Government.

1.5.2 Powers and functions of official liquidators (Section 360)

Section 360 (1) states that the Official Liquidator shall exercise such powers and perform such duties as the Central Government may prescribe.

Sub-Section (2) states that without prejudice to the provisions of Sub-Section (1), the Official Liquidator may:

(a) exercise all or any of the powers as may be exercised by a Company Liquidator under the provisions of this Act, and

(b) conduct inquiries or investigations, if directed by the Tribunal or the Central Government, in respect of matters arising out of winding up proceedings.

Rule 35 (2) of Companies (Winding up) Rules 2013 (2) states that for the purpose of sub Section (1) of Section 360, the Official Liquidator shall exercise following powers and perform following duties:

(1) For winding up of the company by the Tribunal, the Tribunal at the time of passing an order of winding up, may appoint Official Liquidator as Company Liquidator, who shall exercise all powers as may be exercised by the Liquidator in the winding up proceedings.

(2) The Tribunal may also by an order appoint official liquidator as Provisional Liquidator for the purpose of winding up.

(3) Official Liquidator shall continue as the Company Liquidator or provisional liquidator for all such cases of winding up of companies, pending before District Court or High Court immediately before the date of transfer to the Tribunal as per clause (c) of Sub-Section (1) of Section 434 of the Act.

(4) To supervise the functions of any Company Liquidator, or

(5) Provisional Liquidator appointed from the panel, if directed by Tribunal or Central Government.

(6) To advice or guide the Company Liquidator or Provisional Liquidator appointed from the panel on any reference made to him by such Liquidator.

(7) Official Liquidator shall conduct enquires or investigations, if directed by the Tribunal or Central Government in respect of matters arising out of winding up proceedings including all such cases where the company liquidator is appointed from the panel.

(8) To submit report to the Tribunal on any such matter including on the report for dissolution of the company filed by Company Liquidator appointed from the panel, on winding up by the Tribunal or Voluntary Winding up.

(9) The Official Liquidator shall maintain a panel of Security Agency with the approval of Tribunal and of professionals including Valuers', Chartered Accountants, Company Secretaries, Cost Accountants and Advocates to represent and assist the Official Liquidator in the winding up process and proceeding related to winding up petitions and applications before the Tribunal and the Central Government.

(10) Any such powers and duties as may be directed by the Tribunal or Central Government from time to time.

1.5.3 Summary procedure for liquidation (Section 361)

(a) Section 361 (1) states that when the company to be wound up under this Chapter:

(1) has assets of book value not exceeding one crore rupees, and

(2) belongs to such class or classes of companies as may be prescribed, the Central Government may order it to be wound up by summary procedure provided under this Part.

Sub Section (2) states that when an order under Sub-Section (1) is made, the Central Government shall appoint the Official Liquidator as the liquidator of the company.

Sub-Section (3) states that the Official Liquidator shall forthwith take into his custody or control all assets, effects and actionable claims to which the company is or appears to be entitled.

As per Sub-Section(4) the Official Liquidator shall, within thirty days of his appointment, submit a report to the Central Government in such manner and form, as may be prescribed, including a report whether in his opinion, any fraud has been committed in promotion, formation or management of the affairs of the company or not.

Sub-Section (5) states that on receipt of the report under Sub-Section (4), if the Central Government is satisfied that any fraud has been committed by the promoters, directors or any other officer of the company, it may direct further investigation into the affairs of the company and that a report shall be submitted within such time as may be specified.

Sub-Section (6) states that after considering the investigation report under Sub-Section (5), the Central Government may order that winding up may be proceeded under Part I of this Chapter or under the provision of this Part

(b) Rule 39 of Companies Winding up Rules 2013 states the following aspects as to the summary procedure for winding up.

(1) Application under Section 361 for Summary Procedure of Winding-Up- For the purpose of clause (ii) of sub Section (1) of Section 361 of the Act, the classes of company shall be as follows: (a) One Person Company, or (b) Small Company.

(2) Application for winding up

a) Application for winding up by the Company shall be in Form-A with such variations as may be necessary and in any other case it shall be in Form-B with such variations as may be necessary.

b) The applicant shall, not less than one month before filing any application in Form A or B as the case may be publish a general notice, at least once, in a daily newspaper published in English and in the principal language of the State or the Union Territory in which the registered office of the company is situated, clearly indicating the substance of the application and stating that any person whose interest is likely to be affected by the proposed application and may intimate to the Central Government (Regional Director) within twenty-one days of the date of publication of that notice, the nature of interest and grounds of opposition, if any.

(3) Application by the Company. Subject to Section 271 and 272 of the Act, in case the application is made by the company:

a) The company shall not less than one month before filing application, serve on each debenture-holder and creditor of the company by registered post or speed post, individual notice indicating the substance of the application and stating that if his interest is likely to be affected by the proposed application and may intimate to the Central Government (Regional Director) within twenty-one days of the date of publication of that notice, the nature of interest and grounds of opposition, if any.

b) The application shall contain:

1) a list stating the name and address of the creditors and debenture holders and the amount due to each of them up to the latest practicable date preceding the date of filing of the application which shall not precede the date of filing the application by more than thirty days indicating whether the secured or unsecured creditors and details of the property mortgaged or hypothecated to such secured creditors, if any.

2) A director of the company shall file an affidavit to the effect that they have made the full enquiry into the affairs of the company and, having done so, have formed the opinion that the list referred above is correct, and the estimated values as given in the list of debt or claims payable on a contingency or not ascertained are proper estimates of the values of such debt and claims included in the list and the same are borne out by the books and records of the company and that there are no other debts, or claims against, the company to their knowledge.

3) The company shall prove the publication of the notice and service of notice to each of the debenture holder or creditor by an affidavit.

4) Copy of the audited financial statements for the preceding financial year.

5) Statement of Affairs in Form 4 made up to the latest practicable date preceding the date of filing of the application which shall not precede the date of filing the application by more than 30 days. and (f) Copy of the resolution of the Board of Directors authorizing Board to submit the application, and

6) copy of the special resolution of the company in terms of clause (b) of Sub-Section (1) of Section 271 of the Act.

(4) Subject to Section 271 and 272 of the Act in any other case, the application shall be accompanied by an affidavit to prove the publication of the notice, copy of the latest audited financial statements available in the MCA 21 portal, copy of the charge documents available in the MCA 21 portal and an affidavit to prove the service of notice to the secured creditors whose names are available in the charge documents in the manner provided in clause (i) of sub-rule (3).

(5) Objections to the application.

a) Any person intending to oppose the application shall within twenty-one days from the date of service of publication of the notice, as the case may be, deliver, or cause to be delivered, or send by registered post or speed post, the objections supported by an affidavit, in original, to the Central Government and shall also serve a copy of the objections on the applicant and the company at its registered office if the objector is not the company.

b) Where an application for winding up is filed by a person other than the company:

1) the objection, if any, by the company shall be accompanied with the statement of affairs in Form 4.

2) The Central Government if satisfied that a prima facie case for winding up of the company is made out, direct the company to file its objections along with a statement of its affairs in Form 4 within thirty days of the direction.

3) A company which fails to file statement of affairs, shall forfeit the right to oppose the application and such directors and officers of the company as found responsible for such non compliance, shall be liable for punishment under sub Section (4) of Section 274 of the Act.

(6) Affidavit in support: Every application shall be accompanied by an affidavit, verifying the same and shall be drawn up in the first person, and shall state the full name, age, occupation and complete residential address of the deponent and shall be signed by the deponent and sworn before an Oath Commissioner.

(7) Documents may be attested by the party or the authorized representative or the advocate: Where the application is filed by the authorized representative, Memorandum of Appearance shall be appended to the application as in Form C.

(8) Admission of application and directions: Upon the filing of the application, it shall be listed before the Central Government for admission and consideration of objections received, if any.

(9) Consideration and disposal: The Central Government may upon considering the application, in case where there are no objections, wherever applicable, statement of affairs have been received, and found that the company can be would up through summary procedures, may allow the application and pass a winding up order. in any other case may either dismiss the application or may issue notice to the company or the objector to file a reply or issue any other direction deemed fit and proper.

(10) Reply of the notice: The objector or the company as the case may be within a period of thirty days from the receipt of notice file a reply to the application for winding up.

(11) Order: Upon considering the application and the reply, if the central government is of the view that.

a) the grounds for winding up are made out and no further evidence is required it shall pass an order winding up the company.

b) the grounds for winding up are not made out it shall dismiss the application.

c) the adjudication of the application involves complex issues of facts and law or the Central Government is of the opinion that summary procedures under the Part IV of Chapter XX is not possible, the Central Government shall return the application, where after, the applicant shall be at liberty to approach the Tribunal. Sale of assets and recovery of debts due to company Section 362 (1) states that the Official Liquidator shall expeditiously dispose of all the assets whether movable or immovable within sixty days of his appointment.

Sub-Section (2) states that the Official Liquidator shall serve a notice within thirty days of his appointment calling upon the debtors of the company or the contributories, as the case may be, to deposit within thirty days with him the amount payable to the company.

As per Sub-Section (3) when any debtor does not deposit the amount under Sub-Section (2), the Central Government may, on an application made to it by the Official Liquidator, pass such orders as it thinks fit.

Sub-Section (4) requires the amount recovered under this Section by the Official Liquidator to be deposited in accordance with the provisions of Section 349.

1.5.4 Settlement of claims of creditors by official liquidator (Section 363)

As per Section 363 (1), the Official Liquidator within thirty days of his appointment shall call upon the creditors of the company to prove their claims in such manner as may be prescribed, within thirty days of the receipt of such call. As per Sub-Section (2) The Official Liquidator shall prepare a list of claims of creditors in such manner as may be prescribed and each creditor shall be communicated of the claims accepted or rejected along with reasons to be recorded in writing.

1.5.5 Appeal by creditor

As per 364 (1), any creditor aggrieved by the decision of the Official Liquidator under Section 363 may file an appeal before the Central Government within thirty days of such decision. Sub-Section (2) states that the Central Government may after calling the report from the Official Liquidator either dismiss the appeal or modify the decision of the Official Liquidator.

Sub-Section (3) states that the Official Liquidator shall make payment to the creditors whose claims have been accepted. (4) The Central Government may, at any stage during settlement of claims, if considers necessary, refer the matter to the Tribunal for necessary orders.

1.5.6 Order of dissolution of company (Section 365)

Section 365 (1) states that the Official Liquidator shall, if he is satisfied that the company is finally wound up, submit a final report to:

(a) the Central Government, in case no reference was made to the Tribunal under Sub-Section (4) of Section 364, and

(b) in any other case, the Central Government and the Tribunal.

As per Sub-Section (2) the Central Government, or as the case may be, the Tribunal on receipt of such report shall order that the company be dissolved. (3) Where an order is made under Sub-Section (2), the Registrar shall strike off the name of the company from the register of companies and publish a notification to this effect.

[**Note**: Some of the Rules under this Chapter are yet to be notified].

Self Assessment Questions:

(1) Define winding up? What are the various modes of winding up?

(2) Explain the various provisions of winding up by the Tribunal under the Companies Act, 2013.

(3) What is voluntary winding up? Who are entitled to make a petition to the Tribunal?

(4) Describe the duties and powers of liquidator appointed by the Tribunal.

(5) Discuss about fraudulent preference in the course of winding -up.

(6) How is a 'Committee of Inspection' in a compulsory winding up appointed? What are its functions?

(7) How is any vacancy in the Committee filled up?

(8) What is a 'Statement of Affairs'? State the contents that must be included therein. By whom and within what time limit should it be made?

(9) Write short notes on the following:

(a) Committee of Inspection.

(b) Contributory.

(c) Dissolution of Company.

(d) Winding up of Company.

(e) Contingent and prospective Creditor.

(f) Over-riding Preferential payments.

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STUDY NOTE : 1

THE COMPANIES ACT, 2013

PART – L : COMPANIES INCORPORATED OUTSIDE INDIA

This Study Note Includes:

L : 1.1 Foreign Company

L : 1.2 Application of Act to foreign companies

L : 1.3 Documents, to be delivered to Registrar by foreign companies

L : 1.4 Accounts of foreign company

L : 1.5 Display of name, of foreign company

L : 1.6 Service on foreign company

L : 1.7 Debentures, annual return, registration of charges, books of account and their inspection

L : 1.8 Fee for registration of documents

L : 1.9 Interpretation

L : 1.10 Dating of prospectus and particulars to be contained therein

L : 1.11 Provisions as to expert's consent and allotment

L : 1.12 Registration of prospectus

L : 1.13 Offer of Indian Depository Receipts

L : 1.14 Application of sections 34 to 36 of Chapter XX

L : 1.15 Punishment for contravention

L : 1.16 Company's failure to comply with provisions of this Chapter not to affect validity of contracts,

Chapter XXII of the Companies Act, 2013 deals with the companies incorporated outside India. Section 380 to 386 and 392 and 393 shall apply to all foreign companies. Central Government, however, may exempt any class of foreing company on compliance of any above sections.

L : 1.1 FOREIGN COMPANY [SECTION 2(42)]

(a) According to section 2(42) of the Companies Act, 2013, 'foreign company' means any company or body corporate incorporated outside India which:

(1) has a place of business in India whether by itself or through an agent, physically or through electronic mode, and

(2) conducts any business activity in India in any other manner.

(b) According to the Companies (Registration of Foreign Companies) Rules, 2014, 'electronic mode' means carrying out electronically based, whether main server is installed in India or not, including, but not limited to:

(1) business to business and business to consumer transactions, data interchange and other digital supply transactions.

(2) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India.

(3) financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management.

(4) online services such as telemarketing, telecommuting, telemedicine, education and information research, and

(5) all related data communication services, whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

L : 1.2 APPLICATION OF ACT TO FOREIGN COMPANIES (SECTION 379)

Where not less than 50% of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by:

(a) one or more citizens of India, or

(b) by one or more companies or bodies corporate incorporated in India, or

(c) by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with the provisions of Chapter XXII and such other provisions of this Act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India.

L : 1.3 DOCUMENTS, TO BE DELIVERED TO REGISTRAR BY FOREIGN COMPANIES [SECTION 380(1)]

(a) Every foreign company shall, within 30 days of the establishment of its place of business in India, deliver to the Registrar for registration:

(1) a certified copy of the Charter, Statutes or Memorandum and Articles, of the company or other instrument constituting or defining the constitution of the company. If the instrument is not in the English language, a certified translation thereof in the English language.

(2) the full address of the Registered or Principal Office of the company.

(3) a list of the directors and secretary of the company containing such particulars as may be prescribed.

In relation to the nature of particulars to be provided as above, the Companies (Registration of Foreign Companies) Rules, 2014, provide that the list of directors and secretary or equivalent (by whatever name called) of the foreign company shall contain the following particulars, for each of the persons included in such list, namely:

a) personal name and surname in full.

b) any former name or names and surname or surnames in full.

c) father's name or mother's name and spouse's name.

d) date of birth.

e) residential address.

f) nationality.

g) if the present nationality is not the nationality of origin, his nationality of origin.

h) passport Number, date of issue and country of issue. (if a person holds more than one passport then details of all passports to be given)

i) income-tax permanent account number (PAN), if applicable.

j) occupation, if any.

k) whether directorship in any other Indian company, (Director Identification Number (DIN), Name and Corporate Identity Number (CIN) of the company in case of holding directorship).

l) other directorship or directorships held by him.

m) membership number (for Secretary only), and

n) e-mail ID.

(4) the name and address or the names and addresses of one or more persons resident in India authorized to accept, on behalf of the company, service of process and any notices or other documents required to be served on the company.

(5) the full address of the office of the company in India which is deemed to be its principal place of business in India.

(6) particulars of opening and closing of a place of business in India on earlier occasion or occasions.

(7) declaration that none of the directors of the company or the authorized representative in India has ever been convicted or debarred from formation of companies and management in India or abroad, and

(8) any other information as may be prescribed.

(b) According to the Companies (Registration of Foreign Companies) Rules, 2014, the above information shall be filed with the Registrar within 30 days of the establishment of its place of business in India, in Form FC-1 along with prescribed fees and documents required to be furnished as provided in section 380(1). The application shall also be supported with an attested copy of approval from the Reserve Bank of India under the Foreign Exchange Management Act or Regulations, and also from other regulators, if any, approval is required by such foreign company to establish a place of business in India or a declaration from the authorized representative of such foreign company that no such approval is required.

(c) Office where documents to be delivered:

(1) According to the Companies (Registration of Foreign Companies) Rules, 2014, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.

(2) If any foreign company ceases to have a place of business in India, it shall forthwith give notice of the fact to the Registrar, and from the date on which such notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, provided it has no other place of business in India.

(d) Under section 380 (2) every foreign company existing at the commencement of the Companies Act 2013, which has not delivered to the Registrar the documents and particulars specified in section 592(1) of the Companies Act, 1956, it shall continue to be subject to the obligation to deliver those documents and particulars in accordance with the Companies Act, 1956.

(e) Section 380 (3) provides that where any alteration is made or occurs in the documents delivered to the Registrar under section 380, the foreign company shall, within 30 days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration form FC-2 along with prescribed fees.

Action for improper use or description as foreign company: According to the Companies (Registration of Foreign Companies) Rules, 2014, if any person or persons trade or carry on business in any manner under any

name or title or description as a foreign company registered under the Act or the rules made there under, that person or each of those persons shall, unless duly registered as foreign company under the Act and rules made there under, shall be liable for investigation under section 210 of the Companies Act, 2013 and action consequent upon that investigation shall be taken against that person.

L : 1.4 ACCOUNTS OF FOREIGN COMPANY [SECTION 381(1)]

(a) Every foreign company shall, in every calendar year:

(1) make out a balance sheet and profit and loss account in such form, containing such particulars and including or having attached or annexed thereto such documents as may be prescribed, and

(2) deliver a copy of these documents to the Registrar.

(b) According to the Companies (Registration of Foreign Companies) Rules, 2014, every foreign company shall prepare financial statement of its Indian business operations in accordance with Schedule III or as near thereto as possible for each financial year including:

(1) documents that are required to be annexed should be in accordance with Chapter IX i.e., Accounts of Companies.

(2) The documents relating to copies of latest consolidated financial statements of the parent foreign company, as submitted by it to the prescribed authority in the country of its incorporation under the applicable laws there.

(c) The Central Government is empowered to direct that, in the case of any foreign company or class of foreign companies, the requirements of clause (a) of section 381(1) shall not apply, or shall apply subject to such exceptions and modifications as may be specified in notification in that behalf.

(d) If any of the specified documents are not in the English language, a certified translation thereof in the English language shall be annexed. [Section 381 (2)].

(e) Every foreign company shall send to the Registrar along with the documents required to be delivered to him, 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 section 381(1) is made.

According to the Companies (Registration of Foreign Companies) Rules, 2014, every foreign company shall file with the Registrar, along with the financial statement, in Form FC3 with such fee as provided under Companies (Registration Offices and Fees) Rules, 2014 a list of all the places of business established by the foreign company in India as on the date of balance sheet.

According to the Companies (Registration of Foreign Companies) Rules, 2014, if any foreign company ceases to have a place of business in India, it shall forthwith give notice of the fact to the Registrar, and as from the date on which notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, if it does not have other place of business in India.

(f) According to the Companies (Registration of Foreign Companies) Rules, 2014:

(1) Further, every foreign company shall, along with the financial statement required to be filed with the Registrar, attach thereto the following documents. namely:

a) Statement of related party transaction.

b) Statement of repatriation of profits.

c) Statement of transfer of funds (including dividends, if any).

The above statements shall include such other particulars as are prescribed in the Companies (Registration of Foreign Companies) Rules, 2014.

(2) All these documents shall be delivered to the Registrar within a period of 6 months of the close of the financial year of the foreign company to which the documents relate.

(g) Audit of accounts of foreign company: According to the Companies (Registration of Foreign Companies) Rules, 2014:

a) Every foreign company shall get its accounts, pertaining to the Indian business operations prepared in accordance with section 381(1) and Rules thereunder, shall be audited by a practicing Chartered Accountant in India or a firm or limited liability partnership of practicing Chartered Accountants.

b) The provisions of Chapter X i.e., audit and auditors and rules made there under, as far as applicable, shall apply, 'mutatis mutandis', to the foreign company.

L : 1.5 DISPLAY OF NAME, OF FOREIGN COMPANY [SECTION 382]

Every foreign company shall:

(a) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situated.

(b) 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, bills, letter - heads and in all notices, and other official publications of the company, and

(c) if the liability of the members of the company is limited, cause notice of that fact.

(d) to be stated in every such prospectus issued and in all business letters, bills, letter-heads, advertisements and other official publications of the company, in legible English characters.

L : 1.6 SERVICE ON FOREIGN COMPANY [SECTION 383]

Any process, notice or other document required to be served on a foreign company shall be deemed to be sufficiently served, if addressed to any person whose name and address have been delivered to the Registrar under section 380 and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode.

L : 1.7 DEBENTURES, ANNUAL RETURN, REGISTRATION OF CHARGES, BOOKS OF ACCOUNT AND THEIR INSPECTION [SECTION 384]

(a) The provisions of section 71 (Issue of Debentures) shall apply mutatis mutandis to a foreign company.

(b) The provisions of section 92 (Preparation and filing of Annual return) shall, subject to such exceptions, modifications and adaptations as may be made therein by rules made under this Act, apply to a foreign company as they apply to a company incorporated in India.

According to the Companies (Registration of Foreign Companies) Rules, 2014, every foreign company shall prepare and file an annual return in Form FC-4 along with prescribed fees, within a period of 60 days from the last day of its financial year, to the Registrar containing the particulars as they stood on the close of the

financial year.

(c) The provisions of section 128 (Books of account, etc., to be kept by company) 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 to in that section, with respect to monies received and spent, sales and purchases made, and assets and liabilities, in the course of or in relation to its business in India.

(d) The provisions of Chapter VI (Registration of Charges) shall apply mutatis mutandis to charges on properties which are created or acquired by any foreign company.

(e) The provisions of Chapter XIV (Inspection, inquiry and investigation) shall apply mutatis mutandis to the Indian business of a foreign company as they apply to a company incorporated in India.

L : 1.8 FEE FOR REGISTRATION OF DOCUMENTS [SECTION 385]

There shall be paid to the Registrar for registering any document required by the provisions of this Chapter to be registered by him, such fee, as may be prescribed.

According to the Companies (Registration of Foreign Companies) Rules, 2014, fee to be paid to the Registrar for registering any document relating to a foreign company shall be such as provided in the Companies (Registration Offices and Fees) Rules, 2014.

L : 1.9 INTERPRETATION [SECTION 386]

For the purposes of the foregoing provisions of this Chapter, the expression:

(a) 'Certified' means certified in the prescribed manner to be a true copy or a correct translation.

(b) 'Director', in relation to a foreign company, includes any person in accordance with whose directions or instructions the Board of Directors of the company is accustomed to act, and

(c) 'Place of business' includes a share transfer or registration office.

L : 1.10 DATING OF PROSPECTUS AND PARTICULARS TO BE CONTAINED THEREIN [SECTION 387]

(a) Prospectus to be dated and signed [Section 387(1)]

No person shall issue, circulate or distribute in India any prospectus offering to subscribe for securities of a company incorporated or to be incorporated outside India, whether the company has or has not established, or when formed will or will not establish, a place of business in India, unless the prospectus is dated and signed, and

(1) contains particulars with respect to the following matters, namely:

a) the instrument constituting or defining the constitution of the company.

b) the enactments or provisions by or under which the incorporation of the company was effected.

c) address in India where the said instrument, enactments or provisions, or copies thereof, and if the same are not in the English language, a certified translation thereof in the English language can be inspected.

d) the date on which and the country in which the company would be or was incorporated, and

e) whether the company has established a place of business in India and, if so, the address of its principal office in India, and

(2) states the matters specified under section 26 (Matters to be stated in prospectus). Provided that points (1), (2) and (3) of point (a) 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.

(b) No waiver of compliance in prospectus [Section 387(2)]

Any condition requiring or binding an applicant for securities to waive compliance with any requirement imposed by virtue of section 387(1) or purporting to impute him with notice of any contract, documents or matter not specifically referred to in the prospectus, shall be void.

(c) Form of application for securities to be issued along with prospectus [Section 387(3)]

No person shall issue to any person in India a form of application for securities of such a company or intended company as is mentioned in section 387(1), unless the form is issued with a prospectus which complies with the provisions of this Chapter (Chapter XXII) and such issue does not contravene the provisions of section 388:

Exception: If it is shown that the form of application was issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to securities.

(d) Section 387(4) further provides that the provisions of section 387:

(1) shall not apply to the issue to existing members or debenture holders of a company of a prospectus or form of application relating to securities of the company, whether an applicant for securities will or will not have the right to renounce in favor of other persons, and

(2) except in so far as it requires a prospectus to be dated, to the issue of a prospectus relating to securities which are or are to be in all respects uniform with securities previously issued and for the time being dealt in or quoted on a recognized stock exchange, but, subject as aforesaid, section 387 shall apply to a prospectus or form of application whether issued on or with reference to the formation of a company or subsequently.

(e) Nothing in section 387 shall limit or diminish any liability which any person may incur under any law for the time being in force in India or under the Companies Act, 2013 apart from section 387.

L : 1.11 PROVISIONS AS TO EXPERT'S CONSENT AND ALLOTMENT [SECTION 388]

(a) No person shall issue, circulate or distribute in India any prospectus offering for subscription in securities of a company incorporated or to be incorporated outside India, whether the company has or has not been established, or when formed will or will not establish, a place of business in India:

(1) if, where the prospectus includes a statement purporting to be made by an expert, he has not given, or has before delivery of the prospectus for registration withdrawn, his written consent to the issue of the prospectus with the statement included in the form and context in which it is included, or there does not appear in the prospectus a statement that he has given and has not withdrawn his consent as aforesaid, or

(2) if the prospectus does not have the effect, where an application is made in pursuance thereof, of rendering all persons concerned bound by all the provisions of sections 33 and 40, so far as applicable.

(b) For the purposes of this section, a statement shall be deemed to be included in a prospectus, if it is contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.

L : 1.12 REGISTRATION OF PROSPECTUS [SECTION 389]

No person shall issue, circulate or distribute in India any prospectus offering for subscription in securities of a company incorporated or to be incorporated outside India, whether the company has or has not established, or when formed will or will not establish, a place of business in India, unless before the issue, circulation or distribution of the prospectus in India, a copy thereof certified by the chairperson of the company and two other directors of the company as having been approved by resolution of the managing body has been delivered for registration to the Registrar and the prospectus states on the face of it that a copy has been so delivered, and there is endorsed on or attached to the copy, any consent to the issue of the prospectus required by section 388 and such documents as may be prescribed.

According to the Companies (Registration of Foreign Companies) Rules, 2014, the following documents shall be annexed to the prospectus, namely:

(a) any consent to the issue of the prospectus required from any person as an expert.

(b) a copy of contracts for appointment of managing director or manager and in case of a contract not reduced into writing, a memorandum giving full particulars thereof.

(c) a copy of any other material contracts, not entered in the ordinary course of business, but entered within preceding 2 years.

(d) a copy of underwriting agreement, and

(e) a copy of power of attorney, if prospectus is signed through duly authorized agent of directors.

L : 1.13 OFFER OF INDIAN DEPOSITORY RECEIPTS [SECTION 390]

For the purposes of this section, and according to the Companies (Registration of Foreign Companies) Rules, 2014, Indian Depository Receipts (IDR) means any instrument in the form of a depository receipt created by a Domestic Depository in India and authorized by a company incorporated outside India making an issue of such depository receipts.

According to section 390, notwithstanding anything contained in any other law for the time being in force, the Central Government may make rules applicable for:

(a) the offer of Indian Depository Receipts (IDR).

(b) the requirement of disclosures in prospectus or letter of offer issued in connection with IDR.

(c) the manner in which the IDR shall be dealt with in a depository mode and by custodian and underwriters, and

(d) the manner of sale, transfer or transmission of IDR, by a company incorporated or to be incorporated outside India, whether the company has or has not established, or will or will not establish, any place of business in India.

According to the Companies (Registration of Foreign Companies) Rules, 2014, no company incorporated or to be incorporated outside India, whether the company has or has not established, or may or may not establish, any place of business in India shall make an issue of Indian Depository Receipts (IDRs) unless it complies with the conditions mentioned under this rule, in addition to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and any directions issued by the Reserve Bank of India.

The Rules relating to offer, disclosure requirements and manner of transfer and sale related to IDR are contained in Companies (Registration of Foreign Companies) Rules, 2014.

L : 1.14 APPLICATION OF SECTIONS 34 TO 36 OF CHAPTER XX [SECTION 391]

Section 391 of the Companies Act, 2013 came into force partially from 1st April, 2014 which provides for Application of sections 34 to 36 of Chapter XX. According to this section:

The provisions of sections 34 to 36 (both inclusive) shall apply to:

(a) the issue of a prospectus by a company incorporated outside India under section 389 as they apply to prospectus issued by an Indian company.

(b) the issue of IDR by a foreign company -

Subject to secton 376, the provisions of chapter XX, relating to winding up shall apply to foreign companies for closure of business in India, as if it is an Indian company.

L : 1.15 PUNISHMENT FOR CONTRAVENTION [SECTION 392]

Without prejudice to the provisions of section 391, if a foreign company contravenes the provisions of Chapter XXII of the Companies Act, 2013 (i.e., Chapter on Companies incorporated outside India), the foreign company shall be punishable with fine which shall not be less than ₹ 1,00,000 but which may extend to ₹ 3,00,000 and in the case of a continuing offence, with an additional fine which may extend to ₹ 50,000 for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 5,00,000, or with both.

Thus, the punishment for contravention may be summed up as under:

(a) Fine on defaulting foreign company in the range of ₹ 1 lac to 3 lacs.

(b) In case of continuing default an additional fine on the foreign company to the tune of ₹ 50,000 per day after the first during which the contravention continues.

(c) Punishment for every officer of the foreign company who is default shall be:

(1) Imprisonment for a maximum term of 6 months, or

(2) Imposition of a fine of a minimum amount of ₹ 25,000, or

(3) Both - imprisonment and fine.

L : 1.16 COMPANY'S FAILURE TO COMPLY WITH PROVISIONS OF THIS CHAPTER NOT TO AFFECT VALIDITY OF CONTRACTS [SECTION 393]

Any failure by a company to comply with the provisions of Chapter XXII of the Companies Act, 2013, 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. However, 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 such contract, dealing or transaction, until the company has complied with the provisions of the Companies Act, 2013, applicable to it.

Self Assessment Questions

(1) Write short note on

(a) Foreign Company

(b) Documents to be delivered to registrar by Foreign Companies

(c) Dating of Prospectus

(d) Offer of IDR

(2) What are the Provisions as to accounts of Foreign Company under section 381 of Companies Act, 2013?

(3) Explain the Provisions relating to 'Display of name of Foreign Company' and 'Service on Foreign Company'.

(4) Explain the Provisions as to Expert's consent and allotment under Chapter XXII of the Companies Act, 2013?

(5) Explain the Provision as to 'Registration of Prospectus' under Section 389 of Companies Act, 2013?

(6) Explain the punishment provisions under the Companies Act, 2013 if a foreign company contravenes the provisions of Chapter XXII?

STUDY NOTE : 1

THE COMPANIES ACT, 2013

PART – M : OFFENCES AND PENALTIES

This Study Note Includes:

M : 1.1 Types of Penalties

M : 1.2 Offences to be non-cognizable

M : 1.3 Application of fines

The Companies Act, 2013 provides the provisions as to Offences and Penalties in Chapter XXVIII.

M : 1.1 TYPES OF PENALTIES

1.1.1 Offence

Offence is defined as an act or omission made punishable by any law for the time being in force. An offence is constituted as soon as it is found that the acts which constitute that offence have been committed by the accused. An act or omission is an offence only if it is made punishable by any law for the time being in force and not otherwise. Offences are of three kinds:

(a) Bailable or non-bailable offences

(b) Cognizable or non-cognizable offences and

(c) Compoundable or non-compoundable offences.

There is an essential distinction between an offence and the prosecution for an offence. The former forms parts of the substantive law while the latter of procedural law.

The offences and penalties are of different types. The penalty depends upon the nature and gravity of offence. The penalty may be simple imprisonment or fine or both, it depends upon the offence committed by the party. The Companies Act, 2013 also contains the provisions with regard to the offences and penalties there upon. The Contravention of the provisions of the Companies Act, 2013 is considered as offence.

(a) **Bailable or Non-Bailable Offences**

Bailable offence' means an offence (i) which is mentioned as bailable in the First Schedule of the Indian Penal Code or (ii) which is made bailable by any other law for the time being in force. 'Non-bailable offence' means any other offence. Bailable offences are considered less serious than non-bailable offences. In bailable offences, bail can be claimed as of right and is granted as a matter of course by the police officer or by the court. It does not, however, mean that in case of a non-bailable offence, bail can never be granted. If simply means that the accused cannot ask for bail as of right in such cases. The Police officer or the court has discretion to grant bail after considering the facts and circumstances of each case. Again, bailable and non-bailable offences should not be confused with bailable and non-bailable warrants. In appropriate cases, a non-bailable warrant may be issued by a court for bailable offences. The matter is entirely in the discretion of the court. Schedule I specifies which offences are bailable offences and which are non-bailable offences under the Indian Penal Code and under other Statutes.

(b) **Cognizable offence and Non-Cognizable Offences**

'Cognizable offence' is an offence and 'Cognizable case' is a case for which a police officer may arrest without warrant, while 'Non-cognizable offence' is an offence and 'Non-cognizable case' is a case for which a police officer has no authority to arrest without warrant. Schedule I specifies which offences are cognizable and which are non-cognizable under the Indian Penal Code and under other statutes. Non-cognizable cases are considered less grave than cognizable cases. Likewise, non-cognizable offences are considered less serious than cognizable offences. A police officer can investigate a cognizable case without an order of a magistrate, but he cannot investigate without such order if the case is non-cognizable one. If a case involves one or more cognizable offence it would be a cognizable case even if other offence or offences may be non-cognizable

(c) **Compoundable and Non-Compoundable Offences**

A composition is an arrangement or settlement of different between the injured party and the person against whom the complaint is made. Ordinarily, it is the State that has the right or power to punish offenders, although individuals might be directly and personally aggrieved by the commission of the offences. The Criminal Law regards the punishment imposed by the law at the instance of the State on the offender as the proper and sufficient satisfaction not only for the society as a whole, but also for individual or individuals personally aggrieved by the offence. But in case of certain offences the law permits aggrieved person himself to agree to receive satisfaction other than actual punishment in substitution of the punishment.

1.1.2 Types of Penalties

(a) There are five types of penalties that have been contemplated under the Companies Act, 2013. They are:

(1) Fine only

(2) Imprisonment or fine

(3) Imprisonment or fine or with both

(4) Imprisonment and fine and

(5) Imprisonment only

Of the above, the offences referred to in (1) to (3) are compoundable and others are not compoundable.

(b) The persons who may be made liable for the offences and punished under the Act are:

(1) the company

(2) directors and officers of the company; and

(3) any person committing an offence

1.1.3 Officer who is in Default

In this context, it is important to note 'officer who is in default' defined under section 2 (60) of the Companies Act, 2013. According to this section "officer who is in default", for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely:

(a) whole-time director.

(b) key managerial personnel.

(c) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified.

(d) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorizes, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default.

(e) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity.

(f) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance.

(g) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer.

1.1.4 Compounding of certain offences [Section 441]

(a) According to Sub-Section 1, any offence punishable under this Act (whether committed by a company or any officer thereof) with fine only, may, either before or after the institution of any prosecution, be compounded by:

(1) the Tribunal, or

(2) where the maximum amount of fine which may be imposed for such offence does not exceed five lakh rupees, by the Regional Director or any officer authorized by the Central Government, on payment or credit, by the company or, as the case may be, the officer, to the Central Government of such sum as that Tribunal or the Regional Director or any officer authorized by the Central Government, as the case may be, may specify:

Provided that the sum so specified shall not, in any case, exceed the maximum amount of the fine which may be imposed for the offence so compounded:

Provided further that in specifying the sum required to be paid or credited for the compounding of an offence under this sub-section, the sum, if any, paid by way of additional fee under sub-section (2) of section 403 [Fees for filing, etc.,] shall be taken into account:

Provided also that any offence covered under this sub-section by any company or its officer shall not be compounded if the investigation against such company has been initiated or is pending under this Act.

(b) However, as per Sub Section 2, nothing in sub-section (1) shall apply to an offence committed by a company or its officer within a period of three years from the date on which a similar offence committed by it or him was compounded under this section.

(c) For the purposes of this section,

(1) any second or subsequent offence committed after the expiry of a period of three years from the date on which the offence was previously compounded, shall be deemed to be a first offence.

(2) "Regional Director" means a person appointed by the Central Government as a Regional Director for the purposes of this Act.

(d) Every application for the compounding of an offence shall be made to the Registrar who shall forward the same, together with his comments thereon, to the Tribunal or the Regional Director or any officer authorized by the Central Government, as the case may be.

(1) Where any offence is compounded under this section, whether before or after the institution of any prosecution, an intimation thereof shall be given by the company to the Registrar within seven days from the date on which the offence is so compounded.

(2) Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, either by the Registrar or by any shareholder of the company or by any person authorized by the Central Government against the offender in relation to whom the offence is so compounded.

(3) Where the compounding of any offence is made after the institution of any prosecution, such compounding shall be brought by the Registrar in writing, to the notice of the court in which the prosecution is pending and on such notice of the compounding of the offence being given, the company or its officer in relation to whom the offence is so compounded shall be discharged.

(e) The Tribunal or the Regional Director or any officer authorized by the Central Government, as the case may be, while dealing with a proposal for the compounding of an offence for a default in compliance with any provision of this Act which requires a company or its officer to file or register with, or deliver or send to, the Registrar any return, account or other document, may direct, by an order, if it or he thinks fit to do so, any officer or other employee of the company to file or register with, or on payment of the fee, and the additional fee, required to be paid under section 403, such return, account or other document within such time as may be specified in the order.

(f) Any officer or other employee of the company who fails to comply with any order made by the Tribunal or the Regional Director or any officer authorized by the Central Government under sub-section (4) shall be punishable with imprisonment for a term which may extend to six months, or with fine not exceeding one lakh rupees, or with both.

(g) Notwithstanding anything contained in the Code of Criminal Procedure, 1973:

(1) any offence which is punishable under this Act, with imprisonment or fine, or with imprisonment or fine or with both, shall be compoundable with the permission of the Special Court, in accordance with the procedure laid down in that Act for compounding of offences.

(2) any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable.

(h) No offence specified in this section shall be compounded except under and in accordance with the provisions of this section.

Only those offences which are punishable with either Penalty or Penalty or imprisonment i.e. where it is at discretion of the tribunal to impose penalty or imprisonment, are compoundable under section 441. In other words offence which is specifically punishable with imprisonment only or imprisonment plus fine is non-compoundable.

M : 1.2 OFFENCES TO BE NON-COGNIZABLE [SECTION 439]

Section 439 of the Companies Act, 2013 provides for offences to be non-cognizable. According to this section:

(a) Notwithstanding anything in the Code of Criminal Procedure, 1973, every offence under this Act except the offences referred to in sub-section (6) of section 212 shall be deemed to be non-cognizable within the meaning of the said Code.

(b) No court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder of the company, or of a person authorized by the Central Government in that behalf.

(c) The court may take cognizance of offences relating to issue and transfer of securities and non-payment of dividend, on a complaint in writing, by a person authorized by the Securities and Exchange Board of India.

Nothing in this sub-section shall apply to a prosecution by a company of any of its officers.

(d) Where the complainant is the Registrar or a person authorized by the Central Government, the presence of such officer before the Court trying the offences shall not be necessary unless the court requires his personal attendance at the trial. The above provisions shall not apply to 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 in Chapter XX or in any other provision of this Act relating to winding up of companies.

(e) The liquidator of a company shall not be deemed to be an officer of the company.

M : 1.3 APPLICATION OF FINES [SECTION 446]

Section 446 of the Companies Act, 2013 came into force on 12th September, 2013 which provides for Application of fines. According to this section:

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 payment of a reward to the person on whose information the proceedings were instituted.

Self Assessment Questions

(1) State the different types of punishments prescribed under the Companies Act, 2013.

(2) What do you mean by the term 'Compoundable'?

(3) What are the Provisions as to Compounding of certain offences under section 441 of the Companies Act, 2013?

(4) What are the Provisions as to Offences to be Non-Cognizable under section 439 of the Companies Act, 2013?

(5) Write short notes on the following:

(a) Non-Cognizable Offence

(b) Cognizable Offence

(6) What is the difference between

(a) Bailable and Non-bailable offence

(b) Compounding and Non-Compounding of offence

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STUDY NOTE : 1

THE COMPANIES ACT, 2013

PART – N: NATIONAL COMPANY LAW TRIBUNAL AND APPELLATE TRIBUNAL

This Study Note Includes:

N : 1.1 National Company Law Tribunal

N : 1.2 Special Courts

Chapter XXVII of the Companies Act, 2013 deals with the National Company Law Tribunal and Appellate Tribunal.

Background

The Companies (Second Amendment) Act, 2002 provides for the setting up of a National Company Law Tribunal and Appellate Tribunal to replace the existing Company Law Board (CLB) and Board for Industrial and Financial Reconstruction (BIFR). The setting up of the NCLT as a specialized institution for corporate justice is based on the recommendations of the Justice Eradi Committee, a committee set up to examine the existing law relating to winding up proceedings of companies in order to re-model it in line with the latest developments and innovations in the corporate law and governance and to suggest reforms in the procedure at various stages followed in the insolvency proceedings of companies to avoid unnecessary delays in tune with the international practice in this field. The setting up of the NCLT and NCLAT are part of the efforts to move to a regime of faster resolution of corporate disputes, thus improving the ease of doing business in India. It is also expected that the NCLT and NCLAT will also pave the way for the faster implementation of the bankruptcy code. Their setting up is expected to reduce the burden on courts.

The establishment of the National Company Law Tribunal (NCLT) consolidates the corporate jurisdiction of the following authorities:

(a) Company Law Board.

(b) Board for Industrial and Financial Reconstruction.

(c) The Appellate Authority for Industrial and Financial Reconstruction.

(d) Jurisdiction and powers relating to winding up restructuring and other such provisions, vested in the High Courts.

On June 01, 2016, the Ministry of Corporate Affairs (MCA) published a notification regarding the constitution of the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) with effect from the June 01, 2016. The constitution of the aforesaid Tribunals is in exercise of the powers conferred by Sections 408 and 410 respectively of the new Companies Act, 2013.

With the establishment of the NCLT and NCLAT, the Company Law Board under the Companies Act, 1956 stands dissolved w.e.f.01.06.2016.

N : 1:1 NATIONAL COMPANY LAW TRIBUNAL

1.1.1 Definitions

(a) 'Appellate Tribunal' means the National Company Law Appellate Tribunal constituted under Section 410 [Section 2 (4)].

(b) Section 407 of the Companies Act, 2013 provides the definitions of Chairperson, Judicial Members, Member, President and Technical Member as follows:

(1) 'Chairperson' means the Chairperson of the Appellate Tribunal [407(a)].

(2) 'Judicial Member' means a member of the Tribunal or the Appellate Tribunal appointed as such and includes the President or the Chairperson, as the case may be [407(b)].

(3) 'Member' means a member, whether Judicial or Technical of the Tribunal or the Appellate Tribunal and includes the President or the Chairperson, as the case may be [407(c)].

(4) 'President' means the President of the Tribunal [407(d)].

(5) 'Technical Member' means a member of the Tribunal or the Appellate Tribunal appointed as such [407(e)].

1.1.2 Constitution of National Company Law Tribunal (Section 408)

Section 408 of the Act contains the provisions as to constitution National Company Law Tribunal (NCLT).

According to this Section the Central Government shall, by notification, constitute with effect from such date as may be specified therein, a Tribunal to be known as the National Company Law Tribunal consisting of a President and such number of (Judicial and Technical) members, as the Central Government may deem necessary, to be appointed by notification, to exercise and discharge such powers and functions as conferred on it by or under this Act or any other law for the time being in force.

1.1.3 Qualification of President and Members of Tribunal (Section 409)

Section 409 of the Act contains the provisions as to Qualification of President and Members of Tribunal.

According to this Section the qualifications of the President and members of Tribunal are as follows:

(a) Qualification for the President: He shall be a person who is or has been a Judge of a High Court for five years.

(b) Qualification for the Judicial member: A person shall not be qualified for appointment as a Judicial Member unless he is or has been:

(1) a judge of a High Court, or

(2) a District Judge for at least five years, or

(3) an advocate of a court for at least ten years.

(c) Qualification for Technical member**:** A person shall not be qualified for appointment as a Technical Member unless he:

(1) has, for at least fifteen years been a member of the Indian Corporate Law Service or Indian Legal Service and has been holding the rank of Secretary and Additional Secretary to the Government of India, or

(2) is, or has been, in practice as a Chartered Accountant for at least fifteen years, or

(3) is, or has been, in practice as a Cost Accountant for at least fifteen years, or

(4) is, or has been, in practice as a Company Secretary for at least fifteen years, or

(5) is a person of proven ability, integrity and standing having special knowledge and experience, of not less than fifteen years, in, industrial finance, industrial management, industrial reconstruction, investment & accountancy, or

(6) is, or has been, for at least five years, a presiding officer of a Labour Court, Tribunal or National Tribunal constituted under the Industrial Disputes Act, 1947.

1.1.4 Constitution of Appellate Tribunal (Section 410)

Section 410 of the Act contains the provisions as to Constitution of Appellate Tribunal. According to this Section:

The Central Government shall, by notification constitute with effect from such date as may be specified therein, an Appellate Tribunal to be known as the National Company Law Appellate Tribunal (NCLAT) consisting of a Chairperson and such number of Judicial and Technical members, not exceeding eleven, as the Central Government may deem fit.

(a) NCLAT shall be appeals aganist the order of the Tribunal or National Finance Reporting Authority.

(b) any direction or order referred u/s 53N of the Competition Act.

1.1.5 Qualifications of Chairperson and members of Appellate Tribunal (Section 411)

Section 411 of the Act contains the provisions as to Qualifications of Chairperson and members of Appellate Tribunal. According to this Section:

(a) Qualifications of Chairperson: The chairperson shall be a person who is or has been a Judge of the Supreme Court or the Chief Justice of a High Court.

(b) Qualifications of Judicial member: A Judicial Member shall be a person who is or has been a Judge of a High Court or is a Judicial Member of the Tribunal for five years.

(c) Qualifications of Technical member: A Technical Member shall be a person of proven ability, integrity and standing having special knowledge and experience, of not less than twenty five years in various specified disciplines related to the management, conduct of affairs, revival, rehabilitation and winding up of companies.

1.1.6 Selection of Members of Tribunal and Appellate Tribunal (Section 412)

Section 412 of the Act contains the provisions as to Selection of Members of Tribunal and

Appellate Tribunal. According to this Section:

(a) The President of the Tribunal and the chairperson and Judicial Members of the Appellate Tribunal shall be appointed after consultation with the Chief Justice of India. [Section 412(1)].

(b) The Members of the Tribunal and the Technical Members of the Appellate Tribunal shall be appointed on the recommendation of a Selection Committee. [Section 412 (2)].

(c) Constitution of selection Committee: The selection committee shall consist of:

(1) Chief Justice of India or his nominee Chairperson.

(2) a senior Judge of the Supreme Court or a Chief Justice of High Court - Member.

(3) Secretary in the Ministry of Corporate Affairs - Member.

(4) Secretary in the Ministry of Law and Justice – Member, and

Whereas, the Secretary, Ministry of Corporate Affairs shall be the Convener of the Selection Committee [Section 412 (3)].

(d) Functioning of the Selection committee: The Selection Committee shall determine its procedure for recommending persons for the appointment of the members of the Tribunal and the technical members of the Appellate Tribunal [Section 412 (4)].

(e) No appointment of members shall be invalid**:** No appointment of the Members of the Tribunal or the Appellate Tribunal shall be invalid merely by reason of any vacancy or any defect in the constitution of the Selection Committee. [Section 412(5)].

Therefore, the President of the Tribunal and the Chairperson and the Judicial Members of the Appellate Tribunal shall be appointed after consultation with the Chief Justice of India. The members of the Tribunal and the Technical Members of the Appellate Tribunal shall be appointed on recommendation of a Selection committee. The constitution of the selection committee has been provided in the Act. Convener to Selection Committee shall be the Secretary, Ministry of Corporate Affairs.

Selection Committee has been allowed to determine its procedure for recommending persons. However, in case of tie on any matter a chairman shall have a casting vote.

1.1.7 Term of office of President, Chairperson and other Members (Section 413)

Section 413 of the Act contains the provisions as to Term of office of President, Chairperson and other Members NCLT and NCLAT. According to this Section:

(a) The President and every other Member of the Tribunal shall hold office as such for a term of five years from the date on which he enters upon his office, but shall be eligible for re-appointment for another term of five years.

(b) A Member of the Tribunal shall hold office as such until he attains:

(1) the age of sixty seven years (in the case of the President).

(2) the age of sixty five years (in the case of any other Member).

Provided that a person who has not completed fifty years of age shall not be eligible for appointment as Member.

Provided further that the Member may retain his lien with his parent cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.

(c) 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, but shall be eligible for re-appointment for another term of five years.

(d) A Member of the Appellate Tribunal shall hold office as such until he attains:

(1) the age of seventy years (in the case of the Chairperson).

(2) the age of sixty seven years (in the case of any other Member).

Provided that a person who has not completed fifty years of age shall not be eligible for appointment as Member.

Provided further that the Member may retain his lien with his parent cadre or Ministry or Department, as the case may be, while holding office as such for a period not exceeding one year.

1.1.8 Salary, allowances and other terms and conditions of service of Members (Section 414)

Section 414 of the Act contains the provisions as to Salary, allowances and other terms and conditions of Members. According to this Section:

The salary, allowances and other terms and conditions of service of the Members of the Tribunal and the 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 Members shall be varied to their disadvantage after their appointment.

1.1.9 Acting President and Chairperson of Tribunal or Appellate Tribunal (Section 415).

Section 415 of the Act contains the provisions as to Acting President and Chairperson of Tribunal or Appellate Tribunal. According to this Section:

(a) In the event of the occurrence of any vacancy in the office of the President or the Chairperson by reason of his death, resignation or otherwise, the senior-most Member shall act as the President or the Chairperson, as the case may be, until the date on which a new President or Chairperson appointed in accordance with the provisions of this Act to fill such vacancy enters upon his office.

(b) When the President or 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 President or the Chairperson, as the case may be, until the date on which the President or the Chairperson resumes his duties.

1.1.10 Resignation of Members (Section 416)

Section 416 of the Act contains the provisions as to Resignation of Members of NCLT and NCLAT. According to this Section:

The President, the Chairperson or any Member may, by notice in writing under his hand addressed to the Central Government, resign from his office.

Provided that the President, the Chairperson, or the Member shall continue to hold office until the expiry of three months from the date of receipt of such notice by the Central Government or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is earliest.

1.1.11 Removal of Members (Section 417)

Section 417 of the Act contains the provisions as to Removal of Members. According to this Section:

The Central Government may, after consultation with the Chief Justice of India, remove from office the President, Chairperson or any Member, who:

(a) has been adjudged an insolvent, or

(b) has been convicted of an offence which, in the opinion of the Central Government, involves moral turpitude, or

(c) has become physically or mentally incapable of acting as such President, the Chairperson, or Member, or

(d) has acquired such financial or other interest as is likely to affect prejudicially his functions as such President, the Chairperson or Member, or

(e) has so abused his position as to render his continuance in office prejudicial to the public interest.

Provided that the President, the Chairperson or the Member shall not be removed on any of the grounds specified in clauses (b) to (e) without giving him a reasonable opportunity of being heard.

1.1.12 Staff of Tribunal and Appellate Tribunal (Section 418)

Section 418 of the Act contains the provisions as to Staff of Tribunal and Appellate Tribunal. According to this Section:

(a) The Central Government shall, in consultation with the Tribunal and the Appellate Tribunal, provide the Tribunal and the Appellate Tribunal, as the case may be, with such officers and other employees as may be necessary for the exercise of the powers and discharge of the functions of the Tribunal and the Appellate Tribunal.

(b) The officers and other employees of the Tribunal and the Appellate Tribunal shall discharge their functions under the general superintendence and control of the President, or as the case may be, the Chairperson, or any other Member to whom powers for exercising such superintendence and control are delegated by him.

(c) The salaries and allowances and other conditions of service of the officers and other employees of the Tribunal and the Appellate Tribunal shall be such as may be prescribed.

1.1.13 Benches of Tribunal (Section 419)

Section 419 of the Act contains the provisions as to Benches of Tribunal. According to this Section:

(a) The Central Government by notification may constitute such number of Benches of the Tribunal.

(b) The Principal Bench of the Tribunal shall be at New Delhi which shall be presided over by the President of the Tribunal.

(c) The powers of the Tribunal shall be exercisable by Benches consisting of two Members out of whom one shall be a Judicial Member and the other shall be a Technical Member.

The Central Government also constituted 11 (eleven) Benches of the NCLT in exercise of its powers under Sub-Section (1) of Section 419 of the new Companies Act, 2013. Of the said 11 benches, two shall be situated in New Delhi and one each at Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai.

1.1.14 Orders of Tribunal (Section 420)

Section 420 of the Act contains the provisions as to Orders of Tribunal. According to this Section:

(a) The Tribunal may, after giving the parties to any proceeding before it, a reasonable opportunity of being heard, pass such orders thereon as it thinks fit.

(b) The Tribunal may, at any time within two years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it, and shall make such amendment, if the mistake is brought to its notice by the parties.

Provided that no such amendment shall be made in respect of any order against which an appeal has been preferred under this Act.

(c) The Tribunal shall send a copy of every order passed under this Section to all the parties concerned.

1.1.15 Appeal from orders of Tribunal (Section 421)

Section 421 of the Act contains the provisions as to Appeal from orders of Tribunal. According to this Section:

(a) Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal.

(b) No appeal shall lie to the Appellate Tribunal from an order made by the Tribunal with the consent of parties.

(c) 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 of the Tribunal is made available to the person aggrieved and shall be in such form, and accompanied by such fees, as may be prescribed.

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty five days from the date aforesaid, but within a further period not exceeding forty-five days, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within that period.

(d) On the receipt of an appeal under Sub-Section (1), the Appellate Tribunal shall, after giving the parties to the appeal a reasonable opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(e) The Appellate Tribunal shall send a copy of every order made by it to the Tribunal and the parties to appeal

1.1.16 Expeditious disposal by Tribunal and Appellate Tribunal (Section 422).

Section 422 of the Act contains the provisions as to Expeditious disposal by Tribunal and Appellate Tribunal. According to this Section:

(a) Every application or petition presented before the Tribunal and every appeal filed before the Appellate Tribunal shall be dealt with and disposed of by it as expeditiously as possible and every endeavour shall be made by the Tribunal or the Appellate Tribunal, as the case may be, for the disposal of such application or petition or appeal within three months from the date of its presentation before the Tribunal or the filing of the appeal before the Appellate Tribunal.

(b) Where any application or petition or appeal is not disposed of within the period specified in Sub-Section (1), the Tribunal or, as the case may be, the Appellate Tribunal, shall record the reasons for not disposing of the application or petition or the appeal, as the case may be, within the period so specified and the President or the Chairperson, as the case may be, may, after taking into account the reasons so recorded, extend the period referred to in Sub-Section (1) by such period not exceeding ninety days as he may consider necessary.

1.1.17 Appeal to Supreme Court (Section 423)

Section 423 of the Act contains the provisions as to Appeal to Supreme Court. According to this Section:

Any person aggrieved by any order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of receipt of the order of the 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.

1.1.18 Procedure before Tribunal and Appellate Tribunal (Section 424)

Section 424 of the Act contains the provisions as to Procedure before Tribunal and Appellate Tribunal (Section 424). According to this Section:

(a) The Tribunal and the Appellate Tribunal shall not, while disposing of any proceeding before it or, as the case may be, an appeal before it, 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 thereunder, the Tribunal and the Appellate Tribunal shall have power to regulate their own procedure.

(b) The Tribunal and the 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:

(1) summoning and enforcing the attendance of any person and examining him on oath.

(2) requiring the discovery and production of documents.

(3) receiving evidence on affidavits.

(4) subject to the provisions of Sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or a copy of such record or document

from any office.

(5) issuing commissions for the examination of witnesses or documents.

(6) dismissing a representation for default or deciding it 'ex parte'.

(7) setting aside any order of dismissal of any representation for default or any order passed by it 'ex parte', and

(8) any other matter which may be prescribed.

(c) Any order made by the Tribunal or the Appellate Tribunal may be enforced by that Tribunal 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 Tribunal or the Appellate Tribunal to send for execution of its orders to the court within the local limits of whose jurisdiction:

(1) in the case of an order against a company, the registered office of the company is situate, or

(2) in the case of an order against any other person, the person concerned voluntarily resides or carries on business or personally works for gain.

(d) All proceedings before the Tribunal or 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, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

1.1.19 Power to punish for contempt (Section 425)

Section 425 of the Act contains the provisions as to Powers of the NCLT and NCLAT to punish for contempt. According to this Section:

The Tribunal and the Appellate Tribunal shall have the same jurisdiction, powers and authority in respect of contempt of themselves as the High Court has and may exercise, for this purpose, the powers under the provisions of the Contempt of Courts Act, 1971, which shall have the effect subject to modifications that:

(a) the reference therein to a High Court shall be construed as including a reference to the Tribunal and the Appellate Tribunal, and

(b) the reference to Advocate-General in Section 15 of the said Act shall be construed as a reference to such Law Officers as the Central Government may, specify in this behalf.

1.1.20 Delegation of powers (Section 426)

Section 426 of the Act contains the provisions as to Delegation of powers by NCLT and NCLAT. According to this Section:

The Tribunal or the Appellate Tribunal may, by general or special order, direct, subject to such conditions, if any, as may be specified in the order, any of its officers or employees or any other person authorised by it to inquire into any matter connected with any proceeding or, as the case may be, appeal before it and to report to it in such manner as may be specified in the order.

1.1.21 President, Members, Officers, etc., to be Public Servants (Section 427)

Under this Section, the President, Members, officers and other employees of the Tribunal and the Chairperson, Members, Officers and other employees of the Appellate Tribunal shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code.

1.1.22 Protection of action taken in good faith (Section 428)

Under this Section, no suit, prosecution or other legal proceeding shall lie against the Tribunal, the President, Member, officer or other employee, or against the Appellate Tribunal, the Chairperson, Member, officer or other employees thereof or liquidator or any other person authorised by the Tribunal or the Appellate Tribunal for the discharge of any function under this Act in respect of any loss or damage caused or likely to be caused by any act which is in good faith done or intended to be done in pursuance of this Act.

1.1.23 Power to seek assistance of Chief Metropolitan Magistrate, etc. (Section 429)

Section 429 of the Act contains the provisions as to Power of the Tribunal to seek assistance of Chief Metropolitan Magistrate. According to this Section:

(a) The Tribunal may, in any proceeding relating to a sick company or winding up of any other company, in order to take into custody or under its control all property, books of account or other documents, request, in writing, the Chief Metropolitan Magistrate, Chief Judicial Magistrate or the District Collector within whose jurisdiction any such property, books of account or other documents of such sick or other company, are situate or found, to take possession thereof, and the Chief Metropolitan Magistrate, Chief Judicial Magistrate or the District Collector, as the case may be, shall, on such request being made to him:

(1) take possession of such property, books of account or other documents, and

(2) cause the same to be entrusted to the Tribunal or other person authorized by it.

(b) For the purpose of securing compliance with the provisions of Sub-Section (1), the Chief Metropolitan Magistrate, Chief Judicial Magistrate or the District Collector 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.

(c) No act of the Chief Metropolitan Magistrate, Chief Judicial Magistrate or the District Collector done in pursuance of this Section shall be called in question in any court or before any authority on any ground whatsoever.

1.1.24 Civil court not to have jurisdiction (Section 430)

Under this Section, no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Tribunal or the Appellate Tribunal is empowered to determine by or under this Act or any other law for the time being in force 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 any other law for the time being in force, by the Tribunal or the Appellate Tribunal.

1.1.25 Vacancy in Tribunal or Appellate Tribunal not to invalidate acts or proceedings. (Section 431)

Under this Section, no act or proceeding of the Tribunal or the Appellate Tribunal shall be questioned or shall be invalid merely on the ground of the existence of any vacancy or defect

in the constitution of the Tribunal or the Appellate Tribunal, as the case may be.

1.1.26 Right to legal representation (Section 432).

According to this Section, a party to any proceeding or appeal before the Tribunal or the Appellate Tribunal, as the case may be, may either appear in person or authorise one or more Chartered Accountants or Company Secretaries or Cost Accountants or legal practitioners or any other person to present his case before the Tribunal or the Appellate Tribunal, as the case may be.

1.1.27 Limitation (Section 433)

In terms of Section 433 of the Act, the provisions of the Limitation Act, 1963 shall, as far as may be, apply to proceedings or appeals before the Tribunal or the Appellate Tribunal, as the case may be.

1.1.28 Transfer of certain pending proceedings (Section 434)

Section 434 of the Act contains the provisions as to Transfer of certain pending proceedings. According to this Section:

(a) On such date as may be notified by the Central Government in this behalf:

(1) all matters, proceedings or cases pending before the Board of Company Law Administration shall stand transferred to the Tribunal and the Tribunal shall dispose of such matters, proceedings or cases in accordance with the provisions of this Act.

(2) any person aggrieved by any decision or order of the Company Law Board made before such date may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Company Law Board to him on any question of law arising out of such order.

(3) all proceedings under the Companies Act, 1956, shall stand transferred to the Tribunal and the Tribunal may proceed to deal with such proceedings from the stage before their transfer.

(4) Proceedings relating to cases of voluntary winding up of a company where notice of the resolution by advertising has been given but the company has not been dissolved before 1st April, 2017 shall continue to be dealt with in accordance with the Companies Act, 1956.

(b) The Central Government may make rules consistent with the provisions of this Act to ensure timely transfer of all matters, proceedings or cases pending before the Company Law Board or the courts, to the Tribunal under this Section.

N : 1.2 SPECIAL COURTS

Section 435 to 446 under Chapter XXVIII of the Companies Act, 2013 contains provisions as to establishment of Special Courts and offences triable by the Special Courts.

1.2.1 Establishment of Special Courts.

Section 435 of the Act contains the provisions as to Establishment of Special Courts. According to this Section:

(a) The Central Government may, for the purpose of providing speedy trial of offences under this Act, by notification, establish or designate as many Special Courts as may be necessary.

(b) A Special Court shall consist of -

(i) a single judge holding office as Session Judge or Additional Session Judge, in case of offences punishable under the Act with imprisonment of two years or more, and

(ii) a Metropolitan or Judicial Magistrate of 1st Class in case of other offences.

1.2.2 Offences triable by Special Courts (Section 436)

This Section provides a new provision as to offences triable by Special Courts, notwithstanding anything contained in the Code of Criminal procedure, 1973.

Under this Section:

(a) all offences under this Act shall be triable only by the Special Court established for the area in which the registered office of the company in relation to which the offence is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned.

(b) where a person accused of, or suspected of the commission of, an offence under this Act is forwarded to a Magistrate under Sub-Section (2) or Sub-Section (2A) of Section 167 of the Code of Criminal Procedure, 1973, such Magistrate may authorise the detention of such person in such custody as he thinks fit for a period not exceeding fifteen days in the whole where such Magistrate is a Judicial Magistrate and seven days in the whole where such Magistrate is an Executive Magistrate.

When trying an offence under this Act, a Special Court may also try an offence other than an offence under this Act with which the accused may, under the Code of Criminal Procedure, 1973 be charged at the same trial.

The Special Court may try in a summary way any offence if it is punishable with imprisonment up to 3 years.

1.2.3 Appeal and revision(Section 437)

Section 437 of the Act contains the provisions as to Appeal and revision. According to this Section:

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 on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

1.2.4 Application of Code to proceedings before Special Court (Section 438)

Section 435 of the Act contains the provisions as to Establishment of Special Courts. According to this Section:

According to this Section, the provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session or the Court of Metropolitan Magistrate or Judicial Magistrate of First Class and the person conducting a prosecution before a Special Court shall be deemed to be a Public Prosecutor.

1.2.5 Offences to be non-cognizable (Section 439)

According to this Section, subject to the Code of Criminal Procedure, 1973, every offence under this Act except the offences referred to in Sub-Section (6) of Section 212 shall be deemed to be non-cognizable within the meaning of the said Code.

Further, no court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder of the company or of a person authorised by the Central Government in that behalf.

Section 439 deals with the offences that are considered of non-cognizable nature under the Companies Act, 2013.

The term 'Non-cognizable offence' as defined under Section 4 of the Cr.PC. is an offence for which a police officer may not arrest without warrant.

(a) Offences under the Companies Act, 2013 deemed as non-cognizable: Overriding the provisions given under the Code of Criminal Procedure, 1973, every offence under this Act except the offences referred to in Section 212 (6) of the Companies Act, 2013, which deals with the investigation into affairs of company by Serious Fraud Investigation Office (SIFO), shall be deemed to be non-cognizable within the meaning of the said Code.

Therefore, the offences as covered under Section 212 (6) shall now be deemed to be cognizable where police officer may arrest person without warrant and are non-bailable. The Companies Act, 2013 establishes the offence covered under the Section 212 (6) as a public wrong which has to be prevented and controlled. This non-bailable nature of the offences deters the offender and the others from committing further and similar offences.

(b) Cognizance of offence: A court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof only on the written complaint of:

(1) The Registrar.

(2) A shareholder of the company, or

(3) Of a person authorised by the Central Government in that behalf.

Provided that the court may take cognizance of offences relating to issue and transfer of securities and non-payment of dividend, on a complaint in writing, by a person authorised by the Securities and Exchange Board of India.

Provided that nothing in this Sub-Section shall apply to a prosecution by a company of any of its officers.

However, in case of government companies as per the Notification no. G.S.R. 463 (E) dated 5th June 2015, court shall take cognizance of any offences under this Act which is alleged to have been committed by any company or any officer thereof on the complaint in writing of a person authorized by the Central Government in that behalf.

(c) Attendance of complainant: Where the complainant is the Registrar or a person authorised by the Central Government as given under Sub-Section (2), the presence of such officer before the Court trying the offences shall not be necessary unless the court requires his personal attendance at the trial.

(d) Non-application of Sub-Section (2) on the action of the liquidator: The provisions of Sub-Section (2) shall not apply to 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 in Chapter XX or in any other provision of this Act relating to winding up of companies.

The liquidator of a company shall not be deemed to be an officer of the company within the meaning of Sub-Section (2).

1.2.6 Transitional provisions (Section 440)

Under this Section, any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established, be tried by a Court of Session or Metropolitan Magistrate or Judicial Magistrate of First Class exercising jurisdiction over the area.

1.2.7 Compounding of certain offences (Section 441)

This Section contains the provisions as to compounding of offences. In terms of this Section, subject to the Code of Criminal Procedure, 1973, any offence punishable under this Act not being an offence punishible with imprisonment only or imprisonment and fine, may, either before or after the institution of any prosecution, be compounded by:

(a) the Tribunal, or

(b) where the maximum amount of fine which may be imposed for such offence does not exceed five lakh rupees, by the Regional Director or any officer authorised by the Central Government, on payment or credit, by the company or, as the case may be, the officer, to the Central Government of such sum as that Tribunal or the Regional Director or any officer authorised by the Central Government, as the case may be, may specify.

1.2.8 Mediation and Conciliation Panel (Section 442)

Alternative dispute resolution in India is not new and it was in existence even under the previous Arbitration Act, 1940. The Arbitration and Conciliation Act, 1996 has been enacted to accommodate the harmonisation mandates of UNCITRAL Model. To streamline the Indian legal system the traditional civil law known as Code of Civil Procedure (CPC), 1908 has also been amended and Section 89 has been introduced. Section 89 (1) of CPC provides an option for the settlement of disputes outside the court. It provides that where it appears to the court that there exist elements, which may be acceptable to the parties, the court may formulate the terms of a possible settlement and refer the same for arbitration, conciliation, mediation or judicial settlement. Due to extremely slow judicial process, there has been a big thrust on Alternate Dispute Resolution mechanisms in India.

'Alternative Dispute Resolution' (ADR) refers to any means of settling disputes outside the courtroom. Normally ADRs are Cost Effective, Fast, Flexible and Fair. ADR includes dispute resolution processes and techniques that act as a means for disagreeing parties to come to an agreement short of litigation. It is informal. There are various forms or ways of resolving disputes under ADR and generally classified into at least four types: (1) Negotiation (2) Mediation (3) Collaborative Law and (4) Arbitration. Despite historic resistance, ADR has gained widespread acceptance among both the general public and the legal profession in recent years.

1.2.9 Mediation and Conciliation

Section 442 of the Companies Act, 2013 provides for maintenance of Mediation and Conciliation Panel. It states that the Central government shall maintain a panel of experts for mediation

between the parties. Such panel may to be called Mediation and Conciliation Panel. The parties during the pendency of any proceedings before the Central Government or the Tribunal or the Appellate Tribunal under the Act may resort to mediation under these provisions.

After receiving application for referring the matter to Mediation and Conciliation Panel, the Central Government or Tribunal or the Appellate Tribunal, as the case may be, shall appoint one or more experts from such Panel. The matter is required to be disposed off within a period of three months from the date of such reference. The Panel is required to forward its recommendations to the Central Government or Tribunal or the Appellate Tribunal, as the case may be, within that period.

The aggrieved party may file its objections to the Central Government or Tribunal or the Appellate Tribunal, as the case may be. The Central Government or Tribunal or the Appellate Tribunal, may, suo motu, refer any matter pertaining to such proceedings to experts from the Panel.

Difference between Mediation and Conciliation

The meaning of these words as understood in India appears to be similar. 'Mediation' is a way of settling disputes by a third party who helps both sides to come to an agreement, which each considers acceptable. Mediation can be 'evaluative' or 'facilitative'. 'Conciliation', is a procedure like mediation but the third party, the conciliator, takes a more interventionist role in bringing the two parties together and in suggesting possible solutions to help achieve a settlement. The difference lies in the fact that the 'conciliator' can make proposals for settlement, 'formulate' or 'reformulate' the terms of a possible settlement while a 'mediator' would not do so but would merely facilitate a settlement between the parties.

From the very wording it appears that the 'Mediation and Conciliation Panel' as contemplated under Section 442 (as the name suggests) will adopt dual approach of 'Mediation' as well as 'Conciliation' in settling the disputes.

1.2.10 Power of Central Government to appoint Company Prosecutors (Section 443)

Under this Section:

(a) The Central Government may appoint (generally, or for any case, or in any case, or for any specified class of cases in any local area) one or more persons, as Company Prosecutors for the conduct of prosecutions arising out of this Act, and

(b) The persons so appointed as Company Prosecutors shall have all the powers and privileges conferred on Public Prosecutors appointed under Section 24 of the Cr. PC.

1.2.11 Appeal against acquittal (Section 444)

According to this Section:

The Central Government may, in any case arising under this Act, direct:

(a) any Company Prosecutor, or

(b) 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.

Appeal presented by such prosecutor or other person shall be deemed to have been validly presented to the appellate court.

1.2.12 Compensation for accusation without reasonable cause (Section 445)

According to this Section, the provisions of Section 250 of the Code of Criminal Procedure, 1973 shall apply 'mutatis mutandis' (with such changes as may be necessary) to compensation for accusation without reasonable cause before the Special Court or the Court of Session.

1.2.13 Application of fines (Section 446)

Under this Section, 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 payment of a reward to the person on whose information the proceedings were instituted.

1.2.14 Factor for determination of punishment

The Court or the Special Court, shall, while deciding the amount of fine or imprisonment under the Act, shall have due regards to the factors like size of the company, nature of business, injury to public interest, nature of default and repetition of default.

Self-Assessment Questions

(1) Explain the provisions as to constitution of NCLT / NCLAT under Section 408 and Section 410 of the Companies Act 2013.

(2) What are the qualifications of President and Members of the Tribunal under Section 409 of the Companies Act 2013?

(3) How the selection of the members of the NCLT and NCLAT be made under Section 412 of the Companies Act, 2013.

(4) Explain the terms and conditions of Office of President, Chairperson and Members of the NCLT and NCLAT.

(5) Write Short Notes on the following :

(a) Removable of Members under Section 417 of Companies Act, 2013.

(b) Power of the NCLT and NCLAT to Punish for contempt.

(6) Explain the procedure for establishment of Special Courts under the Companies Act, 2013 and discuss the offences triable by the Special Courts.

(7) The NCLT and the NCLAT have been created under the Companies Act, 2013. Discuss the constitutionality of NCLT and NCLAT vis-a-vis the Qualification of their members.

(8) Write Short Notes on the following:

(a) Mediation and conciliation panel

(b) Appointment of Company prosecutors under Section 443.

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STUDY NOTE : 2

SEBI LAWS AND REGULATIONS

PART – A : THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT,1992

This Study Note Includes:

A : 2.1 The Securities and Exchange Board of India Act,1992

A : 2.1 THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992

2.1.1 Introduction

The Securities and Exchange Board of India (SEBI) was constituted as the regulator of capital markets by the Government of India on 12th April 1988 under a resolution of the Government of India. Initially SEBI was a non-statutory body without any statutory power.

During this period, the securities markets in India were governed three principal Acts:

(a) The Capital Issues (Control) Act, 1947, which restricted issuer's access to the securities market and controlled the pricing of issues.

(b) The Companies Act, 1956 (now the Companies Act, 2013), which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues, and

(c) The Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges.

The Capital Issues (Control) Act, 1947 had its origin during the war in 1943 when the objective was to channel resources to support the war effort. The Act was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channeled in to proper lines, i.e., for desirable purposes to serve goals and priorities of the government, and to protect the interests of investors. Under the Act, any firm wishing to issue securities had to obtain approval from the Central Government, which also determined the amount, type and price of the issue.

Major part of the liberalization process was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. With this, Government's control over the issue of capital, pricing of the issues, fixing of the premia and rates of interest on debentures etc., ceased. The office which administered the Act was abolished to allow the market to allocate resources to competing uses.

However to ensure effective regulation of the market, SEBI Act, 1992 was enacted to empower SEBI with statutory powers for:

(1) protecting the interests of investors in securities,

(2) promoting the development of the securities market, and

(3) regulating the securities market. Its regulatory jurisdiction extends over corporate in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with the securities market in the interest of investors or of orderly development for securities market and can

conduct enquiries, audit and inspection of all concerned and adjudicate offences under the Act. In short, it has been given necessary autonomy and authority to regulate and develop an orderly securities market.

The SEBI Act, 1992 with 7 Chapters and 35 Sections, governs all the Stock Exchanges and the securities transactions in India. The legal framework of the Act is as follows:

Chapter	Description
Chapter I	Preliminary
Chapter II	Establishment of the Securities and Exchange Board of India
Chapter III	Transfer of Assets, Liabilities, etc., of the Existing Securities and Exchange Board to the Board
Chapter IV	Powers and Functions of the Board
Chapter V	Registration Certificate
Chapter VA	Prohibition of Manipulative and Deceptive Devices, Insider Trading and Substantial Acquisition of Securities or Control
Chapter VI	Finance, Accounts and Audit
Chapter VIA	Penalties and Adjudication
Chapter VIB	Establishment, Jurisdiction, Authority and Procedure of Appellate Tribunal
Chapter VII	Miscellaneous

The Securities Laws (Amendment) Act, 2014

The Securities Laws (Amendment) Act, 2014 aims to amend and plug the existing loopholes in three cardinal legislations controlling the securities market transactions in India, namely the Securities and Exchange Board of India (SEBI) Act, 1992, the Securities Contracts (Regulation) Act, 1956 and the Depositories Act, 1996. The Act was passed by the Parliament in the first week of August, 2014 after which it received the assent of the President on 22 August 2014 and was simultaneously published in the official gazette to bring the Securities Law (Amendment) Act, 2014 into force.

The Amended Act provides more teeth to the SEBI as follows:

(a) The SEBI powers have been widened and sharpened under the Act. This includes, calling for information and records from any person including any bank or any other authority or board or corporation established or constituted by or under any Central or State Act.

(b) Any pooling of funds under any scheme or arrangement, which is not registered with SEBI or is not covered under the SEBI Act, involving a corpus amount of ₹ 1000 million or more shall be deemed to be a collective investment scheme.

(c) The amount disgorged, pursuant to a direction issued, under Section 11B of SEBI Act or Section 12A of the Securities Contracts (Regulation) Act, 1956 or Section 19 of the Depositories Act, 1996, as the case may be, shall be credited to the Investor Protection and Education Fund established by SEBI and such amount shall be utilised by the SEBI in accordance with the regulations made under the Act.

(d) The power to issue directions under Section 11B of that SEBI Act, shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made there under, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention.

(e) If a person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any

direction of SEBI for refund of monies or fails to comply with a direction of disgorgement order issued under Section 11B or fails to pay any fees due to the Board, the Recovery Officer may proceed to recover from such person the amount by one or more of the following modes, namely:

(i) attachment and sale of the person's movable property.

(ii) attachment of the person's bank accounts.

(iii) attachment and sale of the person's immovable property.

(iv) arrest of the person and his detention in prison.

(v) appointing a receiver for the management of the person's movable and immovable properties.

2.1.2 Securities Exchange Board of India (SEBI)

Securities and Exchange Board of India has functions similar to the SEC or Securities Exchange Commission in the USA. In other words, the SEBI regulates the working of the financial markets in India, vis-à-vis investor protection and laying down of ethical standards for the working of the financial markets in India. That is how SEBI is also called as the watchdog of the Indian Markets.

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as:

".....to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto."

In 1995, the SEBI was given additional statutory power by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992. SEBI has to be responsive to the needs of three groups, which constitute the market:

(i) the issuers of securities.

(ii) the investors, and

(iii) the market intermediaries.

SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. Though this makes it very powerful, there is an appeal process to create accountability. There is a Securities Appellate Tribunal which is a three member tribunal. A second appeal lies directly to the Supreme Court.

Chapter II of the SEBI Act deals with the establishment of the Securities and Exchange Board of India. Section 3 says about the establishment and incorporation of Board. Sub-Section 1 says that a Board by the name of Securities Exchange Board of India shall be established. The Board shall be a body corporate by the name Securities Exchange Board of India which will have perpetual succession and a common seal, with power to acquire, hold and dispose of property, both movable and immovable, and to enter in to contract and can sue or be sued by the said name. The head office of the Board shall be at Bombay. The Board may establish other offices at any other places in India.

The management of the Board is mentioned in Section 4 of the Act. 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, 2013.

(c) one member from amongst the officials of the Reserve Bank.

(d) The remaining five other members shall be appointed by the Central Government of whom at least three shall be the whole time members.

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. 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. The Chairman and members shall be appointed by the Central Government. While choosing, the central government draw two members, i.e., Officers from Union Finance Ministry; One member from the Reserve Bank of India. Further, the remaining five members are also nominated by the Central Government out of them at least three shall be whole time members. The Chairman and the other member shall be persons of ability, integrity and standing who have the 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.

Section 5 says about term of office and conditions of service of Chairman and members of the Board. The term of office and other conditions of service of the Chairman and members shall be as prescribed by the Board. The Central Government shall have the right to terminate the services of the Chairman or a member appointed under Section 4 at any time before the expiry of the period prescribed, 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 by giving to the Central Government notice of not less than three months in writing.

The removal of the office has been mentioned in Section 6. The Central Government shall remove a member from the office if he:

(i) is or at any time has been adjudicated as insolvent.

(ii) is of unsound mind and stands so declared by the competent person.

(iii) has been convicted of an offence which in the opinion of the Central Government involves moral turpitude.

(iv) in the opinion of the Central Government the member has abused his position as to tender his continuation detrimental to the public interest. It is also provided that no member shall be removed under this Section unless he has been given an opportunity of being heard.

Regarding meetings, Section 7 says that the Board shall meet at such places and shall observe such rules of procedure in regard to the transaction of business at its meetings, including quorum as may be provided by the regulations. If the Chairman is unable to attend any of the meetings of the Board, any other member chosen by the members present from amongst themselves at the meeting shall preside at the meeting. All questions which come up to any meeting of the Board shall be decided by the majority votes of the members present and voting and in the event of equality of votes, the Chairman or in his absence, the person presiding shall have a second or casting vote.

But 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 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 part in any deliberation or decision of the Board with respect to that matter. (Section 7A).

No act or proceeding of the Board shall be invalid merely by reason of any vacancy in or any defect in the constitution of the Board, or any defect in the appointment of a person acting as a member of the board, or any irregularity in the procedure of the Board not affecting the merits of the case (Section 8).

2.1.2.1 Transfer of Assets, Liabilities etc., of the existing Securities and Exchange Board to the Board:

Chapter III deals with the transfer of assets, liabilities etc., of the existing Securities and Exchange Board to the Board. Section 10 stipulates that, 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 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 as so 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.

2.1.2.2 Power and Functions of the Securities Exchange Board of India

Chapter IV of the SEBI Act, 1992 deals with the powers and function of the Securities Exchange Board of India. The functions of the securities Exchange Board of India has been dealt in Section 11. Sub-Section (1) of Section 11 declares that it shall be the duty of the Securities Exchange Board of India:

(a) to protect the interest of investors in securities, and

(b) to promote the development of and

(c) to regulate the securities market by such measures as the Board thinks fit and

(d) for matters connected therewith and incidental thereto.

The Board is mainly entrusted with two main functions, namely:

(1) Regulatory functions and

(2) Developmental functions.

a) Regulatory functions

The Board is responsible for:

1) regulating the business in stock exchanges and any other securities markets.

2) 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.

3) 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.

4) registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds.

5) promoting and regulating self-regulatory organizations.

6) prohibiting fraudulent and unfair trade practices relating to securities markets.

7) promoting investors' education and training of intermediaries of securities markets.

8) prohibiting insider trading in securities.

9) regulating substantial acquisition of shares and take-over of companies.

10) 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.

11) 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.

12) 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.

13) levying fees or other charges for carrying out the purposes of this Section.

14) conducting research for the above purposes.

15) 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, and

16) performing such other functions as may be prescribed.

b) Developmental Functions

1) Promoting investors' education.

2) Training of intermediaries.

3) Conducting research and publishing information useful to all market participants.

4) Promotion of fair practices.

5) Promotion of self regulatory organizations.

Beside these above mentioned functions, the Board may take measures to undertake inspection of any book or register or any other document or record of any listed public company 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.

a. The Board shall also have the power of a civil court. Sub-Section (3) of Section 11 says that the Board shall have the same powers as are vested in a civil court under the Civil Procedure Code, 1908 (5 of 1908), while trying suit in respect of the following matters:

1) the discovery and production of books of account and other documents, at such place and such time as may be specified by the Board.

2) summoning and enforcing the attendance of persons and examining them on oath.

3) inspection of any books, registers and other documents of any person referred to in Section 12, at any place.

4)inspection of any book, or register, or other document or record of the company referred to in Sub-Section (2A).

5) issuing commissions for the examination of witnesses or documents.

b. In addition to the above mentioned powers, the Board may, by an order, in writing, in the interest of investors or securities market, take any of the following measures, either pending investigation or inquiry or inquiry or on completion of such investigation or inquiry, namely:

1) suspend the trading of any security in a recognised stock exchange.

2) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities.

3) suspend any office-bearer of any stock exchange or self- regulatory organisation from holding such position.

4) impound and retain the proceeds or securities in respect of any transaction which is under investigation.

5) 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 there under. 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 there under shall be allowed to be attached.

6) 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. The Board before passing any of the above orders shall give an opportunity of being heard to such intermediaries or persons concerned.

c. Further, the Securities Exchange Board of India has also the following powers:

1) Power to call periodical returns from recognized stock exchanges.

2) Power to compel listing of securities by public companies.

3) Power to levy fees or other charges for carrying out the purposes of regulation.

4) Power to call information or explanation from recognized stock exchanges or their members.

5) Power to grant approval to bye-laws of recognized stock exchanges.

6) Power to control and regulate stock exchanges.

7) Power to direct enquiries to be made in relation to affairs of stock exchanges or their members.

8) Power to make or amend bye-laws of recognized stock exchanges.

9) Power to grant registration to market intermediaries.

10) Power to declare applicability of Section 17 of the Securities Contract (Regulation) Act 1956, in any State or area, to grant licenses to dealers in securities.

d. As the primary object of the SEBI is the protection of the investors, accordingly Section 11A gives the power to Board to regulate or prohibit the issue of prospectus, offer document or advertisement soliciting money for issue of securities. For the protection of investors the Board may specify by regulations:

1) the matters relating to issue of capital, transfer of securities and other matters incidental thereto, and

2) the manner in which such matters shall be disclosed by the companies; and by general or special orders:

(a) prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities.

(b) specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

The Board may also specify the requirements for listing and transfer of securities and any other matter incidental thereto. The Board is also having power to issue directions to any such persons or any company.

e. Section 11C deals with investigation power of the Board. Sub-Section (1) says that where the Board has reasonable ground to believe that:

1) the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market, or

2) 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 there under, the Board may, at any time by order in writing, direct any person 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.

It shall be the duty of every manager, managing director, officer and other employee of the company and every intermediary or every person associated with the securities market, to produce to Investigating Authority or any other person authorised by the Board, all the books, registers, other documents and record of or relating to the company or relating to the intermediary. 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 it 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. The Investigating Authority may keep in its custody any books, registers, other documents and record produced 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. It is also provided that the Investigating Authority may call for any book, register, other document and record if they are needed again. It is 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.

f. If any person fails without reasonable cause or refuses:

1) 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, or

2) to furnish any information which is his duty to furnish, or

3) to appear before the Investigating Authority personally when required to do so or to answer any question which is put to him by the Investigating Authority, or

4) to sign the notes of any examination, 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.

The Investing 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.

2.1.2.3 Registration Certificate (Section 7)

A person willing to operate as stock broker, sub broker, share agent, banker to an issue, trustee of trust deed, register to an issue, merchant banker, underwriter, portfolio manager, investment advisor and such other intermediary can do so only if he gets himself registered under the SEBI Act, 1992. Unless he is registered under SEBI an intermediary cannot deal with securities market or cannot even buy or sell or deal in securities.

Section 12 of Chapter V deals with registration of stock brokers, sub-brokers, share transfer agents, etc. It says 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. It is also 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.

Sub-Section (1A) of Section 12 also mentions about registration of depository, participant, custodians, etc. It says that 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. It is prohibited to run any venture capital funds or any collective investment schemes

unless the same is registered under SEBI Act, 1992. Sub-Section (1B) says that 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. All these application for registration shall be in such manner and on payment of such fees as may be determined by the regulations.

2.1.2.4 Prohibition of Manipulative and Deceptive Devices, Insider Trading and Substantial Acquisition of Securities or Control (Section 12A)

Securities and Exchange Board of India has prohibited insider trading, substantial acquisition of securities or control. Insider trading can be defined as securities trading by insiders based on material non-public information in violation of a fiduciary or similar duty of trust and confidence to the company issuing the security to the company's shareholders or to the source of information. The main benefit of the insider trading goes to the insider. An insider can be the directors, officers, shareholders holding substantial number of shares, persons who are not employed by the corporation but receive confidential information from a corporation while providing services to the corporation like professional advisors, lawyers, investment bankers. In other words, the knowledge of unpublished price sensitive information in hands of persons connected to the companies which put them in an advantageous position over others who lack it, such information can be used to make gains by buying shares a cheaper rate anticipating that it might rise and it can be used to insulate themselves against losses by selling shares before the prices fall down, such kind of transaction entered into by persons having access to any unpublished information is called Insider Trading.

Consequently, SEBI banned insider trading and laid down the SEBI (Prohibition of Insider Trading) Regulation 1992. With a view to do away with the lacunae and inadequacies of the 1992 Regulations, SEBI has revamped the entire framework governing insider trading in India. Recently, SEBI (Prohibition of Insider Trading) Regulations, 2015 were notified vide notification dated 15th January, 2015. The regulations came into effect from May 15th, 2015.

Similarly, substantial acquisition of shares and take-overs has also been prohibited by SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

Section 12A of the Act provides that: 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 there under.

(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 there under.

(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 there under.

(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.

2.1.2.5 Penalties

SEBI is empowered to impose penalties under Chapter VIA of SEBI Act, 1992 [Section 15A to 15HB] for various violations such as penalty for failure to furnish information/return, penalty for default in case of stock brokers, penalty for insider trading, penalty for non-disclosure of acquisition of shares and takeovers and penalty for fraudulent and unfair trade practices etc.. In terms of Section 15J, the Adjudicating Officers while imposing penalty 'shall have due regard to' certain factors such as repetitive nature of default, the amount of disproportionate gain or unfair advantage, the amount of loss caused to an investor or group of investors. The details of the penalties are furnished below:

Sl.No	Section	Nature of Voilation	Penality
1	15A	Failure to: (a) furnish information etc. (b) file return etc. (c) maintain books of accounts etc.	Not less than ₹ 1 lakh and may extend to ₹ 1 lakh per day for continuous failure subject to a maximum of ₹ 1 crore.
2	15B	Penalty for failure by any person to enter into agreement with clients	Not less than ₹ 1 lakh and may extend to ₹ 1 lakh per day for continuous failure subject to a maximum of ₹ 1 crore.
3	15C	Penalty for failure to redress investors' grievances	Not less than ₹ 1 lakh and may extend to ₹ 1 lakh per day for continuous failure subject to a maximum of ₹ 1 crore.
4	15D	Penalty for certain defaults in case of mutual funds	Not less than ₹ 1 lakh and may extend to ₹ 1 lakh per day for continuous failure subject to a maximum of ₹ 1 crore.
5	15E	Penalty for failure to observe rules and regulations by an asset management company	Not less than ₹ 1 lakh and may extend to ₹ 1 lakh per day for continuous failure subject to a maximum of ₹ 1 crore.
6	15F	Fails to issue contract notes	Not less than ₹ 1 lakh
		Fails to deliver any security or fails to make payment	Not less than ₹ 1 lakh and may extend to ₹ 1 lakh per day for continuous failure subject to a maximum of ₹ 1 crore.
		Charges in excess of the brokerage specified	Not less than ₹ 1 lakh and may extend five times of the brokerage
7	15G	Penalty for insider trading	Not less than ₹ 10 lakh but which may extend to ₹ 25 crore or three times the amount of profits made out of insider trading, whichever is higher.
8	15H	Penalty for non-disclosure of acquisition of shares and takeovers	Not less than ₹ 10 lakh but which may extend to ₹ 25 crore or three times the amount of profits made out of insider trading, whichever is higher.
9	15HA	Penalty for fraudulent and unfair trade practices	Not less than ₹ 5 lakh but which may extend to ₹ 25 crore or three times the amount of profits made out of insider trading, whichever is higher.
10	15HB	Penalty for contravention where no separate penalty has been provided	Not less than ₹ 1 lakh and may extend ₹ 1 crore.

2.1.2.6 Adjudication

(a) Power to adjudicate (Sec 15I)

(1) For the purpose of adjudging under Sections 15A, 15B, 15C, 15D, 15E, 15F, 15G, 15H, 15HA and 15HB the Board shall appoint any of its 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, if 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.

(b) Factors to be taken into account by the adjudicating officer (Sec 15J)

While adjudging quantum of penalty under Section 15, the adjudicating officer shall have due regard to the following factors, namely:

(1) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default.

(2) the amount of loss caused to an investor or group of investors as a result of the default.

(3) the repetitive nature of the default.

According to Section 15JA, the adjudicating officer should ensure crediting all sums realized by way of penalties to Consolidated Fund of India. Further, all sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

2.1.2.7 Establishment, Jurisdiction, Authority and Procedure of Appellate Tribunal

Establishment, jurisdiction, authority and procedure of appellate tribunal has been given under Chapter VIB. The Securities Appellate Tribunal has been established under Section 15K of the Act. 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. The Central Government shall also specify in the notification the matters and places in relation to which the Securities Appellate Tribunal may exercise jurisdiction.

The composition of the Securities Appellate Tribunal has been dealt under 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.

The qualifications for becoming a member of Securities Appellate Tribunal are given in Section 15M. 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. Sub-Section (2) says that 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.

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. It is provided further that no person shall hold office as Member of the Securities Appellate Tribunal after he has attained the age of sixty-two years.

2.1.2.8 Appeal to Securities Appellate Tribunal (Section 15 T)

(a) Section 15T says about appeal to the Securities Appellate Tribunal. Any person aggrieved:

(1) 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 there under, or

(2) 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.

(b) Sub-Section (2) says that no appeal shall lie to the Securities Appellate Tribunal from an order made:

(1) by the Board on and after the commencement of the Securities Laws (Second Amendment) Act, 1999.

(2) by an adjudicating officer, with the consent of the parties. Every appeal 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.

On receipt of an appeal, 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. 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. The appeal filed before the tribunal 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.

2.1.2.9 Appeal to the Supreme Court (Section 15 Z)

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. It is also 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.

2.1.2.10 Procedure and Powers of the Securities Appellate Tribunal (Section 15U)

The powers and procedures of the Securities Appellate Tribunal have been given under Section 15U. The Securities 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 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. 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 (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) 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.

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 (45 of 1860) 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 (2 of 1974).

The appellant in the Securities Appellate Tribunal 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. 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 is empowered by or under this Act to determine and no injunction shall be granted by an 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.

1.1.1.11 Coordination with other Regulatory Authorities, etc.

The Board also prescribes, under its authority, various rules/regulations/circulars etc., which are applicable to public companies or the companies whose shares are being listed. The rules and regulations prescribed by the SEBI are obviously connected with the issue and the trading at the primary and the secondary market. Thus, the SEBI is expected to coordinate with the Government, Reserve Bank of India, various other organs, Intermediaries, Financial Institutions, World Stock Exchanges and various other recognized stock exchanges in India.

1.1.1.12 Power to make rules and regulations.

By virtue of the powers conferred under Section 29 & 30 of the Act, the SEBI is empowered to make rules and regulations. In this context, the SEBI has framed rules under the Act and also issued a number of regulations, guidance notes, circulars, notifications and clarifications etc., from time to time.

Some important rules/regulations/guidelines prescribed by the SEBI are given hereunder:

1. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

2. SEBI (Prohibition of Insider Trading) Regulations, 2015

3. SEBI (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2015

4. Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Second

Amendment) Regulations, 2015

5. The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Third Amendment) Regulations, 2015

6. The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2015

7. The SEBI (Issue of Capital and Disclosure Requirements) (Sixth Amendment) Regulations, 2015

8. SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

9. SEBI (Central Listing Authority) Regulations, 2003

10. SEBI (Delisting of Securities) Guidelines, 2003

11. SEBI (Employees Stock Option Scheme and Employees Stock Purchase Scheme) Guidelines, 1999

12. SEBI (Issue of Sweat Equity) Regulations, 2002

13. SEBI (Buy-Back of Securities) Regulations, 1998

14. SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997

15. SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003

16. SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 1995

17. SEBI (Mutual Funds) Regulations, 1996

18. SEBI (Collective Investment Schemes) Regulations, 1999

19. SEBI Guidelines for Foreign Institutional Investors

20. SEBI (FIIs) Regulations, 1995

21. SEBI (Venture Capital Funds) Regulations, 1996

22. SEBI (Foreign Venture Capital Funds) Regulations

23. SEBI (Depositories and Participants) Regulations, 1996

24. SEBI (Custodian of Securities) Regulations, 1996

25. SEBI (Credit Rating Agencies) Regulations, 1999

26. SEBI (Merchant Bankers) Rules, 1992

27. SEBI (Merchant Bankers) Regulations, 1992/SEBI (Registrars to an issue and Share Transfer Agents) Rules, 1993

28. SEBI (Registrars to an issue and Share Transfer Agents)Regulation, 1993

29. SEBI (Underwriters) Rules, 1993

30. SEBI (Underwriters) Regulations, 1993

31. SEBI (Debenture Trustees) Rules, 1993

32. SEBI (Debenture Trustees) Regulations, 1993/SEBI (Bankers to an Issue) Rules, 1994

33. SEBI (Bankers to an Issue) Regulations, 1994

34. SEBI (Stock Brokers and Sub-Brokers) Rules, 1992

35. SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992

36. SEBI (Portfolio Manager) Rules, 1993

37. SEBI (Portfolio Manager) Regulations, 1993

38. SEBI (Ombudsman) Regulations, 2003.

Apart from very few prominent rules and regulations framed or prescribed by the SEBI, there are numerous circulars etc., issued by the SEBI for effective discharge of its functions. Among all, the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 or ICDR Regulations, 2009 will be of great significance when it comes to initial issue. There is a separate discussion in the later part of this Chapter on this topic.

Further, the SEBI will discharge the most of important function of Takeovers and has to prevent the indirect takeovers floating the rules and regulations. Also, insider trading, various schemes, mutual funds etc. the rule and regulations in respect of the public companies like buyback of securities etc. will be effectively administered by SEBI.

STUDY NOTE : 2

SEBI LAWS AND REGULATIONS

PART – B : REVISED CLAUSE 49 OF THE LISTING AGREEMENT AND GUIDELINES ISSUED UNDER CLAUSE 49

This Study Note Includes:

With the introduction of SEBI (Listing Obligation & Disclosure Requirement) Regulations, 2015, Clause 49 has been omitted. A shorten version of listing agreement is signed between the company and the Stock Exchange, which inter alia, mentions that LODR Reguations shall be complied with. Students are advised to referred to chapter on LODR in this study material.

STUDY NOTE : 2

SEBI LAWS AND REGULATIONS

PART – C : SEBI ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS (ICDR) REGULATIONS 2009

This Study Note Includes:

C : 2.3 SEBI Issue of Capital and Disclosure Requirements (ICDR) Regulations 2009

C : 2.3 SEBI ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS (ICDR) REGULATIONS 2009

The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 are applicable for public issue, rights issue, preferential issue, an issue of bonus shares by a listed issuer, qualified institutions placement by a listed issuer and issue of Indian Depository Receipts.

2.3.1 Scheme of the Regulations

The regulations are divided into 11 Chapters and 20 schedules as detailed below:

Chapter	Description
I	Preliminary
II	Common Conditions for Public Issues and Rights Issues
III	Provisions as to Public Issue (with 5 parts)
IV	Rights Issue
V	Manner of Disclosures in the Offer Documents
VI	General Obligations of Issuer and Intermediaries with respect to Public Issue and Rights Issue
VII	Preferential Issue
VIII	Qualified Institutions Placement
VIIIA	Institutional Placement Programme
IX	Bonus Issue
X	Issue of Indian Depository Receipts
XA	Right Issue of Indian Depository Rights
XB	Issue of specified securities by Small and Medium Enterprises
XI	Miscellaneous (with 21 Schedules)

The important provisions of the regulations are furnished below:

2.3.1 General conditions for public issues and rights issues

An issuer cannot make a public issue or rights issue of equity shares and convertible securities under the following conditions:

(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 SEBI, or

(b) If any of the promoters, director or person 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 the order or directions made by SEBI.

(c) Unless an application is made to one or more recognised stock exchanges for listing of equity shares and convertible securities on such stock exchanges and has chosen one of them as a designated stock exchange. However, in case of an initial public offer, the issuer should make an application for listing of the equity shares and convertible securities in at least one recognised stock exchange having nationwide trading terminals.

(d) Unless it has entered into an agreement with a depository for dematerialisation of equity shares and convertible securities already issued or proposed to be issued.

(e) Unless all existing partly paid-up equity shares of the issuer have either been fully paid up or forfeited.

(f) Unless firm arrangements of finance through verifiable means towards 75% 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.

Warrants may be issued with the public issue or right issue of specified securities subject to following :

i) Tenure of such warrants shall not exceed 18 months from the date of allotment in the public or rights issue

ii) Not more than one warrant shall be attached to one specified security.

The amount for general corporate purposes as mentioned in the objects of the issue in the draft offer document shall not exceed 25% of the amount raised by the issuer.

With effect from 25th May, 2016, no issuer shall make,

(a) a public issue of equity securities, if the issuer or any of its promoters or directors is a wilful defaulter; or

(b) a public issue of convertible debt instruments if,

(i) the issuer or any of its promoters or directors is a wilful defaulter, or

(ii) 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.

(iii) Conversion price to be decided upfront along with receipt of 25% of the value.

(iv) Consideration to be forfeited if option is not exercised.

An issuer making a rights issue of specified securities, shall make disclosures as specified in Part G of Schedule VIII, in the offer document and abridged letter of offer, if the issuer or any of its promoters or directors is a wilful defaulter.

In case of a rights issue of specified securities referred to in sub-regulation (6) above, the promoters or promoter group of the issuer, shall not renounce their rights except to the extent of renunciation within the promoter group.

2.1.3 Appointment of Merchant banker and other intermediaries

The issuer should appoint one or more merchant bankers, at least one of whom should be a lead merchant banker. The issuer should also appoint other intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue. The issuer should in consultation with the lead merchant banker, appoint only those intermediaries which are registered with SEBI. 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 should be predetermined and disclosed in the offer document.

2.1.4 Conditions for Initial Public Offer (Regulation 26)

(a) An issuer may make an initial public offer (an offer of equity shares and convertible debentures by an unlisted issuer to the public for subscription and includes an offer for sale of specified securities to the public by an existing holder of such securities in an unlisted issuer) if:

(1) The issuer has net tangible assets of at least ` 3 crores in each of the preceding 3 years (of 12 months each) of which not more than 50% are held in monetary assets. If more than 50% of the net tangible assets are held in monetary assets, then the issuer has to make firm commitment to utilize such excess monetary assets in its business or project.

(2) 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.

(3) The issuer company has a net worth of at least ` 1 crores in each of the preceding 3 full years (of 12 months each).

(4) The aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed 5 times its pre-issue net worth as per the audited balance sheet of the preceding financial year.

(5) In case of change of name by the issuer company within last one year, at least 50% of the revenue for the preceding one year should have been earned by the company from the activity indicated by the new name.

(b) Any issuer not satisfying any of the conditions stipulated above may make an initial public offer if:

(1) The issue is made through the book building process and the issuer undertakes to allot at least 75% of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make allotment to the qualified institutional buyers.

(c) An issuer may make an initial public offer of convertible debt instruments without making a prior public issue of its equity shares and listing.

(d) An issuer cannot make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand.

(e) No issuer can make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person any option to receive equity shares after the initial public offer.

2.1.5 Conditions for further public offer (Regulation 27)

(a) An issuer may make a further public offer (an offer of equity shares and convertible securities) if it satisfies the following conditions:

(1) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed 5 times its pre-issue net worth as per the audited balance sheet of the preceding financial year.

(2) if it has changed its name within the last one year, at least 50% of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.

(b) If the issuer does not satisfy the above conditions, it may make a further public offer if it satisfies the following conditions:

a) the issue is made through the book building process and the issuer undertakes to allot at least 75% of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make allotment to the qualified institutional buyers.

2.1.6 Pricing in Public Issues

The issuer determines the price of the equity shares and convertible securities in consultation with the lead merchant banker or through the book building process. In case of debt instruments, the issuer determines the coupon rate and conversion price of the convertible debt instruments in consultation with the lead merchant banker or through the book building process.

2.1.7 Differential Pricing

An issuer may offer equity shares and convertible securities at different prices, subject to the following condition:

(a) the retail individual investors/shareholders or employees entitled for reservation making an application for equity shares and convertible securities of value not more than ` 2 lakh, may be offered equity shares and convertible securities at a price lower than the price at which net offer is made to other categories of applicants provided that such difference is not more than 10% of the price at which equity shares and convertible securities are offered to other categories of applicants.

(b) in case of a book built issue, the price of the equity shares and convertible securities offered to an anchor investor cannot be lower than the price offered to other applicants.

(c) in case of a composite issue, the price of the equity shares and convertible securities offered in the public issue may be different from the price offered in rights issue and justification for such price difference should be given in the offer document.

(d) in case the issuer opts for the alternate method of book building, the issuer may offer specified securities to its employees at a price lower than the floor price. However, the difference between the floor price and the price at which equity shares and convertible securities are offered to employees should not be more than 10% of the floor price.

(e) Face value may be less than 10 but not less than ₹1 if the issue price is ₹ 500 or more per share. If issue price is less than ₹ 500 the face value shall be ₹ 10 /- per share.

2.1.8 Promoters' Contribution (Regulation 32)

The promoters' minimum contribution varies from case to case. The promoters of the issuer are required to contribute in the public issue as follows:

(a) In case of an initial public offer, the minimum contribution should not be less than 20% of the post issue capital.

(b) In case of further public offer, it should be either to the extent of 20 % of the proposed issue size or to the extent of 20% of the post-issue capital.

(c) In case of a composite issue, either to the extent of 20% of the proposed issue size or to the extent of 20% of the post-issue capital excluding the rights issue component.

2.1.9 Lock-in of specified securities held by promoters.

In a public issue, the equity shares and convertible debentures held by promoters are locked-in for the period stipulated below:

(a) minimum promoters' contribution is locked-in for a period of 3 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 is locked-in for a period of 1 year.

However, excess promoters' contribution in a further public offer are not subject to lock-in.

2.1.10 Book Building – Schedule XI

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 the SEBI (ICDR) Regulations 2009.

(a) In an issue made through the book building process, the allocation in the net offer to public category is made as follows:

(1) Not less than 35 % to retail individual investors.

(2) Not less than 15 % to non institutional investors i.e. investors other than retail individual investors and qualified institutional buyers.

(3) Not more than 50% to Qualified Institutional Buyers; 5 % of which would be allocated to mutual funds.

Provided that in addition to five per cent allocation available in terms of clause (3), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

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:

(1) not more than ten per cent to retail individual investors;

(2) not more than fifteen per cent to non-institutional investors;

(3) not less than seventy five per cent to qualified institutional buyers, five per cent of which shall be allocated to mutual funds:

Provided further that in addition to five per cent allocation available in terms of clause (3), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

In an issue made through the book building process, the issuer may allocate up to 60% of the portion available for allocation to qualified institutional buyers to an anchor investor in accordance with the conditions specified in in ICDR Regulations 2009.

(b) In an issue made other than through the book building process, allocation in the net offer to public category will be made as follows:

(1) minimum 50% to retail individual investors, and

(2) remaining to individual applicants other than retail individual investors and other investors including corporate bodies or institutions, irrespective of the number of equity shares and convertible securities applied for.

(3) the unsubscribed portion in either of the categories specified above (point 1 and 2) may be allocated to applicants in the other category.

If the retail individual investor category is entitled to more than 50% on proportionate basis, the retail individual investors will be allocated that higher percentage.

2.1.11 Indian Depository Receipts

A foreign company can access Indian securities market for raising funds through issue of Indian Depository Receipts (IDRs).

An IDR is an instrument denominated in Indian Rupees in the form of a depository receipt created by a Domestic Depository (custodian of securities registered with the Securities and Exchange Board of India) against the underlying equity of issuing company to enable foreign companies to raise funds from the Indian securities markets.

An issuing company making an issue of IDR is required to satisfy the following:

(a) it should be listed in its home country.

(b) it should not be prohibited to issue securities by any regulatory body.

(c) it should have a track record of compliance with securities market regulations in its home country.

2.1.12 Conditions for issue of IDR.

An issue of IDR is subject to the following conditions:

(a) issue size should not be less than ₹ 50 crore.

(b) procedure to be followed by each class of applicant for applying should be mentioned in the prospectus.

(c) minimum application amount should be ₹ 20,000.

(d) at least 50% of the IDR issued should be allotted to qualified institutional buyers on proportionate basis.

(e) the balance 50% 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 has to be disclosed in the prospectus. Allotment to investors within a category will be on proportionate basis.

Further, at least 30% of the IDRs issued will be allocated to retail individual investors and in case of under-subscription in retail individual investor category, spill over to other categories to the extent of under-subscription may be permitted.

(f) At any given time, there will be only one denomination of IDR of the issuing company.

2.1.13 Amendments to SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

SEBI has amended SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations) during May, 2016 to simplify the process of fast track issue of securities and revised the Institutional Placement Program (ITP) framework making it easier for startups companies to raise capital. SEBI has also made consequential changes in other regulations due to introduction of ITP. This move of SEBI permitting wider categories of entities to list without going through IPO and granting various exemptions aims at enabling entities to tap capital markets with ease and aims towards ease of doing business in India.

The salient features of the changes are furnished below:

(a) **Fast Track Issue**

(1) Companies which have average market capitalization of ₹ 10 billion in case of public issue and ₹2.5 billion in case of rights issue can make issue under Fast Track Issue route.

(2) Additional conditions prescribed:

a) The issuer, promoter or promoter group or director of the issuer has not settled any alleged violation of securities laws through consent or settlement mechanism with SEBI during 3 years immediately preceding the reference date.

b) In case of rights issue, promoters and promoter group shall mandatorily subscribe to their rights entitlement and shall not renounce except within the promoter group or in order to comply with minimum public shareholding.

c) Equity shares of the issuer have not been suspended from trading as disciplinary measures during last 3 years immediately preceding the reference date.

d) Annualized delivery based trading turnover of the equity shares during 6 calendar months immediately preceding the month of reference date should be at least 2% of the weighted average number of equity shares listed during such period.

e) There should not be any conflict of interest between lead merchant banker and issuer or its group or associate in accordance with applicable regulations.

f) Must have redressed 95% of the investor complaints.

(b) **Interim use of funds**

Prospectus, letter of offer for public, rights issue shall make following disclosure:

(1) Net issue proceeds pending utilization (for the stated objects) shall be deposited only in the scheduled commercial banks for issue made by Indian issuers.

(2) Interim use of funds is restricted to deposit in a bank having credit rating of 'A' or above by an international credit rating agency for IDR issuers.

(c) **Listing on ITP**

SEBI has replaced the existing guidelines for listing of securities on ITP. The guidelines for listing, which were earlier available only for SME, are now made available to wider class of issuers.

(d) **Eligibility**

(1) Following entities are eligible for listing on ITP:

a) Entity which is intensive in use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition and at least 25% of its pre-issue capital is held by QIB.

b) Any other entity in which at least 50% of pre-issue capital is held by QIB as on the date of filing of draft information document or draft offer document with SEBI.

1) No person, individually or collectively with person acting in concert shall hold more than 25% of post-issue capital.

2) Eligibility norms have been substantially diluted to do away with requirements such as condition of no default by company/ promoter/ group company/ director, no reference to BIFR by company or group companies in preceding 5 years, not more than 10 years of existence, paid-up share capital not exceeding ₹ 250 million and turnover not exceeding ₹ 1 billion in any financial year, at least one investment by AIF, VCF, angel investor, QIB etc.

(2) Listing

a) SEBI has now permitted listing on ITP for eligible issuer through public issue without public issue under previous regime, public issue was not permitted. Issue of capital was permitted only through private placement or rights issue without renunciation subject to certain conditions.

b) Minimum trading lot shall be ₹ 1 million

(3) Listing without public issue

a) Eligible entity shall file draft information document along with necessary documents with SEBI along with prescribed fees.

b) Eligible entity shall obtain in-principle approval from the recognized stock exchange. Such in-principle approval shall be deemed to be waiver from compliance with Rule 19(2)(b) of Securities Contract (Regulations) Rules, 1957 (SCRR).

c) Here, the requirement of having minimum public shareholding will not apply.

d) Listing of securities to take place within 30 days from:

1) date of issuance of observations by SEBI.

2) if no observations issued, then after expiry of the period for issuance of observations by SEBI

e) Provisions of ICDR Regulations relating to allotment issue opening / closing, advertisement, underwriting, no IPO pending conversion of convertible securities, pricing, dispatch of issue material, and other such provisions related to offer of specified securities to public will not apply

(4) Listing pursuant to public issue

a) Eligible entity shall file draft offer document along with necessary documents with SEBI along with prescribed fees.

b) Minimum application size ₹ 1 million.

c) Number of allottees shall be more than 200.

d) Allocation of net public offer shall be made as under:

1) 75% to institutional investors (without separate allocation to Anchor Investor).

2) 25% to non-institutional investors.

3) Under subscription in non-institutional investors can be made available to institutional investors.

4) Allotment to non-institutional investors on proportionate basis.

5) Allotment to institutional investors may be on discretionary basis in which case allotment to each institutional investor to be capped at 10% of issue size.

(5) Lock-in Period

a) Entire pre-issue capital of the shareholders shall be locked-in for a period of one year from the date of allotment in case listing pursuant to public issue or date of listing in case of listing without public issue.

b) Lock-in not applicable to equity shares:

1) allotted to employees pursuant to existing ESOP scheme.

2) held by Venture Capital Fund or Category I Alternative Investment Fund or a foreign venture capital investor provided equity shares were locked in for a period of 1 year from the date of purchase).

3) held by persons other than promoters continuously for a period of 1 year prior to the date of listing (in case of listing without public issue).

4) In case of equity shares held pursuant to conversion of convertible securities, holding period pre-conversion as well as post- conversion will be considered.

c) Locked-in securities of promoter shall be eligible for pledge with commercial banks, financial institutions as collateral security.

d) Specified securities allotted on discretionary basis shall be locked in as per lock-in requirements for Anchor Investor.

e) Promoter shareholding post issue at minimum 25% at the time of listing with lock-in of 3 years done away with.

(6) Exit / Migration to main Board

a) Entity listed without making public issue may exit from ITP, if:

1) Shareholders approve by special resolution through postal ballot where 90% of total votes and majority of non-promoter votes have been cast in favour, and.

2) Recognized stock exchange where securities are listed, approves such exit.

Study Note - 2

SEBI LAWS AND REGULATIONS

PART - D : SEBI (LISTING OBLIGATION AND DISCLOSURE REQUIREMENT) RULES, 2015

This Study Note includes:

D : 2.1 Applicability

D : 2.2 Compliance

D : 2.3 Registrar and Transfer Agents

D : 2.4 Policy on Preservation of Documents - Reg. 9

D : 2.5 Grievance Redressal Mechanism - Reg. 13

D : 2.6 Board of Directors -

D : 2.7 Vigil Mechanism

D : 2.8 Related Party Transactions

D : 2.9 Obligations Pertaining to Material Subsidiaries

D : 2.10 Obligations Pertaining to Independent Directors

D : 2.11 Board Obligation

D : 2.12 Miscellaneous Provisions

D : 2.13 Record to be Maintained

D : 2.1 APPLICABILITY

Listed entity, whose any of the following designated securities are listed on recognized stock exchange(s):

- Specified securities listed on main board or SME Exchange or institutional trading platform;
- non-convertible debt securities
- non-convertible redeemable preference shares
- perpetual debt instrument
- Perpetual non-cumulative preference shares
- Indian depository receipts
- securitized debt instruments
- units issued by mutual funds
- any other securities as may be specified by the Board.

D : 2.2 COMPLIANCE

Qualified Company Secretary as the compliance officer

- Responsible for –
  - (i) Ensuring conformity with the regulatory provisions
  - (ii) Co-ordination with and reporting to the Board, recognised stock exchange(s) and depositories the compliance with rules, regulations and other directives of these authorities
  - (iii) Ensuring that the correct procedures have been followed in filing monitoring email address of grievance redressal division

D : 2.3 REGISTRAR AND TRANSFER AGENTS

Mandatory if total number of security holders exceeds one lakh

- Other wise the listed entity shall have to be registered with the Board
- Ensuring all activities in relation share transfer facility are maintained either in house or by Registrar to an issue and share transfer agent
- Half yearly Compliance Certificate with regard to compliance of the above with stock exchange
- Within 1 month of end of half year

D : 2.4 POLICY ON PRESERVATION OF DOCUMENTS - REG 9

- To be approved by BoD
- Documents to be classified under 2 categories – documents to be preserved permanently and documents to be preserved for minimum 8 years
- Board to specify categories

D : 2.5 GRIEVANCE REDRESSAL MECHANISM -REG 13

- Mandatory registration with SCORES platform or other electronic platform or system of the Board
- Filing of quarterly statement with respect to-
  - number of pending investors' complaints at the beginning and ending of the quarter
  - Complaints received and disposed and remained unresolved
  - within 21 days of the end of the quarter

D : 2.6 BOARD OF DIRECTORS

- Optimum combination of executive and non-executive directors
  - At least one woman director
  - Not less than 50% non-executive directors

- 1/3rd Independent directors. Where chairperson is related to promoter then ½ independent Director
- Shall meet at least four times a year. Board meetings to have maximum time gap of 120 days between any two meetings.

D : 2.7 VIGIL MECHANISM

(i) For directors and employees

(ii) adequate safeguards against victimization of director(s) or employee(s) or any other person

(iii) direct access to the chairperson of the audit committee

D : 2.8 RELATED PARTY TRANSACTIONS

(i) Formulation of policy on "materiality" and on dealing with RPT

(ii) Material RPT : Previous +proposed transaction during FY exceeds 10% of annual consolidated turnover

(iii) All RPT shall require prior approval of the audit committee

Audit committee may grant omnibus approval (reviewed quarterly)

Quarterly review of RPTs pursuant to omnibus approval

Resolution valid for 1 year

Material RPT shall require approval of shareholders (ordinary Resolution)

All related party to abstain from voting

D : 2.9 OBLIGATIONS PERTAINING TO MATERIAL SUBSIDIARIES

- At least 1 ID to be director of unlisted Indian material subsidiary
- Audit committee to review the Financial Statement
- minutes of Board meetings to be placed before Board of the holding company
- statement of all significant transactions and arrangements entered into by the unlisted subsidiary to be placed before board of the holding company
- SR will be required in case of-
  - disposal of shares resulting in reduction of its shareholding to less than 50% or cessation of control over the subsidiary
  - Selling, disposing and leasing of assets amounting to more than 20% of the assets of the material subsidiary on an aggregate basis during a financial year

D : 2.10 OBLIGATIONS PERTAINING TO INDEPENDENT DIRECTORS

- Not to serve as ID in more than 7 listed entities
- At least 1 meeting in a year without the presence of non-independent director
- Duties
  - Review performance of non-independent directors

- Review performance of chairperson
- Assess quality and timeliness of information flowing to the Board

- In case of resignation/ removal of ID - Replacement at the next Board meeting or 3 months
- There should be familiarization programmes for IDs
- Obligations applicable to directors
- Member in not more than ten committees
- Chairperson of not more than five committees across all listed entities in which he is a director
- Disclosures to the Board relating to all material, financial and commercial transactions, where they have personal interest
- NEDs to disclose their shareholding held directly or on behalf of others and the same shall be inserted in the notice of general meeting.

D : 2.11 BOARD OBLIGATION

- Quarterly Compliance Certificate- Listed entity shall submit a quarterly compliance report on corporate governance within fifteen days from close of the quarter
- Details of all material related party transaction during the quarter to be disclosed
- Prior intimations to Stock Exchanges – Reg 29
- Meeting of Board held for following matters
  - financial results viz. quarterly, half yearly, or annual
  - proposal for buyback of securities;
  - proposal for voluntary delisting
  - proposal for fund raising
  - declaration/recommendation of dividend,
  - proposal for issue of convertible securities

D : 2.12 MISCELLANEOUS PROVISIONS

Annual report to be submitted within 21 days of adoption at AGM

(i) Business Responsibility Report is applicable to top 500 listed companies as on March 31 every financial year.

(ii) Annual Information Memorandum to be submitted as specified by SEBI.

(iii) Disclosures on appointment & re-appointment of directors- Reg 36

(iv) Disclosures to the shareholders

- brief resume of the director
- nature of his expertise in specific functional areas
- disclosure of relationships between directors inter-se
- names of listed entities in which the person also holds the directorship and the membership of Committees of the board Transfers:

(v) Detailed procedures with timelines has been prescribed for transfer/ transmission/ transposition of securities

- Board may delegate the power to transfer
- to a committee or to compliance officer or to the registrar to an issue and/or share transfer agent
- Delegated authority to place report on transfer of securities to the board of directors in each meeting
- Registration of transfer
- Transfer within 15 days
- Otherwise to compensate the aggrieved party
- Transmission for securities held in dematerialized mode within 7 days
- Transmission for physical securities- within 21 days
- shareholding of non-executive directors

D : 2.13 RECORD TO BE MAINTAINED

- Half yearly certificate from PCS
  - Within 1 month of end of half year
  - Certificate to be filed with SEs simultaneously
- Remote e-voting:
- All resolutions
- Submission of results within 48 hours of conclusion of the meeting

STUDY NOTE : 2

SEBI LAWS AND REGULATIONS

PART – E : THE SECURITIES CONTRACTS (REGULATION) ACT,1956

This Study Note Includes:

E : 2.1 THE SECURITIES CONTRACTS (REGULATION) ACT,1956

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2.1.1 Securities Laws in India

The earliest legislation remotely touching the stock market was introduced in 1865 by the Government of Bombay to deal with the situation arising out of the Share Mania of 1860-65. Subsequently, Atlay Stock Exchange Enquiry Committee was appointed in September, 1923 which stressed and emphasised the need for the stock exchange to frame and maintain systematic and settled rules and regulations in the interest of general investing public and the trade. Pursuant to these recommendations, the Government of Bombay offered charter to Bombay Stock Exchange (BSE) in July, 1925 and the Government assumed authority to control the rule making power of the exchange and granted BSE monopoly to organise trading in securities but the exchange turned down the offer. Subsequently, a special legislation namely, Bombay Securities Contracts Act, 1925 for controlling stock exchange came into force w.e.f. January 1, 1926.

Today, the legislative framework dealing with securities markets comprises of Securities Contracts (Regulation) Act, 1956, Depositories Act, 1996 and various regulations and guidelines issued by Securities and Exchange Board of India (SEBI) under the SEBI Act, 1992 including listing agreement of the Stock Exchanges. In the year 2002 the Government amended SEBI Act, 1992 empowering SEBI to inspect listed companies in the case of insider trading or fraudulent and unfair trade practices; to order suspension of trading of security, restrain person from accessing securities market, impound proceeds of securities, attach property etc.; to prohibit any company from issuing prospectus or offer document or advertisement; and to issue, cease and desist orders. The amendment Act also enhanced the penalty substantially to rupees one lakh per day up to ceiling of rupees one crore and heavy penalty up to three times of profit or ` 25 crores in case of insider trading or fraudulent and unfair practices. Amendment Act has made the Securities Appellate Tribunal a three member Tribunal presided over by sitting/retired Supreme Court Judge/Chief Justice of High Court and provides for appeal against the order of SAT only to Supreme Court on question of law.

The amendments to the Securities Contracts (Regulation) Act, 1956 (SCRA), proposed under the Act include defining the corporatisation and demutualisation; limiting the organisational form of a stock exchange to a corporate entity; specifying the procedure for corporatisation and demutualisation (including approval of scheme for corporatisation and demutualisation by the Securities and Exchange Board of India); specifying the time limit within which the shares shall be disinvested by stock brokers under the scheme of corporatisation and demutualisation; restricting the voting rights of brokers as shareholders, and brokers' participation on governing boards of stock exchanges so as to plug the loopholes inherent in governance of stock exchanges whose organisational form is mutual.

The Act also proposes to make certain provisions in the SCRA, similar to those contained in the Securities and Exchange Board of India (Amendment) Act, 2002, such as, conferring powers upon the Securities and Exchange Board of India to issue directions to stock exchanges and the companies whose securities

are listed or proposed to be listed, providing appeal from the orders of the Securities Appellate Tribunal to the Supreme Court, enhancing the penalties specified under the Securities Contracts (Regulation) Act, 1956, and adjudication by an adjudicating authority to impose monetary penalties, making provision for compounding of offences and crediting of amount of penalties to the Consolidated Fund of India, etc.

Securities Laws (Amendment) Act, 2014

Securities Laws (Amendment) Act, 2014 is provided the securities market regulator Securities and Exchange Board of India (SEBI) with new powers to effectively pursue fraudulent investment schemes, especially ponzi schemes.

2.1.2 The Securities Contract (Regulation) Act, 1956

The Securities Contract (Regulation) Act, 1956 was enacted by parliament to prevent undesirable transactions in securities by regulating the business of dealing therein, and by providing for certain other matters connected therewith. The Act extends to the whole of India and came into force on 28th February, 1957. The Act defines various terms in relation to securities and provides the detailed procedure for the stock exchanges to get recognition from Government / SEBI, procedure for listing of securities of companies and operation of the brokers in relation to purchase and sale of securities on behalf of investors.

However, 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, in so far 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 share holders 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.

If the Central Government is satisfied that in the interest 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.

2.1.2.1 Scheme of the Act

Section 3 to 22F of the Securities Contract (Regulation) Act, 1956 (as amended by Finance Act 2015) contain the provisions as to 'Recognised Stock Exchanges'; including Application for recognition of stock exchanges, Grant of recognition, Withdrawal of recognition, Illegal Contracts, Void Contracts, Restrictions on Members to act as principals, Licensing of dealers, Spot Delivery etc., Conditions for listing and delisting of securities, Right of Appeal to Central Government / Securities Appellate Tribunal/Supreme Court etc and Power of Central Government to direct rules to be made or to make rules etc.,

Section 23 to 26E of the Act deals with 'Penalties and Procedures' and Section 27-32 contain 'Miscellaneous' provisions.

Further, the Central Government by virtue of the Powers conferred on it under Section 30 of the Securities Contracts (Regulation) Act, 1956 has notified the rules to deal with the procedural matters under the Act. These rules may be called the Securities Contracts (Regulation) Rules, 1957. (as amended).

2.1.2.2 Definition of Securities, Derivatives and Contract

Section 2 of this Act contains definitions of various terms used in the Act. Some of the important definitions

are given below:

(a) Securities include: [Section 2 (h) as amended by Finance Act, 2015]

(1) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or body corporate.

(2) derivative.

(3) units or any other instrument issued by any collective investment scheme to the investors in such schemes.

(4) 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.

(5) units or any other such instrument issued to the investors under any mutual fund scheme.

It has been explained 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 (4 of 1938);]

(6) any certificate of instrument (by whatever name called) issued to an investor by any issuer being a special purpose distinct entity which possess 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.

(7) government securities.

(8) such other instruments as may be declared by the Central Government to be securities, and

(9) rights or interests in securities.

(b) Section 2 (ac) of Securities Contracts Regulation Act, 1956 [as amended by Finance Act, 2015] explains Derivatives as follows:

"Derivative" includes:

(1) 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.

(2) a contact which derives its value from the prices, or index of prices, of underlying securities

(3) commodity derivatives, and

(4) such other instruments as may be declared by the Central Government to be derivatives.

(c) 'Contract' [Section 2 (a)] means a contract for or relating to the purchase or sale of securities.

(d) 'Spot delivery contract' [Section 2 (i) as amended by Finance Act, 2015] means a contract which provides for:

(1) 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 dispatch 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.

(2) 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 depository.

2.1.2.3 Meaning and Definition of Stock Exchange

The stock exchange is really an essential pillar of the private sector corporate economy. It discharges three essential functions:

(a) Firstly, the stock exchange provides a market place for purchase and sale of securities viz. shares, bonds, debentures etc. It, therefore, ensures the free transferability of securities which is the essential basis for the joint stock enterprise system.

(b) Secondly, the stock exchange provides the linkage between the savings in the household sector and the investment in the corporate economy. It mobilizes savings, channelises them as securities into these enterprises which are favoured by the investors on the basis of such criteria as future growth prospects, good returns and appreciation of capital.

(c) Thirdly, by providing a market quotation of the prices of securities a sort of collective judgment simultaneously reached by many buyers and sellers in the market the stock exchange serves the role of a barometer, not only of the state of health of individual companies, but also of the nation's economy as a whole.

In Union of India vs. Allied International Products Ltd. [(1971) 41 Comp Cas 127 SC]: (1970) 3 SCC 5941); the Supreme Court of India has enunciated the role of the Stock Exchanges in these words:

"A Stock Exchange fulfills a vital function in the economic development of a nation; its main function is to 'liquify' capital by enabling a person who has invested money in, say a factory or railway, to convert it into cash by disposing off his shares in the enterprise to someone else. Investment in Joint stock companies is attractive to the public, because the value of the shares is announced day after day in the stock exchanges, and shares quoted on the exchanges are capable of almost immediate conversion into money. In modern days a company stands little chance of inducing the public to subscribe to its capital, unless its shares are quoted in an approved stock exchange. All public companies are anxious to obtain permission from reputed exchanges for securing quotations of their shares and the management of a company is anxious to inform the investing public that the shares of the company will be quoted on the stock exchange".

(1) 'Stock Exchange' means [Section 2(j)]:

a) Any Body of individuals, whether incorporated or not, constituted before corporatization and demutualization under Sections 4A and 4B, or

b) a body corporate incorporated under the Companies Act, 2013 whether under a scheme of corporatization or otherwise,

for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

(2) 'Member' [Section 2 (c)] means a member of recognised stock exchange.

(3) 'Government Security' [Section 2 (b)] 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 Section 2(2) of the Public Debt Act,1944.

Section 2A provides that Words and expressions used herein and not defined in this Act but defined in the Companies Act, 1956 (now Companies Act, 2013) 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.]

2.1.2.4 Recognised Stock Exchanges in India

Recognised Stock Exchange means a stock exchange which is for the time being recognised by the Central Government. No person shall, except with the permission of the Central Government, organize or assist in organizing 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.

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.

(a) Application for recognition of stock exchanges.

Section 3 lays down that any stock exchange, desirous of being recognised for the purposes of this Act may make an application in the prescribed manner to the Central Government.

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:

(1) the governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted.

(2) the powers and duties of the office bearers of the stock exchange.

(3) the admission into the stock exchange of various classes of members, the qualifications, for membership, and the exclusion, suspension, expulsion and re-admission of members therefrom or there into.

(4) the procedure for the registration of the 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.

(b) Grant of recognition to stock exchanges

Section 4 lays down that if the Central Government is satisfied after making such inquiry as maybe necessary in this behalf and after obtaining such further information, if any, as it may require:

(1) 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.

(2) 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 nature of the securities dealt with by it, may impose for the purpose of carrying out the objects of this Act, and

(3) that it would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange.

(4) 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. During July, 2016 the Government has increased the limit for foreign investment in Stock Exchanges from 5% to 15%; in pursuance of implementation of the Budget Announcement while presenting the Union Budget 2016-17 regarding reforms in FDI Policy with respect to enhancement of investment limit for foreign entities in Indian stock exchanges.

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:

(1) the qualifications for membership of stock exchanges.

(2) the manner in which contracts shall be entered into and enforced as between members.

(3) the representation of the Central Government on each of the stock exchanges by such number of persons not exceeding three as the Central Government may nominate in this behalf, and

(4) the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by the Central Government.

Every grant of recognition to a stock exchange under this Section shall be published in the Official Gazette of the State in which the principal office of the stock exchange is situated, and such recognition shall have effect as from the date of its publication in the Gazette of India.

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.

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.

2.1.2.5 Contracts and Options in Securities

(a) **Contracts in Securities**

(1) 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, declare that 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 date of the notification otherwise than between 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.

It has been provided that any contract entered into between members of two or more recognised stock exchanges in such State or States or area, shall:

a) 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.

b) 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 (Section 13).

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 (Section 13A).

(2) 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:

a) as respects the rights of any member of the recognised stock exchange who has entered into such contract in contravention of any such bye-laws, and also

b) as respects the rights of any other person who has knowingly participated in the transaction entailing such contravention.

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 (Section 14)

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 3 days from the date of 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 (Section 15).

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.

All contracts in contravention of the provisions of Sub-Section (1) entered into after the date of the notification issued there under shall be illegal (Section 16).

(b) **Options in securities**

An option contract conveys the right to buy or sell a specific security of commodity at specified price within a specified period of time. The right to buy is referred to as a call option whereas the right to sell is known as a put option. An option contract comprises of its type a put or call, underlying security or commodity expiry date, strike price at which it may be exercised. Options are generally described by the nature of underlying commodity. An option on common stock is said to be stock option; an option on a bond, a bond option; an option on a foreign currency, a currency option, an option on future contract, a future option; and so on. The specified price at which the underlying commodity may be bought (in the case of call) or sold (in the case of put) is called exercise price or the striking price of the option. To buy or sell the underlying commodity pursuant to option contract is to exercise the option. Most of the option may be exercised at any time, up to and including the expiration date.

It is of two different kinds such as calls and puts. Those who take calls option, they are not obligated to purchase given quantity of the underlying variable, at a mentioned price on or prior to a scheduled future date. On the other hand, buyers in case of puts option may not necessarily sell a mentioned quantity of the underlying variable at a mentioned price on or prior to a given date.

The buyer of an option pays the option writer (seller) an amount of money called the option premium or option price. In return, the buyer receives the privilege, but not the obligation, of buying (in the case of call) or selling (in the case of a put) the underlying commodity for the exercise price. In the case of a call option, if the price of the commodity exceeds the exercise price, the call option is said to be in the money and the call option buyer could exercise the option, thereby earning the difference between the two prices-the exercise value or intrinsic value. On the other hand, if the price of the commodity is below the exercise price, the call option is out-of the money and will not be exercised, its intrinsic value is zero. In the case of a put option, if the price of the commodity is below the exercise price, the put option is said to be in-the-money. The put option buyer could exercise the option to

earn the difference between the exercise price and the price of the commodity. A put option is said to be out of the money when the commodity price exceed the exercise price.

An Option provides investors with the opportunity to hedge investments in the underlying shares and share portfolios and can thus reduce the overall risk related to the investments significantly.

2.1.2.6 Listing of Securities

Listing of securities with stock exchange is a matter of great importance for companies and investors, because this provides the liquidity to the securities in the market.

The prices at which the securities are traded in the stock exchange are published in the News papers. Investors are able to know these price trends from such publications. Compared to listed securities the trading of unlisted securities is difficult. The price trends in respect of unlisted securities are seldom known to the investors and the contract between the seller and buyer takes places mostly on one to one basis.

Thus, in order to avail of the benefit of listing the company seeking such listing should be applied as per conditions of listing agreement entered into with stock exchange. It is open to companies to get their securities listed in their Recognised Stock Exchanges and one or more of the other stock exchanges in the country under this Act. Company seeking listing with stock exchanges in other countries shall have to follow the rules and regulations of those exchanges.

Only public companies are allowed to list their securities in the stock exchange. Private Limited Companies cannot get listing facility. However, debt securities of Private companies could be listed in stock exchanges. If the Private companies want to convert their equity, they should first convert themselves into public limited companies and their articles of Association should also not contain any of the prohibitions in respect of transfer as laid down in the listing agreement and as applicable to limited companies.

Section 17A provides for public issue and listing of securities referred to in clause (h) of Section 2.

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 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.

Every issuer referred to in 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.

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 percent per annum.

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.

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 clause (h) of Section 2 by the issuer, being a special purpose distinct entity (Section 17A)

(a) **Types of Listing**

Listing of securities falls under 5 groups:

(1) Initial listing: If the shares or securities are to be listed for the first time by a company on a stock exchange is called initial listing.

(2) Listing for Public Issue: When a company whose shares are listed on a stock exchange comes out with a public issue of securities, it has to list such issue with the stock exchange.

(3) Listing for Rights Issue: When companies whose securities are listed on the stock exchange issue further securities to existing share holders on rights basis, it has to list such rights issues on the concerned stock exchange.

(4) Listing of Bonus Shares: Companies issuing shares as a result of capitalization of profits through bonus issue shall list such issues also on the concerned stock exchange.

(5) Listing for merger or amalgamation: When new shares are issued by an amalgamated company to the share holders of the amalgamating company, such shares are also required to be listed on the concerned stock exchange.

(b) **Benefits of Listing**

The following benefits are available when securities are listed by a company in the stock exchange:

(a) public image of the company is enhanced.

(b) the liquidity of the security is ensured making it easy to buy and sell the securities in the stock exchange.

(c) tax concessions are made available both to the investors and the companies.

(d) listing procedure compels company management to disclose important information to the investors enabling them to make crucial decisions with regard to holding or disposing of such securities.

(e) Shares of listed companies command better credibility as they could be offered as security for loans from Banks and FIs.

(c) **Multiple Listing**

A company with a paid up capital of over ` 5 crores should list its securities or have its securities permitted for trading, on at least one stock exchange having nationwide Trading Terminals. Multiple listing provides arbitrage opportunities to the investors, whereby they can make profit based on the difference in the prices prevailing in the said exchanges.

(d) **Legal Provisions on listing**

As per Section 40 of the Companies Act, 2013, every company intending to offer shares or debentures to the public for subscription by the issue of a prospectus is required to make an application to one or more recognised stock exchanges before such issue for permission for the securities intending to be so offered to be dealt with in the stock exchange(s).

As per Section 40 of the Companies Act, 2013, prospectus should state the names of the stock exchanges where application for listing has been made and any allotment of securities made on the basis of such prospectus should be void if permission of listing is not granted by the stock exchange(s) before the expiry of 10 weeks from the closure of the issue.

As per Section 4 of the Securities Contracts (Regulation) Act, 1956, every recognised stock exchange has the powers to make bye-laws for the listing of securities on the stock exchange, inclusion of any security for the purpose of dealings and suspension or withdrawal of securities and the prohibition of trading in any specified security, subject to SEBI approval.

Every company while submitting its application for listing with the stock exchange(s) should produce a number of documents as enclosures to satisfy the requirements of the concerned stock exchange. It should also give a number of under takings as a condition precedent before listing as a sought by the concerned stock exchange. Finally when the stock exchange(s) agree(s) to list the securities, the company shall execute a listing agreement with the stock exchange(s). The listing agreements of different stock exchanges have clauses ranging from 50 to 60.

When a company signs a listing agreement with a stock exchange, it means it has entered a legally binding contract with that exchange and it has to ensure compliance of each and every term and condition in the listing agreement. For failure to ensure such compliance the stock exchange can take an action against the company after giving an opportunity of being heard.

Listing of securities on Indian Stock Exchanges, thus, is essentially governed by the provisions in the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956, the Securities Contracts (Regulations) Rules, 1957, Rules, Bye-laws, regulations of concerned stock exchange, the listing agreement entered into by the issuer and stock exchange and circulars / guidelines issued by the Central Government and SEBI.

2.1.2.7 Penalties and Procedure

Section 23 to 26 E of the Securities Contracts (Regulation) Act, 1956 prescribes various penalties against persons who contravene provisions of the Act. They offences are listed below:

(a) Penalty (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 19, or

d) enters into any contract in derivative in contravention of Section 18A or the rules made under Section 30, or

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 willfully 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 person 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 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.

(b) Penalty for failure to furnish information, return, etc. (Section 23 A)

Under this Section, any person, who is required under this Act or any rules made there under:

1) to furnish any information, document, books, returns or report to a recognised stock exchange, fails to furnish the same within the time specified therefor in the listing agreement or conditions or bye-laws of the recognised stock exchange, shall be liable to a penalty 106[which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees] for each such failure.

2) 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 [which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.]

(c) Penalty for failure by any person to enter into an agreement with clients [Section 23 B)

If any person, who is required under this Act or any bye-laws of a recognised stock exchange made there under, to enter into an agreement with his client, fails to enter into such an agreement, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees] for every such failure.

Minor ammendment was made by Finance Act, 2018 which provides that an adjudicating officer shall always be deemed to have been exercised under the provisions of this section.

(d) Penalty for failure to redress investors' grievances [Section 23 C]

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 which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues

subject to a maximum of one crore rupees.

Minor ammendment was made by Finance Act, 2018 which provides that an adjudicating officer shall always be deemed to have been exercised under the provisions of this section.

(e) Penalty for failure to segregate securities or moneys of client or clients [Section 23 D]

If any person, who is registered under Section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 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 which shall not be less than one lakh rupees but which may extend to one crore rupees.

(f) Penalty for failure to comply with provision of listing conditions or delisting conditions or grounds [Section 23 E]

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 which shall not be less than five lakh rupees but which may extend to twenty five crore rupees.

(g) Penalty for excess dematerialisation or delivery of unlisted securities (Section 23 F).

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 which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees.

(h) 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 shall not be less than five lakh rupees but which may extend to twenty-five crore rupees.

(i) 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 bye- laws 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 shall not be less than one lakh rupees but which may extend to one crore rupees.

(j) Power to adjudicate [Section 23-I]

a) 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.

b) 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.

c) The Board may call for and examine the record of any proceedings under this Section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify.

2.1.2.8 Appeal to Securities Appellate Tribunal (Section 23L)

According to the Section:

(a) Any person aggrieved, by the order or decision of the recognized stock exchange or the adjudicating officer or any order made by the Securities and Exchange Board of India under 129[or Sub-Section (3) of Section 23-I], 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.

(b) 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.

(c) 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.

(d) 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.

(e) 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.]

2.1.2.9 Appeal and Revision (Section 26 C)

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 on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

2.1.2.10 Appeal to Supreme Court (Section 22 F)

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.

2.1.2.11 Power of Securities and Exchange Board of India to make regulations [Section 31)

(a) Without prejudice to the provisions contained in Section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 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.

(b) 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:

(1) 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.

(2) the eligibility criteria and other requirements under Section 17A.

(3) the terms determined by the Board for settlement of proceedings under Sub-Section (2) of Section 23JA.

(4) any other matter which is required to be, or may be, specified by regulations or in respect of which provision is to be made by regulations.

(c) 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.

STUDY NOTE : 2

SEBI LAWS AND REGULATIONS

PART – F : SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

This Study Note Includes:

F : 2.6 SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

F : 2.6 SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

2.6 SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

These regulations have been issued in repeal of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015. These are effective from 15th January, 2015. These regulations have enjoined a role upon the "Compliance Officer" of the company to ensure compliance with the requirements. Some of the important definitions are :

2.6.1 Regulation 2 (d) : "Connected Person"

"Connected Person" means (i)any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship between himself and the company whether temporary or permanent, that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access.

Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be connected persons unless the contrary is established,:

a. an immediate relative of connected persons specified in clause (i); or

b. a holding company or associate company or subsidiary company; or

c. an intermediary as specified in section 12 of the Act or an employee or director thereof; or

d. an investment company, trustee company, asset management company or an employee or director thereof; or

e. an official of a stock exchange or of clearing house or corporation; or

f. a member of board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof; or

g. a member of the board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013; or

h. an official or an employee of a self-regulatory organization recognised or authorized by the Board; or

i. a banker of the company; or

j. a concern, firm, trust, Hindu undivided family, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than ten per cent. of the holding or interest;

2.6.2 Regulation 2(g): "Insider"

"Insider" means any person who is:

(i) A connected person; or

(ii) in possession of or having access to unpublished price sensitive information.

2.1.3 Regulation 2(n): "Unpublished price sensitive information"

"unpublished price sensitive information" means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following:

(i) financial results;

(ii) dividends;

(iii) change in capital structure;

(iv) mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions;

(v) changes in key managerial personnel; and

(vi) material events in accordance with the listing agreement.

"Generally available imformation" means informaion i.e., accessable to the public on a non-discriminatory basis.

It must be understood that the definition of "connected person" as above brings into its ambit the relatives as well as a host of other persons and the persons in the know of things inside the company are required to be quite careful about divulging of information which may turn price sensitive if it gets to a market intermediary. While the regulation 3(1) is specific that no insider shall communicate, provide or allow access to any unpublished price sensitive information relating to a company or securities listed or proposed to be listed, to any person including other insiders except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations, regulation 3(2) states that no person shall procure or cause the communication by any insider of unpublished price sensitive information. An explanatory note under sub-regulation (2) states that inducement and procurement of unpublished price sensitive information not in furtherance of one's legitimate duties and discharge of obligations would be illegal under this provision. The Board of Directors of the company are required to get executed agreements to ensure confidentiality and non-disclosure obligations on the part of functionaries who handle price sensitive information and when in possession of such information. Regulation 4 states that when in possession of Unpublished price sensitive information, no insider shall trade in securities that are listed or proposed to be listed on a stock exchange subject to certain exceptions where the I annocence may be proved by the insider. In the case of connected persons, the onus of establishing that they were not in possession of unpublished price sensitive information shall be upon them and the Boards of Companies are expected to specify standards as may be deemed necessary.

"Compliance Officer" referred above, means any senior officer, designated so and reporting to Board of Director, who is financially literate and capable of appreciating the legal provisions and compliance thereof.

An insider is entitled to formulate a trading plan and present it to the compliance officer for approval and public disclosure pursuant to which trades may be carried out on his behalf in accordance with such plan. The same has to be in compliance with sub-regulation (2) of Regulation 5. The trading plan once approved by the compliance officer shall be irrevocable and and insider shall mandatorily have to implement the plan. Upon approval of the trading plan, the compliance officer shall notify the plan to the stock exchanges on which the securities are listed. Initial disclosures have been prescribed at the time of notification of the regulations and further continual disclosures have also been prescribed within 2 trading days if the value of the securities traded whether in one transaction or a series of transactions over a calender quarter aggregating to a value in excess of ₹ 10 lakhs or such other value as may be specified. This requirement is applicable to every promoter, key managerial personnel and director of every company whose securities are listed on any recognized stock exchange and as and when a new key managerial personnel or director takes over. The companies are also required to disclose the same

within 2 trading days of receipt of disclosure.

The Board of Directors of a listed company are required to formulate and publish a code of fair disclosure containing the practices and procedures in the company's official website. The Board of Directors of a market intermediary too shall formulate a code of conduct for its employees to regulate, monitor and report trading towards achieving compliance with the regulations. The market intermediaries too shall have a compliance despite their being not listed companies.

SELF-ASSESSMENT QUESTIONS

1) To strengthen the Corporate Governance framework for listed companies in India, the Listing Agreement is amended in order to align the provisions of the Listing Agreement with the Companies Act, 2013. Explain.

2) Explain the important provisions of SEBI Issue of Capital and Disclosure Requirements (ICDR) Regulations 2009 with regard to eligibility for IPO and lock in and pricing.

3) Write short notes on the following:

   (a) Listing of securities

   (b) Penalties and procedures under Securities Contracts (Regulation) Act, 1956

4) Write short notes on the following:

   (a) Book Building

   (b) Benefits of Listing

   (c) Market Intermediaries

5) Explain the Provisions as to Power and Functions of the Securities Exchange Board of India

6) Discuss the provisions as to Prohibition of Manipulative and Deceptive Devices, Insider Trading and Substantial Acquisition of Securities or Control under SEBI Act, 1992.

7) What are the penalties envisaged under SEBI Act, 1992?

8) Write an essay on history and establishment of Securities Exchange Board of India.

9) Write short notes on the following:

   a) Manipulative and Deceptive Devices

   b) Insider Trading and Substantial Acquisition of Securities or Control

10) Explain the procedure for making an Appeal against the orders of the Securities Appellate Tribunal.

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STUDY NOTE : 3

THE COMPETITION ACT, 2002

This Study Note Includes:

3.1 Competition - Meaning, objectives, extent and applicability

3.2 Competition Commission of India

3.3 Areas affecting competition

3.1 COMPETITION - MEANING, OBJECTIVES, EXTENT AND APPLICABILITY

3.1.1 Introduction

In India the first competition law was enacted in 1969 i.e. Monopolies and Restrictive Trade Practices Act, 1969 ['MRTP Act, 1969']. The enactment of MRTP Act, 1969 was based on the socio – economic philosophy enshrined in the Directive Principles of State Policy contained in the Constitution of India. The MRTP Act, 1969 underwent amendments in the 1974, 1980, 1982, 1984, 1986, 1988 and 1991.

In the wake of liberalization and privatization that was triggered in India in early nineties, a realization gathered momentum that the existing Monopolistic and Restrictive Trade Practices Act, 1969 ("MRTP Act") was not equipped adequately enough to tackle the competition aspect of the Indian economy. With starting of the globalization process, Indian enterprises started facing the heat of competition from domestic players as well as from global giants, which called for level playing field and investor-friendly environment. Hence, need arose with regard to competition laws to shift the focus from curbing monopolies to encouraging companies to invest and grow, thereby promoting competition while preventing any abuse of market power.

In line with the international trend and to cope up with the changing realities India, consequently, enacted the Competition Act, 2002. The Competition Act, 2002 was amended by the Competition (Amendment) Act, 2007 and again by the Competition (Amendment) Act, 2009.

3.1.2 What Constitutes Competition Law and Policy?

Competition law and policy is defined as those Government measures that affect the behaviour of enterprises and structure of the industry with a view to promote efficiency and maximize welfare.

The two elements of such Government measures are:

Competition Policy: Set of policies, such as liberalized trade policy, relaxed FDI policy, de-regulation, etc., that enhances competition in the markets.

Competition Law: To prevent anti-competitive practices with minimal intervention.

3.1.3 Competition - Meaning

A broad definition of Competition is a situation in a market in which firms or sellers independently strike for the buyers' patronage in order to achieve a particular business objective, for example profit, sales or market share (World Bank, 1999). A pre-requisite for a good competition is trade, trade is the unrestricted liberty of every man to buy, sell and barter, when, where and how, of whom and to whom he pleases. For a free market to be in existence the handicap is that for a given distribution of income of those who can pay the highest price will most be able to purchase the goods regardless their relative needs. However, the

real culprit is income distribution system and not the competitive system. In an unregulated free market, in certain circumstances it could be of greater benefit to the owner to withhold goods from market in order to extract a higher price. Despite the efforts to regulate prices which have been unsuccessful, the caution in a free market as compared to the problems in an unregulated market can be overcome by posturing competition by which the *ultimate raison d'etre* of competition, namely the, interest of the consumer can be protected.

3.1.4 Need for Competition

Competition is now almost universally acknowledged as the best means of ensuring that consumers have access to the broadest range of services at the most competitive prices. Producers will have maximum incentive to innovate, reduce their costs and meet consumer demand. Competition thus promotes allocative and productive efficiency. But all this requires healthy market conditions and governments across the globe are increasingly trying to remove market imperfections through appropriate regulations to promote competition.

3.1.5 Unfair Competition

Unfair competition means adoption of practices such as collusive price fixing, deliberate reduction in output in order to increase prices, creation of barriers to entry, allocation of markets, tie-in sales, predatory pricing, discriminatory pricing, etc.

3.1.6 Objectives of the Competition Act, 2002

Keeping in view of the economic development of the country, the Competition Act, 2002 was laid down to provide for an establishment of a Commission seeks to achieve the following objectives:

(a) to prevent practices having adverse effect on competition.

(b) to promote and sustain competition in markets.

(c) to protect the interests of consumers.

(d) to ensure freedom of trade carried on by other participants in markets in India and for matters connected therewith or incidental thereto.

The objectives of the Act are sought to be achieved through the instrumentality of the Competition Commission of India (CCI) which has been established by the Central Government with effect from 14th October, 2003.

3.1.7 Extent and applicability of the Act

The Competition Act, 2002 extends to whole of India except the State of Jammu and Kashmir. It is a tool to implement and enforce competition policy and to prevent and punish anti-competitive business practices by firms and unnecessary Government interference in the market. The Competition law is equally applicable on written as well as oral agreement, arrangements between the enterprises or persons.

3.2 COMPETITION COMMISSION OF INDIA

3.2.1 Establishment of Commission (Section 7)

Section 7 provides for the establishment of the Competition Commission of India. The Commission shall be a body corporate by the aforesaid name having perpetual succession and a common seal with power to acquire, hold and dispose of property and to contract and shall sue or be sued. The place of head office of the Commission shall be decided by the Central Government. Further, the Commission may establish offices at other places in India.

3.2.2 Composition of Commission (Section 8)

The Commission shall consist of the Chairperson and not less than two and not more than six other Members, to be appointed by the Central Government. 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 15 years in international trade, economics, business, commerce, law, finance, accounting, 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. The Chairperson and other members shall be whole time members.

3.2.3 Selection Committee for Chairperson and other Members of the Commission (Section 9)

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 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.	Members

The term of the Selection Committee and the manner of selection of panel of names shall be such as may be prescribed.

3.2.4 Term of office of Chairperson and other Members (Section 10)

The Chairperson and every other 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 re-appointment and shall hold office up to the age of 65 years.

In the event of the occurrence of a vacancy in the office of the Chairperson by reason of his death, resignation or otherwise, or due to or during the absence, the senior most member shall as the Chairperson.

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. (Sub-Section 5).

3.2.5 Resignation, Removal and Suspension of Chairperson and other Members (Section 11)

The Chairperson or any other Member may, by notice in writing under his hand addressed to the Central Government, resign his office. 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 (Sub-Section 1).

As per Sub-Section 2, 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

3.2.6 Restriction on employment of Chairperson and other Members in certain cases (Section 12)

The Chairperson and other Members shall not, for a period of two years from the date on which they cease to hold office, accept any employment in, or be connected with the management or administration of, any enterprise which has been a party to a proceeding before the Commission, other than employment in Government or Government Organisation/Companies.

3.2.7 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. The Chairperson may also 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.

3.2.8 Salary and allowances and other terms and conditions of service of Chairperson and other Members (Section 14)

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 (expenses of living) and medical facilities shall be such as may be prescribed and the same shall not be varied to their disadvantage after their appointment.

3.2.9 Vacancy, etc., not to invalidate proceedings of Commission (Section 15)

Any act or proceeding of the Commission shall not be invalidated merely on the ground 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.

3.2.10 Appointment of Director General, etc. (Section 16)

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.

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.

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.

The salary, allowances and other terms and conditions of service of the Director General and Additional, Joint, Deputy and Assistant Directors General or, such officers or other employees, shall be such as may be prescribed.

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.

3.2.11 Secretary and officers and other employees of Commission (Section 17)

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. 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.

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.

3.2.12 Duties of Commission (Section 18)

In terms of Section 18 of the Act, it shall be the duty of the Commission to eliminate practices having adverse effect on competition, to promote and sustain competition in markets in India, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets in India. 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.

3.2.13 Inquiry into certain agreements and dominant position of enterprise (Section 19)

The Commission is empowered to inquire into any alleged contravention of the provisions contained in Section 3(1) or Section 4(1) 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 regulations, 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.

3.2.14 Powers and Functions of the Commission

(a) Appreciable Adverse effect: The Commission shall, while determining whether an agreement has an appreciable adverse effect on competition, have due regard to all or any of the following factors, namely:

  (1) creation of barriers to new entrants in the market.
  (2) driving existing competitors out of the market.
  (3) foreclosure of competition by hindering entry into the market.
  (4) accrual of benefits to consumers.
  (5) improvements in production or distribution of goods or provision of services.
  (6) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

(b) Dominant position of enterprise: The Commission shall, while inquiring whether an enterprise enjoys a dominant position or not, have due regard to all or any of the following factors, namely:

  (1) market share of the enterprise.
  (2) size and resources of the enterprise.
  (3) size and importance of the competitors.
  (4) economic power of the enterprise including commercial advantages over competitors.
  (5) vertical integration of the enterprises or sale or service network of such enterprises.
  (6) dependence of consumers on the enterprise.

(7) 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.

(8) 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.

(9) countervailing buying power.

(10) market structure and size of market.

(11) social obligations and social costs.

(12) 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.

(13) any other factor which the Commission may consider relevant for the inquiry.

(c) Relevant Market: 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".

(d) Relevant Geographic Market: The Commission shall, while determining the "relevant geographic market", have due regard to all or any of the following factors, namely:

(1) regulatory trade barriers.

(2) local specification requirements.

(3) national procurement policies.

(4) adequate distribution facilities.

(5) transport costs.

(6) language.

(7) consumer preferences.

(8) need for secure or regular supplies or rapid after-sales services.

(e) Relevant Product Market: While determining the "relevant product market", the Commission shall have due regard to all or any of the following factors, namely:

(1) physical characteristics or end-use of goods.

(2) price of goods or service.

(3) consumer preferences.

(4) exclusion of in-house production.

(5) existence of specialised producers.

(6) classification of industrial products.

In an important judgment, viz., Competition Commission of India vs. Steel Authority of India Limited ([2010] 103 SCL269 (SC), the Hon'ble Supreme Court of India laid the following guidelines even though the appeal to the Supreme Court was made on refusal of the Competition Commission to grant time as desired by Steel Authority of India Limited. At the threshold stage while directing the Director General to proceed with the enquiry under Section 19, the Respondent Steel Authority of India Limited was directed to furnish information as desired by the Director General. On the point of refusal to grant time to Steel Authority, the matter went upto the Supreme Court after the Competition Appellate Tribunal held that not allowing time to the Steel Authority was in violation of natural justice.

The Commission also requested the Appellate Tribunal for impalement in the matter which was also refused. On further appeal to the Supreme Court, in an elaborate judgment, the following guidelines were enunciated and the Supreme Court directed that till the competent authority makes clear regulations, the principles / guidelines of the Supreme Court should be followed.

(i) Regulation 16 prescribes limitation of 15 days for the Commission to hold its first ordinary meeting to consider whether prima facie case exists or not and in cases of alleged anti-competitive agreements and/or abuse of dominant position, the opinion on existence of prima facie case has to be formed within 60 days. Though the time period for such acts of the Commission has been specified, still it is expected of the Commission to hold its meetings and record its opinion about existence or otherwise of a prima facie case within a period much shorter than the stated period.

(ii) All proceedings, including investigation and inquiry should be completed by the Commission/ Director General most expeditiously and while ensuring that the time taken in completion of such proceedings does not adversely affect any of the parties as well as the open market in purposeful implementation of the provisions of the Act.

(iii) Wherever during the course of inquiry, the Commission exercises its jurisdiction to pass interim orders, it should pass a final order in that behalf as expeditiously as possible and in any case not later than 60 days.

(iv) The Director General in terms of regulation 20 is expected to submit his report within a reasonable time. No inquiry by the Commission can proceed any further in absence of the report by the Director General in terms of section 26(2). The reports by the Director General should be submitted within the time as directed by the Commission but in all cases not later than 45 days from the date of passing of directions in terms of section 26(1).

(v) The Commission as well as the Director General shall maintain complete confidentiality as envisaged under section 57 and regulation 35. Wherever the confidentiality is breached, the aggrieved party certainly has the right to approach the Commission for issuance of appropriate directions in terms of the provisions of the Act and the Regulations in force.

3.2.15 Inquiry into combination by Commission (Section 20)

The Commission may, upon its own knowledge or information relating to acquisition referred to in Section 5(a) or acquiring of control referred to in Section 5(b) or merger or amalgamation referred to in Section 5(c), inquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India.

Further, the Commission shall not initiate any inquiry after the expiry of one year from the date on which such combination has taken effect.

The Commission shall, on receipt of a notice under Section 6(2) 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.

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.

The Ministry of Corporate Affairs enhanced on the basis of the wholesale price index, the value of assets and the value of turnover, by hundred percent for the purposes of Section 5 of the Competition Act, 2002.

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.

(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.

3.2.16 Reference by statutory authority (Section 21)

This Section provides that 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. Also any statutory authority may *suo motu* make such a reference to the Commission. On receipt of a reference, 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 therefor on the issues referred to in the said opinion.

3.2.17 Reference by Commission (Section 21 A)

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. The Commission may, *suo motu,* make such a reference to the statutory authority. On receipt of a reference 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.

3.2.18 Meetings of Commission (Section 22)

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. 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. 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.

3.2.19 Procedure for inquiry under Section 19 (Section 26)

(a) Section 26 prescribes the detailed procedure for any inquiry initiated *suo motu* by the Commission and various complaints and references referred to in Section 19 of the Act.

The procedure is as follows:

(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. 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 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 to the parties concerned. 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 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 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 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 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 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)

(b) 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:

(1) 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 re-enter such agreement or discontinue such abuse of dominant position, as the case may be.

(2) 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.

(3) direct that the agreements shall stand modified to the extent and in the manner as may be specified in the order by the Commission.

(4) 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.

(5) Omitted

(6) pass such other order or issue such directions as it may deem fit.

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. (Section 27)

It may be relevant to point out an order of Competition Commission in the case of Belaire Owners Association vs. DLF Limited 109SCL 655 (CCI) (case nos. 18 and 19 of 2010) where a penalty of 7% of average of turnover for last three preceding years was levied in exercise of the powers under section 27(b). The penalty amount worked out to ` 630 crores and the appeal of the Company before the Competition Appellate Tribunal was partially decided in favour of the company that the Competition Commission could not direct modification of agreements entered into before the commencement of the section 4 but the CAT held that the company abused its dominant position being in Gurgaon which is the relevant market and directed the deposit of the penalty. As of now, the matter is before the Hon'ble Supreme Court for final hearing and the company has deposited the penalty amount with the Supreme Court. The developments in this case would be watched with interest by the corporates as the penalty amount ordered is substantially large and has greater implications for the corporates.

3.2.20 Division of enterprise enjoying dominant position (Section 28)

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. The order 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) Omitted.

(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.

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.

3.2.21 Procedure for investigation of combination (Section 29)

(a) Meaning of Combination*:* It is the acquisition of one or more companies by one or more people or merger or amalgamation of enterprises shall be treated as 'Combination' of such enterprises and

Persons in the following cases:

(a) acquisition by large enterprises;

(b) acquisition by group;

(c) acquisition of enterprise having similar goods/services;

(d) acquisition enterprise having similar goods/services by a group;

(e) merger of enterprises;

(f) merger in group company

(b) Notice to parties: 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. 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.

(c) Directions to parties to publish details: 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 the Director General 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 (Sub-Section 2).

(d) Invitation to affected party: 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.

(e) Additional information: The Commission may, within fifteen working days from the expiry of the period specified before, 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 to the combination within fifteen days from the expiry of the above specified period. After receipt of all information and within a period of forty-five working days from the expiry of the period for additional information, the Commission shall proceed to deal with the case of accordance within the provisions contained in Section 31.

3.2.22 Procedure in case of notice under sub-Section 2 of Section 6 (Section 30)

Where any person or enterprise has given a notice under 6(2), the Commission shall examine such notice and form its *prima facie* opinion and proceed as per provisions contained in Section 29.

3.2.23 Orders of Commission on certain combinations (Section 31)

The Commission can issue orders on certain combinations.

(a) Approval of combination (Sub-Section 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 of Section 6(2) (Sub-Section 1).

(b) Direction: 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 (Sub-Section 2).

(c) Modification: 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, to the parties to such combination (Sub-Section 3). 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 (Sub-Section 4). If the parties to the combination, who have accepted the modification, 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 (Sub-Section 5).

(d) Amendment to modification: 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 (6). If the Commission agrees with the amendment submitted by the parties under sub-Section (6), it shall, by order, approve the combination (Sub-Section 7). 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) (Sub-Section 8).

(e) Consequence of non-acceptance of the modification: If the parties fail to accept the modification proposed by the Commission within thirty working days as referred above 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 (Sub-Section 9). As per Sub-Section 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

(1) the acquisition referred to in clause (a) of Section 5. or

(2) the acquiring of control referred to in clause (b) of Section 5. or

(3) the merger or amalgamation referred to in clause (c) of Section 5, shall not be given effect to. The Commission may however, if it considers appropriate, frame a scheme to implement its order.

(f) Deemed approval by Commission: If the Commission does not, on the expiry of a period of 210 days from the date of notice given to the Commission referred to in Section 29(2), pass an order or issue direction in accordance with the provisions of sub -Section (1) or (2) or (7), the combination shall be deemed to have been approved by the Commission. For the purpose of determining the period of 210 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 (Sub-Section 12).

(g) Consequence of a combination declared void by Commission: 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 (Sub-Section 13). As per Sub-Section 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.

3.2.24 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.

3.2.25 Power to grant interim relief (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.

3.2.26 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.

3.2.27 Power of Commission to regulate its own procedure (Section 36)

(a) In the discharge of its functions, the Commission 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 Commission shall have the powers to regulate its own procedure.

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:

(1) summoning and enforcing the attendance of any person and examining him on oath.

(2) requiring the discovery and production of documents.

(3) receiving evidence on affidavit.

(4) issuing commissions for the examination of witnesses or documents.

(5) 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 of record or document from any office.

(b) The Commission may call upon such experts, from the field 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. The Commission may direct any person:

(1) to produce before the Director General or the Secretary or an officer authorized 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.

(2) to furnish to the Director General or the Secretary or any other officer authorized 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.

3.2.28 Rectification of orders (Section 38)

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. [Sub-Section (1)]

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.

However, the Commission shall not, while rectifying any mistake apparent from record, amend substantive part of its order passed under the provisions of this Act.

3.2.29 Execution of orders of Commission imposing monetary penalty (Section 39)

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.

Commission 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.

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 there under 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 XVIID 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.

The court to which the order is so sent shall execute the order as if it were a decree or order sent to it for execution.

3.2.30 Director General to investigate contravention (Section 41)

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. The Director General shall have all the powers as are conferred upon the Commission under Section 36(2). Without prejudice to this power, the provisions of 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.

3.2.31 Penalties

(a) Contravention of orders of Commission (Section 42)

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. If any person, without reasonable clause, 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.

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. 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 authorized by it.

(b) 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.

3.3 AREAS AFFECTING COMPETITION

(a) The focus of the competition law is towards the following areas affecting competition namely:

(1) Prohibition of certain agreements, which are considered to be anti-competitive in nature. Such agreements [namely tie in arrangements, exclusive dealings (supply and distribution), refusal to deal and resale price maintenance] shall be presumed as anti- competitive if they cause or are likely to cause an appreciable adverse effect on competition within India.

(2) Prohibition of Abuse of dominant position by imposing unfair or discriminatory conditions or limiting and restricting production of goods or services or indulging in practices resulting in denial of market access or through in any other mode are prohibited.

(3) Regulation of combinations which cause or are likely to cause an appreciable adverse affect on competition within the relevant market in India is also considered to be void.

(b) The Competition Act, 2002 (as amended), [the Act], follows the philosophy of modern competition laws and aims at fostering competition and protecting Indian markets against anti-competitive practices. The Act prohibits anti-competitive agreements, abuse of dominant position and regulates combinations (mergers and acquisitions) with a view to ensure that there is no adverse effect on competition in India. The provisions of the Act relating to regulation of combinations have been enforced with effect from 1st June, 2011.

The important concepts incorporated in the Competition Act, 2002 have been defined under Section 2 of the Act. These are discussed below:

(1) Acquisition

Under Section 2(a) the term acquisition has been specifically defined. It means directly or indirectly, acquiring or agreeing to acquire:

a) shares, voting rights or assets of any enterprise.

b) control over management or control over assets of any enterprise.

The terms 'acquiring' or 'acquisition' are relevant for Regulation of Combinations.

(2) Agreement

Under Section 2(b) the term 'agreement' includes arrangement or understanding or action in concert.

a) whether or not, such arrangement, understanding or concert is in formal or in writing. or

b) whether or not such arrangement, understanding or concert is intended to be enforceable by legal proceedings.

It implies that an arrangement need not necessarily be in writing. The term is relevant in the context of Section 3, which envisages that anti-competitive agreements shall be void and thereby prohibited by the law.

(3) Cartel

According to Section 2(c) Cartel includes an association of producers, sellers or 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.

The nature of a cartel is to raise price above competitive levels, resulting in injury to consumers and to the economy. For the consumers, cartelisation results in higher prices, poor quality and less or no choice for goods or/and services. An international cartel is said to exist, when not all of the enterprises in a cartel are based in the same country or when the cartel affects markets of more than one country. An import cartel comprises enterprises (including an association of enterprises) that get together for the purpose of imports into the country.

3.3.1 Prohibition of certain agreements

(a) Chapter II of the Competition Act, 2002 deals with Prohibition of certain Agreements along with Abuse of Dominant Position and Regulation of Combinations.

An anti-competitive agreement is an agreement having appreciable adverse effect on competition. Anti-competitive agreements include, but are not limited to:

(1) agreement to limit production and/or supply.
(2) agreement to allocate markets.
(3) agreement to fix price.
(4) bid rigging or collusive bidding.
(5) conditional purchase/sale (tie-in arrangement).
(6) exclusive supply/distribution arrangement.
(7) resale price maintenance. and
(8) refusal to deal.

(b) Section 3(1) of the Competition Act provides that 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. Section 3(2) further declares that any anti-competitive agreement within the meaning of sub-Section 3(1) shall be void. Under the law, the whole agreement is construed as void if it contains anti-competitive clauses having appreciable adverse effect on competition. Section 3(3) provides that following kinds of agreements entered into between enterprises or association of enterprises or persons or associations of persons or person or enterprise or practice carried on, or decision taken by any association of enterprises or association of persons, including cartels, engaged in identical or similar goods or services which:

(1) directly or indirectly determines purchase or sale prices.

(2) limits or controls production, supply, markets, technical development, investment or provision of services.

(3) 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, and

(4) directly or indirectly results in bid rigging or collusive bidding. shall be presumed to have an appreciable adverse effect on the competition and onus to prove otherwise lies on the defendant. The explanation appended to the Section 3 defines the term 'bid rigging' as any agreement between enterprises or persons which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding. Efficiency enhancing joint ventures entered into by parties engaged in identical or similar goods or services, shall not be presumed to have appreciable adverse effect on competition but judged by rule of reason. The term 'cartel' used in the Section is the most severe form of entering into 'anti competitive agreements' and has been defined in Section 2(c). Bid rigging takes place when bidders collude and keep the bid amount at a pre-determined level. Such pre-determination is by way of intentional manipulation by the members of the bidding group. Bidders could be actual or potential ones, but they collude and act in concert.

3.3.2 Prohibition of Abuse of dominant position

(a) Dominance refers to a position of strength which enables an enterprise to operate independently of competitive forces or to affect its competitors or consumers or the market in its favour. Abuse of dominant position impedes fair competition between firms, exploits consumers and makes it difficult for the other players to compete with the dominant undertaking on merit. Abuse of dominant position includes:

(1) imposing unfair conditions or price,
(2) predatory pricing,
(3) limiting production/market or technical development ,
(4) creating barriers to entry,
(5) applying dissimilar conditions to similar transactions,
(6) denying market access, and
(7) using dominant position in one market to gain advantages in another market.

(b) Section 4 of the Competition Act, 2002 expressly prohibits any enterprise or group from abusing its dominant position, meaning thereby a position of strength, enjoyed by an enterprise or group, in the relevant market, in India, which enables it to:

(1) operate independently of competitive forces prevailing in the relevant market. or

(2) affect its competitors or consumers or the relevant market in its favour.

In line with the latest global trend, the dominance shall not be determined with reference to assets, turnover or market share. As per Section 2(r) 'relevant market' means the market, which may be determined by the Commission with reference to the 'relevant product market' or 'relevant geographic market' or with reference to both the markets. Thus, for determining dominance, these are relevant concepts. The term '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.

(c) For the purposes of this clause, activity includes profession or occupation. article includes a new article and service includes a new service. unit or division, in relation to an enterprise, includes:
(1) a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods.

(2) any branch or office established for the provision of any service. Section 4(2) states that there shall be abuse of dominant position, if an enterprise or group directly or indirectly imposes unfair or discriminatory.

a) condition in purchase or sale of goods or services, or

b) price in purchase or sale (including predatory price) of goods or service.

Explanation appended to Section 4 (2) clarifies that the unfair or discriminatory condition in purchase or sale of goods or services shall not include any discriminatory condition or price which may be adopted to meet the competition. Section 4(2)(b) includes in abuse of dominant position an enterprise or group limiting or restricting:

1) production of goods or provision of services or market therefore, or

2) technical or scientific development relating to goods or services to the prejudice of consumers.

(d) Similarly Section 4 (2) (c), (d) and (e) specify three other forms of abuses namely, if any person indulges in practice or practices resulting in denial of market access in any manner. or 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 and also, if any person uses dominant position in one relevant market to enter into, or protect, other relevant market. The term predatory price has been defined as 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 goods or provision of services, with a view to reduce competition or eliminate the competitors.
Thus, the two conditions precedent to bring a case with the ambit of predatory pricing are:

(1) selling goods or provision of service at a price which is below its cost of production, and

(2) that practice is resorted to eliminate the competitors or to reduce competition.

The Competition Commission of India has been empowered under Section 19(4) of the Act to determine whether any enterprise or group enjoys a dominant position or not, in the 'relevant market' and also to decide whether or not there has been an abuse of dominant position. It may be noted that mere existence of dominance is not to be frowned upon unless the dominance is abused.

3.3.3 Combinations

Broadly, combination under the Act means acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has direct or indirect control over another enterprise engaged in competing businesses, and mergers and amalgamations between or amongst enterprises when the combining parties exceed the thresholds set in the Act. The thresholds are specified in the Act in terms of assets or turnover in India and abroad. The words combination and merger are

used interchangeably in this booklet. Entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India is prohibited and such combination shall be void.

3.3.4 Thresholds for Combinations

India is one of the fastest growing economies in the world. The growth process is driven both by organic and inorganic (through the mergers and acquisition route) growth of enterprises. It is neither feasible nor advisable to review all the mergers and acquisitions. It is natural to presume that in the case of small size combinations there is less likelihood of appreciable adverse effect on competition in markets in India. The Act provides for sufficiently high thresholds in terms of assets/turnover, for mandatory notification to the Commission.

The Act also provides for revision of the threshold limits every two years by the government, in consultation with the Commission, through notification, based on the changes in Wholesale Price Index (WPI) or fluctuations in exchange rates of rupee or foreign currencies. Vide notification S.O. 675 (E) dated 4th March, 2016, the Government has enhanced the value of assets and turnover mentioned in Section 5, by fifty percent. The current thresholds for the combined assets/turnover of the combining parties are as follows:

Individual: Either the combined assets of the enterprises would value more than (₹) 2,000 crores in India or the combined turnover of the enterprise is more than (₹) 6,000 crores in India. In case either or both of the enterprises have assets/turnover outside India also, then the combined assets of the enterprises value more than US$ 1 billion, including at least (₹) 1,000 crores in India, or turnover is more than US$ 3 billions, including at least (₹) 3,000 crores in India.

Group: The group to which the enterprise whose control, shares, assets or voting rights are being acquired would belong after the acquisition or the group to which the enterprise remaining the merger or amalgamation would belong has either assets of value of more than (₹) 8,000 crores in India or turnover more than (₹) 24,000 crores in India. Where the group has presence in India as well as outside India then the group has assets more than US$ 4 billion including at least ₹ 1,000 crores in India or turnover more than US$ 12 billion including at least ₹ 3,000 crores in India.

The term Group has been explained in the Act. As per Notification S.O. 634(E) dated 4th March, 2016, the exemption to the "group" exercising less than fifty percent of voting rights in other enterprise from the provisions of Sec. 5 of the Act under Notification No. S.O. 481(E) dated 4th March, 2011, has been continued for a further period of 5 years.

The above thresholds are presented in the form of a table below:

	APPLICABLE TO	**ASSETS**		**TURNOVER**	
In India	Individual	₹ 2,000 cr.		₹ 6,000 cr.	
	Group	₹ 8,000 cr.		₹ 24,000 cr.	
In India and outside		ASSETS		TURNOVER	
		Total	Minimum Indian Component	Total	Minimum Indian Component
	Individual parties	$ 1 bn.	₹1,000 cr.	$ 3 bn.	₹ 3,000 cr.
	Group $	$ 4 bn.	₹1,000 cr.	$ 12 bn.	₹ 3,000 cr.

The turnover shall be determined by taking into account the values of sales of goods or services. 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. The value of assets shall include the brand value, value of goodwill, or Intellectual Property Rights etc., referred to in explanation (c) to Section 5 of the Act.

3.3.5 Exemption Notifications

In exercise of the powers conferred by clause (a) of Section 54 of the Act, the Central Government, in public interest, has exempted:

(a) an enterprise, whose control, shares, voting rights or assets are being acquired has either assets of the value of not more than ₹ 350 crore in India or turnover of not more than ₹ 1,000 crore in India from the provisions of Section 5 of the said Act for a period of five years.

(b) a banking company in respect of which the Central Government has issued a notification under Section 45 of the Banking Regulation Act, 1949, from the application of the provisions of Sections 5 and 6 of the Act for a period of five years.

(c) Exemption to all combinations u/s 5 of the Act involving the CPSEs operating in the oil and gas sectors along with subsidiaries of CPSEs in this sector. (Notification in Nov. 2017)

3.3.6 Combination Notice

The review process for combination under the Act involves mandatory pre-combination notification to the Commission. Any person or enterprise proposing to enter into a combination shall give notice to the Commission in the specified form disclosing the details of the proposed combination within 30 days of the approval of the proposal relating to merger or amalgamation by the board of directors or of the execution of any agreement or other document in relation to the acquisition, as the case may be. In case, a notifiable combination is not notified, the Commission has the power to inquire into it within one year of the taking into effect of the combination.

The Commission also has the power to impose a fine which may extend to one per cent of the total turnover or the assets of the combination, whichever is higher, for failure to give notice to the Commission of the combination.

Any combination for which notice has been filed with the Commission would not take effect for a period of 210 days from the date of notification or till the Commission passes an order, whichever is earlier. If the Commission does not pass an order during the said period of 210 days, the combination shall be deemed to have been approved.

3.3.7 Acquisition or financing facility by PFIS, VCFS etc.

In case of share subscription or financing facility or any acquisition, inter alia, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement, details of such acquisition are required to be filed with the Commission within seven days from the date of acquisition.

3.3.8 Procedure for Investigation of Combinations

As per the Combination Regulations, the Commission shall form its prima facie opinion as to whether the combination is likely to cause or has caused appreciable adverse effect on competition within the relevant market in India within 30 days from the receipt of the notice. If the Commission is prima facie of the opinion that a combination has caused or is likely to cause adverse effect on competition in Indian markets, it shall issue a notice to show cause to the parties as to why investigation in respect of such combination should not be conducted. On receipt of the response, if the Commission is of the prima facie opinion that the combination has or is likely to have appreciable adverse effect on competition, the Commission shall deal with the notice as per the provisions of the Act.

3.3.9 Evaluation of 'appreciable adverse effect on competition

The Act envisages appreciable adverse effect on competition in the relevant market in India as the criterion for regulation of combinations. In order to evaluate appreciable adverse effect on competition, the Act

empowers the Commission to evaluate the effect of Combination on the basis of factors mentioned in sub Section (4) of Section 20. Factors to be considered by the Commission while evaluating appreciable adverse effect of Combinations on competition in the relevant market:

(a) actual and potential level of competition through imports in the market.
(b) extent of barriers to entry into the market.
(c) level of concentration in the market .
(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.

3.3.10 Consequence of failure to give notice

The Commission also has the power to impose a fine which may extend to one per cent of the total turnover or the assets of the combination, whichever is higher, for failure to give notice to the Commission of the combination.

3.3.11 Appeals

(a) Competition Appellate Tribunal

Section 53A empowers the Central Government to establish, by notification, an Appellate Tribunal to be known as Competition Appellate Tribunal:

(1) 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.

(2) 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 sub-Section(2) of Section 53Q of this Act, and pass orders for the recovery of compensation under Section 53N of this Act.

(b) Appeal to Appellate Tribunal

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. 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. However, 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. 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. The Appellate Tribunal shall send a copy of every order made by it to the Commission and the parties to the appeal. 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.

(c) Appeal to Supreme Court

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. 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.

(d) Power to Punish for contempt

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 (70 of 1971) shall have effect subject to modifications that:

(1) the reference therein to a High Court shall be construed as including a reference to the Appellate Tribunal.

(2) 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.

Self Assessment Questions

(1) Discuss the powers and functions of Competition Commission of India.

(2) The Competition Act, 2002 does not prohibit dominance, but the abuse of dominant position. Explain.

(3) Explain the provisions as to Prohibition of Abuse of dominant position under the Competition Act, 2002.

(4) Explain the provisions as to Prohibition of certain agreements under Chapter II of the Competition Act 2002.

(5) Explain the guidelines enunciated by the Supreme Court in the case of Competition Commission of India vs. Steel Authority of India Limited.

(6) Write short notes on:

(i) Combinations.

(ii) Cartel.

(iii) Acquisition.

(iv) Competition Appellate Tribunal.

(v) Role of Director General in assisting the commission.

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STUDY NOTE : 4

FOREIGN EXCHANGE MANAGEMENT ACT, 1999

This Study Note Includes:

4.1 Introduction
4.2 Broad structure of the FEMA
4.3 Important definitions
4.4 Regulation and management of foreign exchange
4.5 Authorised person

4.1 INTRODUCTION

Under Article 246 of the Constitution of India, the Parliament has exclusive power to make laws with respect to any of the matters enumerated in the Union List in the Seventh Schedule. Entry 16 of the Union List deals with Foreign jurisdiction; Entry 36 deals with Currency, coinage and legal tender, foreign exchange; Entry 37 deals with Foreign loans and Entry 41 deals with Trade and commerce with foreign countries; import and export across customs frontiers; definition of customs frontiers.

When a business enterprise imports goods from other countries, exports its products to them or makes investments abroad, it deals in foreign exchange. Therefore, the management of foreign exchange is very important in the present day business.

A system of exchange control was first time introduced through a series of rules under the Defence of India Act, 1939 on temporary basis. The foreign exchange crises persisted for a long time and finally it got enacted in the statute under the title 'Foreign Exchange Regulation Act, 1947'. Subsequently, this act was replaced by the Foreign Exchange Regulation Act, 1973 (FERA) which was came into force with effect from January 1, 1974 and regulating foreign exchange for more than 26 years under this Act.

In 1991 Government of India initiated the policy of economic liberalization. After this foreign investment in many sectors were permitted in India. In 1997, Tarapore Committee on Capital Account Convertibility, constituted by the Reserve Bank of India, recommended change in the legislative framework governing foreign exchange transactions. Accordingly, the Foreign Exchange Regulation Act, 1973 was repealed and replaced by the new Foreign Exchange Management Act, 1999 (FEMA) with effect from June 01, 2000. Under FEMA the emphasis was on management of foreign exchange.

4.1.1 Objective of the Act

The main objective of FERA was conservation and proper utilization of the foreign exchange resources of the country. It also sought to control certain aspects of the conduct of business outside the country by Indian companies and in India by foreign companies. When a business enterprise imports goods from other countries, exports its products to them or makes investments abroad, it deals in foreign exchange. Foreign exchange means 'foreign currency' and includes deposits, credits and balances payable in any foreign currency and secondly drafts, travelers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency.

4.1.2 Extent

This Act extends to the whole of India and also applies to all branches, offices and agencies outside India owned or controlled by a person resident in India. It is also applicable to any contravention committed outside India by any person to whom this Act is applicable. Accordingly, FEMA does not apply to citizens of India who are outside India unless they are resident of India.

4.1.3 Purpose of the Act

The preamble to FEMA lays down the purpose of the Act is to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India. Rationale for strict regulations under FERA 1973, after independence India was left with little forex reserves and during the oil Crisis of seventies ballooning oil import bills further drained foreign exchange reserves.

The Act has assigned an important role to the Reserve Bank of India (RBI) in the administration of FEMA. The rules, regulations and norms pertaining to several sections of the Act are laid down by the Reserve Bank of India, in consultation with the Central Government. The Act requires the Central Government to appoint as many officers of the Central Government as Adjudicating Authorities as required for holding inquiries pertaining to contravention of the Act. There is also a provision for appointing one or more Special Directors (Appeals) to hear appeals against the order of the Adjudicating authorities. The Central Government has also established an Appellate Tribunal for Foreign Exchange to hear appeals against the orders of the Adjudicating Authorities and the Special Director (Appeals). The FEMA provides for the establishment, by the Central Government, of a Directorate of Enforcement with a Director and such other officers or class of officers as it thinks fit for taking up for investigation of the contraventions under this Act.

4.1.4 Benefits of the Act

In the FERA regime accent was to regulate everything that was specified, relating to foreign exchange whereas FEMA lay down that 'everything other than what is expressly covered is not controlled'. The overriding objective of FERA was to regulate and minimize dealings in foreign exchange and foreign securities while FEMA on the other hand aims to aid in creation of a liberal foreign exchange market in India. It is also to be understood that the foreign exchange reserves started increasing after the liberalization regime and foreign exchange was started to be allowed more freely in contrast to the earlier FERA regime.

This difference in terminology reflects seriousness of government towards deregulation of foreign exchange and promotion of free flow of international trade. To facilitate external trade, section 5 of the Act removes restrictions on withdrawal of foreign exchange for the purpose of current account transactions. As external trade i.e., imports/export of goods & services involve transactions on current account, there is no need for seeking RBI permissions in connection with remittances involving external trade. All transactions which fall within the category current account transactions are deemed permitted unless expressly specified and in respect of capital account transactions, they need to be expressly permitted to be transacted,

4.1.5 The difference between the title, FERA and FEMA of legislations

In view of the stated change, the title of the legislation has rightly been changed from 'Foreign Exchange Regulation Act' to 'Foreign Exchange Management Act'. The main change that has been brought is that FEMA is a civil law, whereas the FERA was a criminal law. In simple word, for contravention of provisions under the FEMA arrest and imprisonment would not be resorted whereas it was the norm under the previous act. Drastic tenor of FERA can be gauged from the fact that it provided for imprisonment for violation of even very minor offenses. In FERA, the presumption was upon the accused to defend himself as he was deemed guilty, whereas in FEMA, the onus is upon the Enforcement Directorate to prove the guilt of the accused.

4.2 BROAD STRUCTURE OF THE FEMA

The overall structure of Foreign Exchange Management Act, 1999 is covered by legislations, rules and regulations. These legislations, rules and regulations relating to Foreign Exchange Management Act, 1999, can be divided in to the followings:

(a) FEMA contains 7 chapters divided into 49 sections (Supreme Legislation) as detailed below:

Chapter	Description	
I	Preliminary	01 – 02
II	Regulation and Management of Foreign Exchange	03 – 09
III	Authorised Person	10 – 12
IV	Contravention and Penalties	13 – 15
V	Adjudication and Appeal	16 – 35
VI	Directorate of Enforcement	36 – 38
VII	Miscellaneous	39 – 49

(b) 5 sets of Rules made by Ministry under section 46 of FEMA. (Delegated legislations).

(c) 23 sets of Regulations made by RBI under section 47 of FEMA. (Subordinate Legislations).

(d) Master Circular/Directions issued by Reserve Bank of India every year. The latest set of master directions were issued during January 2016.

(e) Foreign Direct Investment (FDI) policy issued by Department of Industrial Policy and Promotion (DIPP) time to time.

(f) Notifications and A. P. (DIR Series) Circulars issued by Reserve Bank of India.

(g) Enforcement Directorate.

4.3 IMPORTANT DEFINITIONS

(a) Authorized Bank

'Authorized Bank' means a bank including a co-operative bank (other than an authorized dealer) authorized by the Reserve Bank to maintain an account of a person resident outside India.

(b) Authorized Dealer

'Authorized Dealer' means a person authorized as an authorized dealer under sub-section (1) of section 10 of FEMA.

(c) Authorized person - Section 2(c)

'Authorized person' means an authorized dealer, money changer, off-shore banking unit or any other person for the time being authorized under sub-section (1) of section 10 to deal in foreign exchange or foreign securities.

(d) Capital

'Capital' means equity shares, fully, compulsorily & mandatorily convertible preference shares, fully, compulsorily & mandatorily convertible debentures and warrants.

The equity shares issued in accordance with the provisions of the Companies Act, as applicable, shall include equity shares that have been partly paid. Preference shares and convertible debentures shall be required to be fully paid, and should be mandatorily and fully convertible. Further, 'warrant' includes Share Warrant issued by an Indian Company in accordance to provisions of the Companies Act, as applicable.

(e) Capital account transaction - Section 2(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) Current account transaction - Section 2(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:

(1) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business.

(2) payments due as interest on loans and as net income from investments.

(3) remittances for living expenses of parents, spouse and children residing abroad, and

(4) expenses in connection with foreign travel, education and medical care of parents, spouse and children.

(g) Depository Receipt (DR)

'Depository Receipt' (DR) means a negotiable security issued outside India by a Depository bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian bank in India. In other words, it is a foreign currency denominate instrument, issued by foreing depositary on the books of securities transferred to it by the company. DRs are traded on Stock Exchanges in the US, Singapore, Luxembourg, etc. DRs listed and traded in the US markets are known as American Depository Receipts (ADRs) and those listed and traded anywhere/elsewhere are known as Global Depository Receipts (GDRs). DRs are governed by Notification No. FEMA 330/ 2014-RB, issued by Reserve bank of India.

(h) Export - Section 2(l)

'export', with its grammatical variations and cognate expressions, means:

(1) the taking out of India to a place outside India any goods.

(2) provision of services from India to any person outside India.

(i) Foreign currency - Section 2(m)

'foreign currency' means any currency other than Indian currency.

(j) Foreign Currency Convertible Bond (FCCB)

'Foreign Currency Convertible Bond' (FCCB) means a bond issued by an Indian company expressed in foreign currency, the principal and interest of which is payable in foreign currency. FCCBs are issued in accordance with the Foreign Currency Convertible Bonds and ordinary shares (through depository receipt mechanism) Scheme, 1993 and subscribed by a non-resident entity in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part.

(k) FDI

'FDI' means investment by non-resident entity/person resident outside India in the capital of an Indian company under Schedule 1 of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000. This term is not defined in the Act or the regulations, but in the Consolidated FDI Policy Circular of the Government of India, Department of Industrial Policy and Promotion.

(l) Foreign exchange - Section 2(n)

'foreign exchange' means foreign currency and includes,-

(1) deposits, credits and balances payable in any foreign currency.

(2) drafts, travelers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency.

(3) drafts, travelers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency.

(m) FIPB

'FIPB' means the Foreign Investment Promotion Board constituted by the Government of India which stand abolished from May, 2017.

(n) Foreign Institutional Investor (FII)

'Foreign Institutional Investor'(FII) means an entity established or incorporated outside India which proposes to make investment in India and which is registered as a FII in accordance with the Securities and Exchange Board of India (SEBI) (Foreign Institutional Investor) Regulations 1995.

(o) Foreign Portfolio Investor(FPI)

'Foreign Portfolio Investor'(FPI) means a person registered in accordance with the provisions of Securities and Exchange Board of India (SEBI) (Foreign Portfolio Investors) Regulations, 2014, as amended from time to time.

(p) Foreign Venture Capital Investor (FVCI)

'Foreign Venture Capital Investor' (FVCI) means an investor incorporated and established outside India, which is registered under the Securities and Exchange Board of India (Foreign Venture Capital Investor) Regulations, 2000 [SEBI (FVCI) Regulations] and proposes to make investment in accordance with these Regulations.

(q) Foreign security - Section 2(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.

(r) Government route

'Government route' means that investment in the capital of resident entities by non-resident entities can be made only with the prior approval of Government (FIPB, Department of Economic Affairs (DEA), Ministry of Finance or Department of Industrial Policy & Promotion, as the case may be).

(s) Import - Section 2(p)

'import', with its grammatical variations and cognate expressions, means bringing into India any goods or services.

(t) Indian currency - Section 2(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 28A of the Reserve Bank of India Act, 1934 (2 of 1934).

(u) Investment on repatriable basis

'Investment on repatriable basis' means investment, the sale proceeds of which, net of taxes, are eligible

to be repatriated out of India and the expression 'investment on non-repatriable basis' shall be construed accordingly.

(v) Non-resident entity

'Non-resident entity' means a 'person resident outside India' as defined under FEMA.

(w) Non-Resident Indian (NRI)

'Non-Resident Indian' (NRI) means an individual resident outside India who is a citizen of India or is an 'Overseas Citizen of India' cardholder within the meaning of section 7 (A) of the Citizenship Act, 1955. 'Persons of Indian Origin' cardholders registered as such under Notification No. 26011/4/98 F.I. dated 19.8.2002 issued by the Central Government are deemed to be 'Overseas Citizen of India' cardholders.

(x) Person - Section 2(u)

'person' includes:

(1) an individual,

(2) a Hindu undivided family,

(3) a company,

(4) a firm,

(5) an association of persons or a body of individuals, whether incorporated or not,

(6) every artificial juridical person, not falling within any of the preceding sub-clauses, and

(7) any agency, office or branch owned or controlled by such person.

(y) Person of Indian Origin (PIO)

'Person of Indian Origin' (PIO) means a citizen of any country other than Bangladesh or Pakistan, if:

(8) he at any time held Indian Passport, or

(9) he or either of his parents or any of his grandparents was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955), or

(10) the person is a spouse of an Indian citizen or a person referred to in sub-clause (i) or (ii).

(z) Person resident in India - Section 2(v)

'person resident in India' means:

(a) 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:

(1) 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.

(2) 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.

(b) any person or body corporate registered or incorporated in India.

(c) an office, branch or agency in India owned or controlled by a person resident outside India.

(d) an office, branch or agency outside India owned or controlled by a person resident in India.

(aa) Person resident outside India - Section 2(w)

'person resident outside India' means a person who is not resident in India.

(ab) Repatriate to India - Section 2(y)

'repatriate to India' means bringing into India the realized foreign exchange and-

(a) the selling of such foreign exchange to an authorized person in India in exchange for rupees, or

(b) the holding of realized amount in an account with an authorized person in India to the extent notified by the Reserve Bank and includes use of the realized amount for discharge of a debt or liability denominated in foreign exchange and the expression "repatriation" shall be construed accordingly.

4.4 REGULATION AND MANAGEMENT OF FOREIGN EXCHANGE

Chapter II of the Foreign Exchange Management Act, 1999 deals with Regulation and Management of Foreign Exchange.

4.4.1 Dealing in foreign exchange, etc. (Section 3)

Section 3 prohibits the following transactions, namely:

(a) dealing in or transferring any foreign exchange or foreign securities by any person not being an authorized person.

(b) making any payment to or for the credit of any person resident outside India in any manner.

(c) receiving otherwise than through an authorized person, any payment by order or on behalf of any person resident outside India in any manner.

As per the explanation given under 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 authorized 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 authorized person.

(d) entering 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.

As per the explanation given under 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.

4.4.2 Holding of foreign exchange (Section 4)

According to this Section, except as 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.

This section restricts a resident in India from acquiring, holding, owing, possessing or transferring in any manner foreign exchange, foreign security or any immovable property situated outside India. However the acquisition such immovable property outside India on lease for a period not exceeding five years is permissible provided such transactions are not specifically prohibited.

In terms of regulations relating to acquisition and transfer of immovable property outside India, such acquisition by a person resident in India would require prior approval of Reserve Bank except in the following cases:

(a) Property held outside India by a foreign citizen resident in India.

(b) Property acquired by a person on or before 8th July, 1947 and held with the permission of Reserve Bank.

(c) Property acquired by way of gift or inheritance from persons referred to in above.

(d) Property purchased out of funds held in RFC account.

4.4.3 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. The law in regard to current account transactions is found in the Foreign Exchange Management (Current Account Transactions) Rules, 2000 and there are three schedules to the said Rules. Schedule I specifies the transactions which are altogether prohibited. A perusal of the schedule reveals that the foreign exchange is not available for remittance out of lottery earnings, income from racing/riding, purchase of lottery tickets, commission on exports towards equity, commission on exports through Rupee State Credit Route etc. are altogether prohibited on account of certain conditions and for good conduct. Schedule II specifies the transactions which are subject to the approval of the Reserve Bank of India. Schedule II consists of foreign exchange requirement for cultural tours, advertisement in foreign print media by a State Government and Public Sector Undertakings, remittance of freight of vessel chartered by a Public Sector undertaking, payment of ocean freight by a Government or Public Sector Undertaking, remittance of prize money exceeding US$ 1,00,000 for sponsorship of sports etc. Since the type of transactions in Schedule II relate to the Government entities and are subject to the rules and regulations of Government entities, the approval of Central Government from the specified department is required. Schedule III relates to the transactions for which an upper ceiling has been prescribed with regard to the type of transactions. The foreign exchange today for a transaction is permissible without limit, if there are no specific restrictions and the authorized dealer banks would be making available subject to the applicant furnishing a declaration for compliance with FEMA and compliance with remittance of taxes as applicable. For foreign travel on private and official trips, gifts, donations, taking up employment, maintenance of close relatives, commission on sale of residential flats, consultancy services, reimbursement of pre-incorporation expenses, foreign studies, medical treatment abroad etc. foreign exchange is available as per Schedule III.

4.4.4 Capital account transactions (Section 6)

(a) According to this Section, any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction subject to the provisions of sub section 2 of this Section.

(b) Further, the Reserve Bank may, in consultation with the Central Government, specify:

(1) any class or classes of capital account transactions, which are permissible.

(2) 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 amortisation of loans or for depreciation of direct investments in the ordinary course of business.

(c) Without prejudicial to the generality of the provision of sub-section (2), the Reserve Bank may, by regulations, prohibit, restrict or regulate the following:

(1) transfer or issue of any foreign security by a person resident in India.

(2) transfer or issue of any security by a person resident outside India.

(3) transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India.

(4) any borrowing or lending in foreign exchange in whatever form or by whatever name called.

(5) 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.

(6) deposits between persons resident in India and persons resident outside India.

(7) export, import or holding of currency or currency notes.

(8) transfer of immovable property outside India, other than a lease not exceeding five years, by person a resident in India.

(9) acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India.

(10) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred:

a) by a person resident in India and owed to a person resident outside India; or

b) by a person resident outside India.

(d) 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.

The RBI vide A.P. (DIR Series) Circular No. 90 dated 9th January, 2014 has issued a clarification on section 6(4) of the Act. This circular clarifies that section 6(4) of the Act covers the following transactions:

(1) Foreign currency accounts opened and maintained by such a person when he was resident outside India.

(2) Income earned through employment or business or vocation outside India taken up or commenced which such person was resident outside India, or from investments made while such person was resident outside India, or from gift or inheritance received while such a person was resident outside India.

(3) Foreign exchange including any income arising therefrom and conversion or replacement or accrual to the same, held outside India by a person resident in India acquired by way of inheritance from a person resident outside India.

(4) A person resident in India may freely utilize all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without approval of Reserve Bank, provided the cost of such investments and/or any subsequent payments received therefor are met exclusively out of funds forming part of eligible assets held by them and the transactions is not in contravention to extant FEMA provisions.

(e) 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 a such person when he was resident in India or inherited from a person who was resident in India.

(f) 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.

4.4.5 Export of goods and services (Section 7)

(a) Every exporter of goods shall:

(1) 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.

(2) furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realization of the export proceeds by such exporter.

(b) 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.

(c) 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.

4.4.6 Realisation and repatriation of foreign exchange (Section 8)

According to this Section, 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. The regulations are contained in the Foreign Exchange Management (Realisation, Repatriation and Surrender of Foreign Exchange) Regulations, 2015.

4.4.7 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 there on 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 there from.

(e) foreign exchange acquired from employment, business, trade, vocation, service, 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.

4.4.8 Possession and Retention of Foreign Exchange

The Reserve Bank of India has specified the following persons with the limits for possession and retention of foreign currency by a person resident in India:

(a) Authorised Persons in accordance with the limits advised by the Reserve Bank.

(b) Any person may possess foreign coins without no restriction.

(c) Any person resident in India is permitted to retain in aggregate foreign currency not exceeding USD 2,000 or its equivalent in the form of currency notes/bank notes or travellers cheques acquired by him.

(d) A person resident in India but not permanently resident therein is permitted without limit, if the foreign currency was acquired when he was resident outside India and was brought into India and declared to the Customs Authorities.

4.4.9 Forms of business may be conducted by a Foreign Company in India.

A foreign company planning to set up business operations in India may:

(a) Incorporate a company under the Companies Act, 1956 (now Companies Act 2013), as a Joint Venture or a Wholly Owned Subsidiary.

(b) Set up a Liaison Office/Representative Office or a Project Office or a Branch Office of the foreign company which can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000.

4.4.10 Foreign Investments in India

Foreign Direct Investment (FDI) is a category of cross border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) i.e., resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long term relationship with the direct investment enterprise to ensure the significant degree of influence by the direct investor in the management of the direct investment enterprise. The objectives of direct investment are different from those of portfolio investment whereby investors do not generally expect to influence the management of the enterprise.

Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI Policy which is formulated and announced by the Government of India. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India issues a Consolidated FDI Policy on an yearly basis elaborating the policy and the process in respect of FDI in India. The latest Consolidated FDI Policy is governed by the provisions of the Foreign Exchange Management Act (FEMA), 1999. FEMA Regulations which prescribe amongst other things the mode of investments i.e. issue or acquisition of shares / convertible debentures and preference shares, manner of receipt of funds, pricing guidelines and reporting of the investments to the Reserve Bank.

4.4.11 Foreign Currency Borrowings

Resident entities may borrow in foreign currency for the following purposes:

(a) *For execution of projects outside India and for exports on deferred payment terms:* A person resident in India may borrow, whether by way of loan or overdraft or any other credit facility, from a bank situated outside India, for execution outside India of a turnkey project or civil construction contract or in connection with exports on deferred payment terms, provided the terms and conditions stipulated by the authority which has granted the approval to the project or contract or export is in accordance with the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000.

(b) External Commercial Borrowings (ECB): ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters apply in totality and not on a standalone basis. The framework for raising loans through ECB (herein after referred to as the ECB Framework) comprises the following three tracks:

(1) Medium term foreign currency denominated ECB with minimum average maturity of 3/5 years.

(2) Long term foreign currency denominated ECB with minimum average maturity of 10 years.

(3) Indian Rupee (₹) denominated ECB with minimum average maturity of 3/5 years.

Forms of ECB: The ECB Framework enables permitted resident entities to borrow from recognized non-resident entities in the following forms:

a) Loans including bank loans.

b) Securitized instruments (e.g., floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares/debentures).

c) Buyers' credit.

d) Suppliers' credit.

e) Foreign Currency Convertible Bonds (FCCBs).

f) Financial Lease, and

g) Foreign Currency Exchangeable Bonds (FCEBs),

4.4.12 Entry Routes for Investment

Investments in India have to be in accordance with any one of the schedules to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000. There are nine schedules to the Regulations.

Investments can be made by non-residents in the equity shares/fully, compulsorily and mandatorily convertible debentures/fully, compulsorily and mandatorily convertible preference shares of an Indian company, through the Automatic Route or the Government Route which is also alternatively referred to as the approval route. Under the Automatic Route, the non-resident investor or the Indian company does not require any approval from Government of India for the investment. Under the Government Route, prior approval of the Government of India is required. Proposals for foreign investment under Government route, are considered by respective administrative ministry of central government. Various filing are required to be made to RBI in automatic route.

4.4.13 Eligible investee entities

(a) FDI in an Indian Company.

(b) FDI in Partnership Firm/Proprietary Concern.

(c) FDI in Trusts which are Venture Capital Trusts regulated by the Securities and Exchange Board of India and Investment vehicles as detailed in the next paragraph.

(d) FDI in Limited Liability Partnerships (LLPs).

FDI in resident entities other than those mentioned above is not permitted.

4.4.14 Investment Vehicle

An entity being 'investment vehicle' registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose including Real Estate Investment Trusts (REITs) governed by the SEBI (REITs) Regulations, 2014, Infrastructure Investment Trusts (InvIts) governed by the SEBI (InvIts) Regulations, 2014, Alternative Investment Funds (AIFs) governed by the SEBI (AIFs) Regulations, 2012 and notified under Schedule 11 of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 is permitted to receive foreign investment from a person resident outside India (other than an individual who is citizen of or any other entity which is registered / incorporated in Pakistan or Bangladesh), including an Registered Foreign Portfolio Investor (RFPI) or a non-resident Indian (NRI).

4.4.15 Caps on Investments

Investments can be made by non-residents in the capital of a resident entity only to the extent of the percentage of the total capital as specified in the FDI policy. Those are secretarial caps, i.e., upper limit of investment in each of the business/industry sector.

4.4.16 Procedure for receiving Foreign Direct Investment (FDI) in an Indian company

An essential requirement for receiving foreign direct investment is the compliance with the KYC (Know your customer) requirement specified by the Reserve Bank of India. As and when the negotiations take place for foreign investment, the overseas investor should be apprised of the need to receive the KYC certification through the Banking channels.

An Indian company may receive Foreign Direct Investment (FDI) under the two routes as given under:

(a) **Automatic Route**

FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities / sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

(b) **Government Route**

FDI in activities not covered under the automatic route requires prior approval of the Government which is considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. Application can be made in the prescribed Form. Plain paper applications carrying all relevant details are also accepted. No fee is payable.

The Indian company having received FDI either under the Automatic route or the Government route is required to comply with provisions of the FDI policy including reporting the FDI to the Reserve Bank of India.

4.4.17 Instruments for receiving Foreign Direct Investment in an Indian company

Foreign investment is reckoned as FDI only if the investment is made in equity shares, fully and mandatorily convertible preference shares and fully and mandatorily convertible debentures with the pricing being decided upfront as a figure or based on the formula that is decided upfront. Partly paid equity shares and

warrants issued by an Indian company in accordance with the provision of the Companies Act, 2013 and the SEBI guidelines, as applicable, shall be treated as eligible FDI instruments w.e.f. July 8, 2014 subject to compliance with FDI scheme. The pricing and receipt of balance consideration shall be as stipulated in terms of A.P. (DIR Series) Circular No.3 dated July 14, 2014 as modified from time to time.

Any foreign investment into an instrument issued by an Indian company which:

(a) gives an option to the investor to convert or not to convert it into equity or

(b) does not involve upfront pricing of the instrument as a date would be reckoned as ECB and would have to comply with the ECB guidelines.

The FDI policy provides that the price / conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the extant FEMA regulations [valuation as per any internationally accepted pricing methodology on arm's length basis for the unlisted companies and valuation in terms of SEBI (ICDR) Regulations, for the listed companies] without any assured return.

4.4.18 Modes of payment allowed for receiving Foreign Direct Investment in an Indian company

An Indian company issuing shares / convertible debentures under FDI Scheme to a person resident outside India shall receive the amount of consideration required to be paid for such shares / convertible debentures by:

(a) inward remittance through normal banking channels.

(b) debit to NRE / FCNR account of a person concerned maintained with an AD Category–I bank.

(c) conversion of royalty/lump sum/technical know-how fee due for payment or conversion of ECB, shall be treated as consideration for issue of shares.

(d) conversion of import payables / pre incorporation expenses / share swap can be treated as consideration for issue of shares with the approval of FIPB.

(e) debit to non-interest bearing Escrow account in Indian Rupees in India which is opened with the approval from AD Category–I bank and is maintained with the AD Category–I bank on behalf of residents and non-residents towards payment of share purchase consideration.

If the shares or convertible debentures are not issued within 180 days from the date of receipt of the inward remittance or date of debit to NRE / FCNR (B)/Escrow account, the amount shall be refunded. Further, Reserve Bank may on an application made to it and for sufficient reasons permit an Indian Company to refund / allot shares for the amount of consideration received towards issue of security if such amount is outstanding beyond the period of 180 days from the date of receipt.

4.4.19 Issue of ADRs/GDRs by Indian companies

In terms of Schedule 10 to Notification No. FEMA.20/2000-RB dated May 3, 2000, a person will be eligible to issue or transfer eligible securities to a foreign depository, for the purpose of converting the securities so purchased into depository receipts in terms of Depository Receipts Scheme, 2014 and guidelines issued by the Government of India there under from time to time.

4.4.20 Issue Foreign Currency Convertible Bonds (FCCBs)

FCCBs can be issued by Indian companies in the overseas market in accordance with the Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

The FCCB being a debt security, the issue needs to conform to the External Commercial Borrowing

guidelines, issued by RBI.

4.4.21 Issue of shares against Lumpsum Fee, Royalty, ECB, Import of capital goods / machineries etc.

An Indian company eligible to issue shares under the FDI policy and subject to pricing guidelines as specified by the Reserve Bank from time to time, may issue shares to a person resident outside India.

4.4.22 Investment by NRI and RFPI in Indian Depository Receipts (IDRs)

NRI and Registered Foreign Portfolio Investors (RFPI) have been permitted to invest, purchase, hold and transfer IDRs of eligible companies resident outside India and issued in the Indian capital market.

4.4.23 Regulations for Foreign Venture Capital Investment

A SEBI registered Foreign Venture Capital Investor has general permission from the Reserve Bank of India to invest in a Venture Capital Fund (VCF) or an Indian Venture Capital Undertaking (IVCU), in the manner and subject to the terms and conditions specified by the RBI.

4.4.24 Sector Specific Conditions on FDI

(a) Prohibited Sectors

FDI is prohibited in:

(1) Lottery Business including Government / private lottery, online lotteries, etc.

(2) Gambling and Betting including casinos etc.

(3) Chit funds.

(4) Nidhi company.

(5) Trading in Transferable Development Rights (TDRs).

(6) Housing and Real Estate Business or Construction of Farm Houses 'Real estate business' shall not include development of townships, construction of residential / commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014.

(7) Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

(8) Activities / sectors not open to private sector investment e.g.,

a) Atomic Energy and

b) Railway operations (other than permitted activities mentioned in para 5.2).

Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business and Gambling and Betting activities.

(b) Permitted Sectors

(1) In the following sectors/activities, FDI up to the limit indicated against each sector/activity is allowed, subject to applicable laws/regulations; security and other conditionalities. In sectors/ activities not listed below, FDI is permitted up to 100% on the automatic route, subject to applicable laws/regulations; security and other conditionalities.

Wherever there is a requirement of minimum capitalization, it shall include share premium received along with the face value of the share, only when it is received by the company upon issue of the shares to the non-resident investor. Amount paid by the transferee during post-issue transfer of shares beyond the issue price of the share, cannot be taken into account while calculating minimum capitalization requirement.

(2) Sectoral cap i.e., the maximum amount which can be invested by foreign investors in an entity, unless provided otherwise, is composite and includes all types of foreign investments, direct and indirect, regardless of whether the said investments have been made under Schedule 1 (FDI), 2 (FII), 2A (FPI), 3 (NRI), 6 (FVCI), 9 (LLPs), 10 (DRs) and 11(Investment Vehicle) of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations. FCCBs and DRs having underlying of instruments which can be issued under Schedule 5, being in the nature of debt, shall not be treated as foreign investment. However, any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned as foreign investment under the composite cap.

(3) Foreign investment in sectors under Government approval route resulting in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities will be subject to Government approval. Foreign investment in sectors under automatic route but with conditionalities, resulting in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities, will be subject to compliance of such conditionalities.

(4) The sectors which are already under 100% automatic route and are without conditionalities would not be affected.

(5) Notwithstanding anything contained in paragraphs a) and c) above, portfolio investment, up to aggregate foreign investment level of 49% or sectoral/statutory cap, whichever is lower, will not be subject to either Government approval or compliance of sectoral conditions, as the case may be, if such investment does not result in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities. Other foreign investments will be subject to conditions of Government approval and compliance of sectoral conditions as laid down in the FDI policy.

(6) Total foreign investment, direct and indirect, in an entity will not exceed the sectoral/statutory cap.

(7) Any existing foreign investment already made in accordance with the policy in existence would not require any modification to conform to amendments introduced through Press Note 8 (2015 Series).

(8) The onus of compliance of above provisions will be on the investee company.

FDI is a capital account transaction and thus any violation of FDI regulations are covered by the penal provisions of the FEMA. Reserve Bank of India administers the FEMA and Directorate of Enforcement under the Ministry of Finance is the authority for the enforcement of FEMA. The Directorate takes up investigation in any contravention of FEMA.

4.4.25 Remittance, Reporting and Violation

Both the above transactions entails either inward remittance to India or outward remittance from India. The FEMA, 1999 provides a detailed mechanism for remittance, reporting and consequent violations. Therefore, the Government has provided elaborated scheme for remittance, reporting and violation of FDI policy as detailed below:

(a) Remittance and Repatriation

(1) Remittance of sale proceeds/Remittance on winding up/Liquidation of Companies.

(2) Repatriation of Dividend.

(3) Repatriation of Interest.

(b) Reporting of FDI

(1) Reporting of Inflow in form Advance Reporting Form as per Section I of the Government of India Circular (Section I of policy circular).

(2) Reporting of issue of shares in form FC GPR (Section II of Policy Circular)

(3) Reporting of transfer of shares in form FC TRS (Section 4 of Policy).

(4) Reporting of Non-Cash (applicable in cases where shares are issued in conversion of External Commercial Borrowings in ECB – 2 for whole/partial conversion as applicable as stated in the Policy.

(5) Reporting of FCCB/DR Issues in form DRR as per Section 5 of the Policy Circular.

It may be stated that the KYC report about the overseas investing entity should be collected from overseas banker in the format (section II of Policy Circular) prescribed and submitted to the Reserve Bank.

(c) Adherence to Guidelines/Orders and Consequences of Violation.

4.5 AUTHORISED PERSON (SECTION 10)

(a) 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. [Sub-section (1)].

(b) An authorisation under this section shall be in writing and shall be subject to the conditions laid down therein [Sub-section (2)].

(c) An authorisation granted under sub-section (1) may be revoked by the Reserve Bank at any time if the Reserve Bank is satisfied that:

(1) it is in public interest so to do, or

(2) 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 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.

(d) 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.

(e) 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 reasonable 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.

(f) 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 provision of the Act for the purpose of this section.

4.5.1 Reserve Bank's powers to issue directions to authorised person (Section 11)

(a) 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.

(b) 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.

(c) 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 head, impose on the authorized 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.

Case Law

In Policy decisions; there will be no Judicial intervention. *[Prof. Krishnaraj Goswami vs. Reserve Bank of India; (2008) 83 SCL 133 (BOM)]:* The Government of India took a policy decision to permit FDI in infrastructure companies in securities market viz., stock exchanges, depositories and clearing corporation. SEBI issued a circular in this regard. RBI also issued a circular A.P.(DIR Series) Circular No. 25 dated 22.12.2006 giving certain directions to authorized dealers.

In this case, the petitioner challenged the RBI Circular as invalid in as much as it restricts the trade activities of general corporate sector. Bombay High Court observed that the RBI had issued the impugned circular dated 22.12.2006 by way of directions as contemplated under section 10(4) and 11(1) of the FEMA. A bare reading of the provisions of these sections clearly shows that RBI has power to issue direction s to authorized persons and this power is wide enough to cover any kind of directions so far it provides for regulation of foreign exchange management. The contention of petitioner, that RBI had no jurisdiction to issue such circulars, cannot accepted. Section 10(4) clearly stipulate that an authorized person, in all dealings, is bound by the directions, general, or special, issued by RBI. Similarly, section 11(1) provides that RBI may, for the purpose of securing compliance of the provisions of the FEMA and of any rules, regulations and directions made thereunder, give to the authorized persons any direction in regard to making of payment or the doing or desist from doing of any act relating to foreign exchange or foreign security.

The petitioner had not challenged the policy decision of the Central Government, but had merely questioned the incidental act i.e. the impugned circular. In any event, these are policy decisions which fall within the domain of the authorities concerned in the Central Government. The effect and repercussions of such policy decision can hardly be subject matter of judicial review. Policy decision unless and until are reversed or inconsistent with the constitutional mandate or a patent abuse of power, judicial intervention will normally be not necessitated. Petition dismissed.

4.5.2 Power of Reserve Bank to inspect authorised person (Section 12)

(a) 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:

(1) verifying the correctness of any statement, information or particulars furnished to the Reserve Bank.

(2) obtaining any information or particulars which such authorised person has failed to furnish on being called upon to do so.

(3) securing compliance with the provisions of this Act or of any rules, regulations, directions or orders made thereunder.

(b) 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.

Self Assessment Questions

(1) Write short notes on:

(a) Current Account Transaction

(b) Capital Account Transaction

(2) Explain the procedure for making declaration of export of goods and software and the period within which the collection of proceeds of exports to be realised.

(3) Explain the significance of Foreign Exchange Management Act 1999 and contrast it with Foreign Exchange Regulation Act, 1973.

(4) What are the rights of a citizen to obtain Foreign Exchange under the Foreign Exchange Management Act, 1999?

(5) According to Foreign Exchange Management Act, 1999, a person resident in India shall take all reasonable steps to repatriate to India any amount of foreign exchange earned and accrued to him.

(6) What is meant by the expression 'Repatriate to India'? State the cases where foreign exchange can be held or need not be repatriated to India by a resident in India.

(7) What are the reporting requirements for foreign domestic investment?

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STUDY NOTE : 5

LAW RELATED TO BANKING SECTOR

PART – A : THE BANKING REGULATION ACT, 1949

This Study Note Includes:

A : 5.1 Introduction

A : 5.2 About Banking Regulation Act, 1949

A : 5.3 Salient features of the Banking Regulation Act, 1949

A : 5.1 INTRODUCTION

Banking in India in the modern sense originated in the last decades of the 18th century. Among the first banks were the Bank of Hindustan, which was established in 1770 and liquidated in 1829-32 and the General Bank of India, established in 1786 but failed in 1791.

The largest bank, and the oldest still in existence, is the State Bank of India (S.B.I). It originated as the Bank of Calcutta in June 1806. In 1809, it was renamed as the Bank of Bengal. This was one of the three banks funded by a presidency government, the other two were the Bank of Bombay and the Bank of Madras. The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955. For many years the presidency banks had acted as quasi-central banks until the Reserve Bank of India was established in 1935, under the Reserve Bank of India Act, 1934.

In 1960, the State Bank of India was given control of eight state-associated banks under the State Bank of India (Subsidiary Banks) Act, 1959. These are now called its associate banks. As of now, all the associate Banks of State Bank of India and the lately established Bharatiya Mahila Bank Limited are under merger with the State Bank of India. In 1969 the Indian government nationalised 14 major private banks. In 1980, 6 more private banks were nationalised. These nationalised banks are the majority of lenders in the Indian economy. They dominate the banking sector because of their large size and widespread networks.

The Indian banking sector is broadly classified into scheduled banks and non-scheduled banks. The scheduled banks are those which are included under the 2nd Schedule of the Reserve Bank of India Act, 1934. The scheduled banks are further classified into: Nationalised banks, State Bank of India and its associates, Regional Rural Banks (RRBs), foreign banks, and other Indian private sector banks. Private Sector Banks could also be categorized into older Private Sector Banks and the newer Private Sector Banks. The term commercial bank refers to both scheduled and non-scheduled commercial banks which are regulated under the Banking Regulation Act, 1949.

Currently, 74% FDI is permitted in the private sector banking, of which up to 49% is allowed under the automatic route and beyond that through the approval of the Foreign Investment Promotion Board (FIPB). However, portfolio investments in the banking sector can go up to 49%.

Business of Banks

The Banks in general accept the deposits from public by way of different categories – e.g. savings bank accounts, current accounts and fixed deposits as well as recurring deposits, cash certificates etc. The deposits could be categorized in two broad groups i.e. savings bank and current account where withdrawals are based on demand by the account holders and fixed deposits which are time deposits for a specific period of time. Since the banks are expected to be ready with cash or honour cheques drawn on them by savings bank customers as well as current account customers, the rate of interest payable on such categories (CASA) is lower than the interest paid on fixed deposits. Banks are required to maintain the reserves in accordance with the stipulations in Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) and after meeting the reserve requirements and also for the day

to day liability for payments to customers in the form of cash balances, the remainder is generally lent by way of advances to various borrowers. The banks are required to earn a minimum interest spread on the advances which should provide for the administrative overheads and meet the cost of deposits too.

The Cash Reserve Ratio (CRR) at present is 4% and the Statutory Liquidity Ratio (SLR) is 21% as per the Reserve Bank of India website (August 2016).

As of now, the commercial banks have been facing the persistent problem of increasing non-performing assets for which they are forced to make provisions in accordance with the regulations of the Reserve Bank of India and declare losses. In order to tackle the problem of growing Non Performing Assets, a new step worth mention is the passing of the Insolvency and Bankruptcy Code, 2016 by both the houses of the Parliament. The first step in the implementation of the Act by notifying the sections of the Act dealing with the establishment of the Insolvency and Bankruptcy Board of India has been recently taken by the Ministry of Corporate Affairs. In view the need to be updated with this code, a write up about the Bureaucracy and Insolvency code is also provided at the end of the Chapter. The code proposes to consolidate and amend the law relating to Corporate Insolvencies and also individual bankruptcies. The jurisdiction for adjudication of cases of corporate insolvency is proposed to be handed over to the National Company Law Tribunal and in respect of individual bankruptcies the jurisdiction would rest with the Debt Recovery Tribunals. It is expected that the implementation of this new code would be a game changer in the corporate scenario.

A : 5.2 ABOUT BANKING REGULATION ACT, 1949

The Banking Regulation Act, 1949 is a central legislation that regulates all banking firms in India. Initially, the law was applicable only to banking companies.

The Act provides a framework using which commercial banking in India is supervised and regulated. The Act supplements the Companies Act, 1956. Primary Agricultural Credit Society and cooperative land mortgage banks are excluded from the Act.

The Act gives the Reserve Bank of India (RBI) to power to license banks, have regulation over shareholding and voting rights of shareholders, supervise the appointment of the boards and management, regulate the operations of banks, lay down instructions for audits, impose moratorium, mergers and liquidation, issue directives in the interests of public good and on banking policy and impose penalties.

In 1965, the Act was amended to include cooperative banks under its purview by adding the Section 56. Cooperative banks, which operate only in one state, are formed and run by the state government. But, RBI controls the licensing and regulates the business operations. The Banking Act was a supplement to the previous acts related to banking.

The Legal Framework of the Banking Regulation Act, 1949 is as follows:

Part	Description	Sections
I	Preliminary	1 to 5A
II	Business of Banking Companies	6 to 36A
IIA	Control over Management	36AA to 36AC
IIAB	Supersession of Board of Directors of Banking Company	36ACA
IIB	Prohibition of certain activities in relation to Banking Companies	36 AD
IIC	Acquisition of the undertakings of Banking Companies in certain cases	36AE to 36 AJ
III	Suspension of business and winding up of Banking Companies	36B to 45
IIIA	Special provision for speedy disposal of Winding up proceedings	45A to 45X
IIIB	Provision Relating to certain operation of Banking Companies	45Y to 45 ZF

IV	Miscellaneous	46 to 55A
V	Application of the Act to Cooperative Banks	56

A : 5.3 SALIENT FEATURES OF THE BANKING REGULATION ACT, 1949

The important provisions under Banking Regulation Act, 1949 are as follows:

5.3.1 Forms of business in which banking companies may engage [Section 6]

'Banking' means the accepting, for the purpose of landing and investment of deposit of money from the parties, repayble of demand.

This section provides that a Banking Company may engage in addition to the business of banking, a list of activities as detailed below:

(a) Agent for any government or local authority or persons but not as a managing agent or secretary and treasurer of a company.

(b) May effect, insure/ guarantee/underwrite, participate in managing or carrying out of any issue of loans or any other securities made by state, local body, company, corporation, association and may also lend for the purpose.

(c) May carry on or transact every kind of guarantee or indemnity business.

(d) May manage, sell and realize any property which may come its possession in satisfaction of its claims.

(e) May acquire, hold and deal with any property or any right , title or interest therein which forms the security for any loans or advances sanctioned.

(f) May undertake and execute trusts.

(g) May undertake the administration of estates as executor, trustee or otherwise.

(h) May establish and support or aid in the establishment of associations, institutions, funds, trusts and conveniences for the benefit of its present or past employees and their dependents and may grant or guarantee moneys for charitable purposes.

(i) May acquire, construct, maintain and alter any building or works necessary for its purposes.

(j) May sell, improve, manage, develop, exchange, lease, mortgage dispose off or otherwise deal with any of its properties and rights.

(k) May take over and undertake the whole or any part of the business of any person or company when such business is of a nature described above.

(l) May do all such other things as are incidental or conducive to the promotion or advancement of its business.

(m) May engage in any other form of business which the Central Govt. specifies to be lawful.

The above list of activities is exhaustive but not comprehensive. Of the several kinds of services listed above both under main business as well as ancillary business, some are 'agency services' and some are general utility services.

5.3.2 Board of Directors to include persons with professional and other experience (Section 10A)

Every company is required to ensure that the composition of the Board of Directors complies with this section. Not less than 51% of the total number of the Board of Directors shall consist of persons who shall have specialized knowledge or practical experience in accountancy, agriculture and rural economy, banking, co-operation, finance, law, small scale industry or any other field which in the opinion of the Reserve Bank of India would be useful to the Banking company. Of these, there shall be minimum two persons with special knowledge or experience in agriculture and rural economy, co-operation and small scale industry. Persons in the categories herein stated shall not have substantial interest or be connected with corporate / companies (not being section 8 Companies or companies engaged in small scale industry) or with trading, commercial or industrial concerns as employees, manager or managing agents. They could however, be connected with small industrial concern firms. The intention behind this provision is that the Board should be perfectly balanced with specialists drawn from various streams should form part of the Board and can provide a broad spectrum of experience. The directors of a banking company other than Chairman and Whole time director shall hold office for a period of 8 years.

5.3.3 Banking company to be managed by whole time Chairman [Section10B]

Every banking company in existence on the commencement of the Banking Regulation (Amendment) Act, 1994 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.

5.3.4 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 [Section10BB].

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 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. The Chairman of the Board of Directors of a Banking Company shall hold office for a period of five years.

5.3.5 Requirements regarding minimum paid up capital and reserves [Sections 11 & 12]

Section 11 of the Banking Companies Act lays down the requirements regarding the minimum standard of paid up capital and reserves as a condition for the commencement of business.

Under the provisions of Section 12, the subscribed capital of the company is not less than half of its authorized capital and the paid up capital is not less than half of its subscribed capital, provided when the capital is increased this proportion may be permitted to be secured within a period to be determined by the Reserve Bank not exceeding two years from the date of increase.

While the concept of minimum capital as above is a statutory prescription, in the current context, Capital adequacy ratio is very much relevant to be understood as the banks have now been forced to provide for the non performing assets (NPAs) in their books of account while announcing the results. The banks are now compared on an international rating and no banks can today operate without having sufficient capital as banks are required to engage with other banks for their business relationship and the erosion of capital in one bank could impact the other banks with which it has relationship. The subject matter of capital adequacy in commercial banks has been discussed and recommended by the Basel Committee guidelines. As of now, Indian commercial banks are required to be compliant with the Basel

III Recommendations. The major features of Basel III are as under:

No person can exercise voting rights of morethan 10% regardless of his holding which may be increased to 20% in phased manner.

(i) The three pillars upon which the edifice of capital structure stands are :

Minimum Regulatory Capital requirements based on risk weighted assets (RWAs) maintaining capital worked out through credit, market and operational risk areas Supervisory Review Process – regulating tools and frameworks for dealing with peripheral risks that bank face Market discipline specifying the disclosures that banks need to make to increase the transparency of banks

(ii) The banks are expected to have better capital quality and buffers (capital conservation and counter cyclical) and specifications for Minimum common Equity tier I and Tier II.

(iii) The banks are required to be compliant with Basel III norms on January 1, 2019 and a minimum total capital of 9% of total risk weighted assets is to be ensured.

It may be informed that during the last two quarters, the public sector banks in general have declared lower net profits or ran into losses in comparison to the previous years in compliance with the stipulations of the Reserve Bank of India. The rising non-performing assets of the Banks is a matter of concern for the banks as well as regulators.

5.3.6 Restriction on commission, brokerage, discount, etc. on sale of shares [Sections 13]

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.

5.3.7 Prohibition of charge on unpaid capital [Section 14]

According to Section 14, no banking company shall create any charge upon its unpaid capital, and any such charge if created, shall be invalid.

5.3.8 Limiting the payment of dividends [Section 15]

Section 15 prohibits every banking company from paying any dividend on its shares unless it has completely written off the capitalized expenses specified therein.

According to this section no banking company shall pay any dividend on its shares until all its capitalized expenses such as Preliminary Expenses, Brokerage and Commission on issue of shares, etc., have been completely written off.

However, as per the Banking Companies (Amendment) Act 1959, Banking Company may pay dividend on its shares without writing off the following:

(a) The depreciation in the value of investments in the approved securities provided such depreciation has not been actually capitalized or accounted for a loss.

(b) The depreciation in the value of its investments in shares, debentures, bonds, etc., (other than approved securities) where adequate provision has been made for such depreciation. The auditor of the banking company should approve such provision.

(c) The bad debts where the adequate provision has been made in this behalf and the auditor of the banking company should approve such provision.

(d) Banks pay dividends after taking specific approval of the Reserve Bank of India.

5.3.9 Transfer to Reserve Fund [Section 17]

Under Section 17, Banking companies incorporated in India are obligated to transfer to the reserve fund a sum equivalent to not less than 20% of the profit each year, unless the amount in such fund together with the amount in the share premium account is more than or equal to its paid-up capital.

However, vide its notification dated 20.09.2006, RBI has notified the following:

All scheduled commercial banks operating in India (including foreign banks) should transfer not less than 25 per cent of the 'net profit' (before appropriations) to the Reserve Fund.

5.3.10 Maintenance of cash reserve by non-scheduled banks [Section 18]

According to Section 18, every banking company not being a scheduled bank (i.e., a non-scheduled bank) has to maintain in India on daily basis by way of cash reserve with itself or in current account opened with the Reserve Bank or the State Bank of India or any notified Bank or partly in cash with itself and partly in such account or accounts a sum equivalent to at least 3% of its total time and demand liabilities.

The requirement for maintenance of Cash Reserve Ratio (CRR) by Scheduled Banks is specified in the Section 42 of the Reserve Bank of India Act, 1934.

5.3.11 Restrictions on holding of shares in other companies [Section 19]

Section 19 of the Act restricts the scope of formation of subsidiary companies by a banking company, as well as the holding of shares in other companies. That is, this section prevents banking companies from carrying on trading activities by acquiring a controlling interest in non-banking companies. This section restricts the scope of formation of subsidiary companies by a banking company, as well as the holding of shares in other companies.

A banking company may form a subsidiary company for the purposes referred to in the section, as well as for other purposes as are incidental to the business of banking, subject to the previous permission in writing of the RBI.

5.3.12 Restrictions on loans and advances [Sections 20 & 21]

Section 20 lays down the restrictions on banking companies on granting any loan to any of its director or to any firm in which a director is interested or to any individual or whom a director stands as a guarantor. Further the banking companies are prohibited from granting loans or advances on the security of its own shares. RBI is also empowered to control advances by any bank, on public interest.

Under Section 21, the RBI has been empowered to determine the policy to be followed by the banks in relation to advances. Thus, RBI gives directions to banking companies on the following matters:

(a) The purposes for which an advance may or may not be granted.

(b) The margins to be maintained in case of secured advances.

(c) The rate of interest charged on advances, other financial accommodation and commission on guarantees.

(d) The maximum amount of advance or other financial accommodation that a bank may make to or guarantee that it may issue for, a single party, having regard to the paid-up capital, reserves and deposits of the concerned bank.

5.3.13 Licensing of banking companies [Section 22]

(a) According to this section, no banking company can commence or carry on banking business in

India unless it holds a licence granted to it by the Reserve Bank for the purpose. This section states the following requirements for granting licence:

(1) Necessity of licensing and mode of applying for it.

(2) Conditions for granting of licenses.

(3) Cancellation of licenses and appeals from such orders.

(b) Before granting any license under this section, the Reserve Bank may require to be satisfied by an inspection of the books of the company that the following conditions are satisfied:

(1) that the company is in a position to pay its present or future depositors in full as their claims accrue.

(2) that the affairs of the company are not likely to be conducted in a manner detrimental to the interests of its present or future depositors.

(3) in the case of the carrying on of banking business by such company in India will be in the public interest and that the government or laws 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. However, RRBs have been established under a separate Act of Parliament, viz., RRBs Act 1976 and not under Banking Regulation Act.

(c) The Reserve Bank may cancel a license granted to a banking company under this section:

(1) If the company ceases to carry on banking business in India, or

(2) If the company at any time fails to comply with any of the conditions imposed upon it, or

(3) 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. The decision of the Central Government shall be final.

Thus, every banking company which likes to start banking business in India must obtain licence from RBI. While on this section, it would be relevant to take note of the guidelines announced by the Reserve Bank of India during 2016 for licensing of new Banks. The salient features of the guidelines are provided at annexure I to this chapter. It is stated that the licences from Reserve Bank of India would now be available on tap, meaning that there is no specific period when the applications could be made. During the year 2015, two licences were issued by the Reserve Bank of India viz. for Bandhan Bank Limited and IDFC Bank Limited. It is expected that some of the prominent Non Banking Finance Companies may apply for conversion as banks under this provision. During the last year, the Reserve Bank also announced a few licences for payment banks some of which have already started operation.

5.3.14 Control on the opening of new business [Section 23]

According to this section, the RBI has been empowered to control the opening of new and transfer of existing places of business of banking companies. As such, no banking company shall open a new place of business in India or outside India and change the place without obtaining the prior permission of the RBI.

No permission is required for opening a branch within the same city, town or village and for opening a temporary place of business for a maximum period of one month within a city, where the banking company already has a place of business for the purpose of providing banking facilities to the public on the occasion of an exhibition, a conference, a mela, etc.

5.3.15 Maintenance of a percentage of liquid assets (SLR) [Section 24]

Under this section, every banking company shall maintain in India in liquid assets for an amount not less than 25% of the total of its time and demand liabilities at the close of business on any day. The liquid assets include cash, gold or unencumbered approved securities and they are valued at a price not exceeding the current market price.

5.3.16 Maintenance of Assets in India [Section 25]

Section 25 requires for the maintenance of assets equivalent to at least 75% of its demand and time liabilities in India, at the close of business of the last Friday of every quarter.

5.3.17 Submission of Returns of unclaimed Deposits [Section 26]

According to this section, every banking company shall submit a return in the prescribed form and manner to the RBI, giving particulars, regarding un-operated accounts in India for 10 years. This return is to be submitted within 30 days after the close of each calendar year.

In the case of fixed deposits, the 10 years period is counted from the date of expiry of such fixed period. RRBs are however required to forward such returns to National Bank for Agriculture and Rural Development (NABARD).

5.3.18 Submission of Return, Forms, etc., to RBI [Section 27]

Under this section, every banking company shall submit to be RBI a return in the prescribed form and manner showing its assets and liabilities in India on the last Friday of every month, (if that Friday is a public holiday under the negotiable instruments Act, 1881, on the preceding working day.)

Besides, the RBI may at any time direct a banking company to furnish the statements and information relating to the business or affairs of the banking company within the specified period mentioned therein.

Such directions may be issued when the RBI considers it is necessary or expedient to obtain for the purpose of the Act. And the RBI may call for information every half year, regarding the investments of banking company and the classifications of advance given in respect of industry, commerce and agriculture.

5.3.19 Powers to Publish Information [Section 28]

Under this section, the RBI is authorized to publish in the public interest any information obtained under the Banking Regulation Act. The information is published in the consolidated form as the RBI may think fit.

5.3.20 Maintenance of Accounts and Balance Sheets [Section 29]

This section provides for the preparation of Balance Sheet and Profit & Loss Account as on the last working day of the year in respect of all business transacted by a banking company incorporated in India and in respect of all business transacted through its branches in India by a banking company incorporated outside India. It is prepared in the forms set out in the Third Schedule.

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.

5.3.21 Audit of the Balance Sheet and Profit & Loss Account [Section 30]

As per this section, the balance sheet and Profit & 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.

The auditor is required to state in his report in the case of a banking company incorporated in India,

(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 this audit.

(d) Whether the Profit & 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 shareholders of the company.

5.3.22 Submission of returns to RBI [Section 31]

This section provides for publication of the Profit & Loss Account, Balance Sheet and the Auditor's report in the prescribed manner as well as for the submission of three copies thereof as returns to the Reserve Bank within a period of three months which may be extended up to six months.

5.3.23 Inspection [Section 35]

This Section was incorporated with a view to safeguard the interest of shareholders and depositors of banking companies, as a result of which bank directors and managers are likely to be cautious in employing the funds of their institutions.

Under this section RBI is entrusted with wide powers to cause an inspection of any banking company and its books and accounts.

5.3.24 Giving directions to Banking Companies [Section 35A]

Under Section on 35A, the Reserve Bank may caution or prohibit banking companies generally or any banking company in particular against entering into certain types of operations, where the Reserve Bank is satisfied that (a) in the public interest or (b) in the interest of banking policy. or 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 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.

Power of Central Government to authorise RBI for issueing direction to bank for initiating resolution process (35AA)

Central Government may authorise RBI to issue direction to banking company to initiate insolvency process, in respect of default, under IBC Code, 2016.

Power of RBI to issue direction in respect of stressed assets (35AB)

RBI may issue direction to bank for for resolution of stressed assets and may from authorities/committees for the same.

5.3.25 Prior approval from RBI for appointment of Managing Director, etc. [Section 35B]

According to this section, prior approval of RBI should be obtained for the appointment, re-appointment, remuneration and removal of the chairman or a director of a banking company. And for the amendments of provisions in the Memorandum or Articles or Resolutions of a General Meeting or Board of Directors, the prior approval of RBI is necessary.

5.3.26 Removal of managerial and any other persons from office [Section 36AA and Section 36AB]

Under these sections, the RBI has power to remove managerial and other persons from office and to appoint additional directors.

Suspension of Board of Directors in certain cases.

RBI/Central Government may in consultatio of RBI on satisfacton what affairs of the banks conducted in a manner detrimental to the depositors and is against public interest. U/s 36(E), Central Government has the power to acquire the undertaking of the banking company, under above situation.

5.3.27 Suspension of Business [Section 37]

According to this section when a banking company is temporarily unable to meet its obligations it may apply to the High Court requesting an order for staying the commencement or continuance of all legal actions and proceedings against it for a period of not exceeding 6 months. Such stay is generally called a moratorium.

For such requisition, the banking company should submit an application along with a report of the RBI in this regard. In that report the RBI indicates that the banking company is able to pay its debts if the application is granted. If such report is not obtained from the RBI, the banking company cannot get the grant of moratorium.

5.3.28 Winding up of Banking Companies [Section 38 to 44]

Sections 38 to 44 of the Act lay down the provisions for winding up of a banking company. The RBI may apply for the winding up of a banking company if.

(a) It fails to comply with the requirements as to minimum Paid-up capital and reserves as laid down in Section 11, or

(b) Is disentitled to carry on the banking business for want of license under Section 22, or

(c) It has been prohibited from receiving fresh deposits by the Central Government or the Reserve Bank, or

(d) It has failed to comply with any requirement of the Act, and continues to do so even after the Reserve Bank calls upon it to do so, or

(e) The Reserve Bank thinks that a compromise or arrangement sanctioned by the court cannot be worked satisfactorily, or

(f) The Reserve Bank thinks that according to the returns furnished by the company it is unable to pay its debts or its continuance is prejudicial to the interests of the depositors.

The banking company cannot be voluntarily wound up unless the Reserve Bank certifies that it is able to pay its debts in full.

5.3.29 Amalgamation of Banking Companies [Section 44A]

The procedures for amalgamation of banking companies are given under this section. As per this section the scheme of amalgamation (i.e., the terms and conditions of amalgamation) is to be approved by 2/3 majority of the total voting ratios of the shareholders in a general meeting.

The unwilling shareholders are entitled to receive the value of their shares as may be determined by the RBI. The RBI has to sanction the scheme of amalgamation after the shareholders' approval.

The assets and liabilities are transferred to the acquiring bank according to the directions of RBI mentioned in the sanction order. The RBI issues order for the dissolution of the first bank on a specified date. During preparation of scheme of amalgamations RBI may suspend business with approval with Central Government.

STUDY NOTE : 5

LAW RELATING TO BANKING SECTOR

PART – B: THE SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002

This Study Note Includes:

B : 5.1 Introduction

B : 5.2 Important Definitions

B : 5.3 Regulation of Securitisation and Reconstruction of Financial Assets of Banks and Financial Institutions

B : 5.4 Enforcement of Security Interest

B : 5.1 INTRODUCTION

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was enacted with a view to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The Act, 2002 came into force on the 21st day of June, 2002. The Act enables the banks and financial institutions to realise long-term assets, manage problems of liquidity, asset liability mis-match and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction.

The Act further provides for setting up of asset reconstruction companies which are empowered to take possession of secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realise the secured assets and take over the management of the business of the borrower. The Securities and Reconstruction of Financial assets and enforcement of Security Interest Act, 2002 was amended in 2004 and 2012 respectively.

The preamble to the Act provides that it is an Act to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The legal framework for securitisation in India emerged with the above enactment. Its purpose is to promote the setting up of asset reconstruction/securitisation companies, which are supposed to take over the Non Performing Assets (NPA) accumulated with the banks and public financial institutions. Special powers under the Act have been given to lenders and securitisation/ asset reconstruction companies, to enable them to take over assets of borrowers without first resorting to courts.

The constitutional validity of the SARFAESI Act was challenged in Mardia Chemicals Ltd. Vs. the Union of India [2004] 59 CLA 380 (SC) in the Supreme Court of India and the Supreme Court upheld the constitutional validity of the Act but declared that portion of section 17 of the Act requiring deposit of 75% of the disputed amount before filing the appeal with the Debt Recovery Tribunal under section 17(2) as unconstitutional.

Student may note that with the introduction of Insolvency Code, the relevance of this Act has diminished. However, a financial creditor has option to recover dues or exercise any other right either through this Act or Insolvency Code.

B : 5.2 IMPORTANT DEFINITIONS

Asset Reconstruction [Section 2(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 realization of such financial assistance.

Asset Reconstruction Company [Section 2(ba)]

"Asset reconstruction company" means a company registered with Reserve Bank under section 3 for the purposes of carrying on the business of asset reconstruction or securitisation, or both.'

Borrower [Section 2(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, or who has raised funds through issue of debt securities.

Default [Section 2(j)]

"Default" means -

(a) non-payment of any debt or any other amount payable by the 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; or

(b) Non-payment of any debt or any other amount payable by the borrower with respect to debt securities after notice of ninety days demanding payment of dues served upon such borrower by the debenture trustee or any other authority in whose favour security interest is created for the benefit of holders of such debt securities.

Financial asset [Section 2(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

(va) any beneficial right, title or interest in any tangible asset given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire such tangible asset; or

(vb) any right, title or interest on any tangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of such intangible asset or an obligation incurred or credit otherwise extended to enable the borrower to acquire such intangible asset or obtain licence of the intangible asset;

(vi) any financial assistance.

Non-performing asset [Section 2(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.

Qualified institutional buyer [Section 2(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 pension fund or a foreign institutional investor registered under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or regulations made thereunder, or any other body corporate as may be specified by the Board.

Scheme [Section 2(y)]

"Scheme" means a scheme inviting subscription to security receipts proposed to be issued by a securitisation company or reconstruction company under that scheme.

Securitisation [Section 2(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.

Securitisation company [Section 2(za)]

"Securitisation company" means any company formed and registered under the Companies Act, 1956 (1 of 1956) for the purpose of securitisation.

B : 5.3 REGULATION OF SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS OF BANKS AND FINANCIAL INSTITUTIONS

Chapter II of the Act, comprising of Sections 3 to 12 provides for regulation of securitisation and reconstruction of financial assets of banks and financial institutions.

5.3.1 Registration of Securitisation Companies or Reconstruction Companies. (Section 3)

A company can commence or carry on the business of securitisation or asset reconstruction only after obtaining a certificate of registration granted under this section and having the owned fund of not less than two crore rupees or such other higher amount as the Reserve Bank, may be notification specify. The Reserve Bank may, by notification, specify different amounts of owned fund for different class or classes of securitisation companies or reconstruction companies. However, the term "owned fund" is not defined in the Act and hence we have to refer to the definition of "net owned fund" as mentioned in the explanation to Section 45I of the Reserve Bank of India Act, 1935. 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.

(a) The Reserve Bank may, for the purpose of considering to grant its approval for 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 securitization company or reconstruction company, or otherwise, that the following conditions are fulfilled, namely:

(1) that the securitisation company or reconstruction company has not incurred losses in any of the three preceding financial years.

(2) 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.

(3) that the directors of securitisation company or reconstruction company have adequate professional experience in matters related to finance, securitisation and reconstruction.

(4) * Omitted .

(5) that any of its directors has not been convicted of any offence involving moral turpitude.

(6) that a sponsor of an asset reconstruction company is a fit and proper person in accordance with the criteria as may be specified in the guidelines issued by the Reserve Bank for such person.

(7) that securitisation company or reconstruction company has complied with or is in a position to comply with prudential norms specified by the Reserve Bank.

(8) 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.

(b) A certificate of registration is thereafter granted to the securitisation company or the reconstruction company to commence or carry on business of securitisation or asset reconstruction, and it must be noted that the Reserve Bank may also prescribe any other conditions, which it may consider, fit to impose. In case the Reserve Bank is of the opinion that the above conditions are not satisfied then it may reject the application, after the applicant is given a reasonable opportunity of being heard.

Once a company is registered as a securitisation company or reconstruction company, it must obtain prior approval of the Reserve Bank for the following purposes:

(1) any substantial change in its management including appointment of any direction on the Board of Directors of the asset reconstruction company or managing director or Chief Executive Officer thereof.

(2) change of location of its registered office.

(3) change in its name.

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 and binding. The expression "substantial change in management" means the change in the management by way of transfer of shares or change affecting the sponsorship in the company by way of transfer of shares or amalgamation or transfer of the business of the company.

5.3.2 Cancellation of certificate of registration (Section 4)

Reserve Bank has the power under Section 4 of the Securitisation Act to cancel the Certificate of Registration issued by it to any ARC, If the Company.

(a) Ceases to receive or hold any investment from qualified institutional buyer.

(b) Ceases to carry on asset reconstruction business.

(c) It fails to comply with the conditions of registration.

(d) Fails to fulfill the conditions of Section 3(3).

(e) Fails to comply with the directions of RBI.

(f) Fails to maintain accounts.

(g) Fails to submit documents on inspection by RBI.

(h) Obtains approval from RBI for any substantial change in its management.

Before cancelling registration, Reserve Bank 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.

5.3.3 Acquisition of rights or interest in financial assets (Section 5)

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 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.

Any document executed by any bank or financial institution in favour of the asset reconstruction company acquiring financial assets for the purpose of asset reconstruction of securitisation shall be exempted from stamp duty in accordance with the provisions of Indian Stamp Act.

5.3.4 Measures for assets reconstruction (Section 9)

without prejudice to the provisions contained in any other law for the time being in force, an asset reconstruction company may for the purposes of asset reconstruction, 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 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 this Act.

(e) settlement of dues payable by the borrower;

(f) taking possession of secured assets in accordance with the provisions of this Act;

(g) conversion of any portion of debt into shares of a borrower company.

Provided that conversion of any part of debt into shares of a borrower company shall be deemed always to have been valid, as if the provisions of this clause were in force at all material times.

The Reserve bank for this purpose shall determine the policy and issue necessary directions including the directions for regulation of management of the business of the borrower and fees to be changed. The asset reconstruction company shall take measures as per the directions of RBI.

5.3.5 Other functions of securitisation company or reconstruction company (Section 10)

Any securitisation company or reconstruction company 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 fees 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.

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.

For the purposes of this section, 'securitisation company' or 'reconstruction company' does not include its subsidiary.

5.3.6 Resolution of disputes (Section 11)

Where any dispute relating to securitisation or reconstruction or non-payment of any amount due including 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.

B : 5.4 ENFORCEMENT OF SECURITY INTEREST

Provisions dealing with enforcement of security interest are contained in Chapter III of the Act, comprising of Sections 13 – 19. These provision are detailed below:

5.4.1 Enforcement of security interest (Section 13)

(a) 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 the court or tribunal, by such creditor in accordance with the provisions of this Act.

(b) 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.

(c) The notice 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. If, on receipt of the notice, 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 fifteen days of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower. It may be noted 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. If, 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.

(d) In case the borrower fails to discharge his liability in full within the period specified above, the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:

(1) 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.

(2) 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. It may be noted 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.

(3) 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.

(4) 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.

(e) Any payment made by any person to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

(1) Where the sale of an immovable property, for which a reserve price has been specified, has been postponed for want of a bid of an amount not less than such reserve price, it shall be lawful for any officer of the secured creditor, if so authorised by the secured creditor in this behalf, to bid for the immovable property on behalf of the secured creditor at any subsequent sale.

(2) Where the secured creditor, referred to in sub-section (5A), is declared to be the purchaser of the immovable property at any subsequent sale, the amount of the purchase price shall be adjusted towards the amount of the claim of the secured creditor for which the auction of enforcement of security interest is taken by the secured creditor, under sub-section (4) of section 13.

(3) The provisions of section 9 of the Banking Regulation Act, 1949 shall, as far as may be, apply to the immovable property acquired by secured creditor under sub-section (5A).

(f) Any transfer of secured asset after taking possession thereof or takeover of management, 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.

(g) Where any action has been taken against a borrower, 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.

(h) Where the amount of dues of the secured creditor together with all costs, charges and expenses incurred by him is tendered to the secured creditor at any time before the date of publication of notice for public auction or inviting quotations or tender from public or private treaty for transfer by way of lease, assignment or sale of the secured assets:

(i) the secured asset shall not be transferred by way of lease assignment or sale by secured creditor; and

(ii) in case, any step has been taken by the secured creditor for transfer by way of lease or assignment or sale of the asset before tendering of such amount, no futher step shall be taken by such secured creditor for transfer by way of lease or assignment or sale of such secured assets.

(i) 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 unless exercise of such right is agreed upon by the secured creditors representing not less than sixty per cent in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors:

However, 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 (now section 326 of the Companies Act, 2013).

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 (now section 325 of the Companies Act, 2013), 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 529A of that Act : The liquidator shall intimate the secured creditor the workmen's dues in accordance with the provisions of section 529A of the Companies Act, 1956 (now section 326 of the Companies Act, 2013) and in case such workmens' dues cannot be ascertained, the liquidator shall intimate the estimated amount of workmens'. 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.

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: and that the secured creditor shall furnish an undertaking to the liquidator to pay the balance of the workmen's dues, if any.

(1) 'record date' means the date agreed upon by the secured creditors representing not less than sixty per cent in value of the amount outstanding on such date.

(2) '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.

(j) 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.

(k) 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 point No.4.

(l) 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.

(m) No borrower shall, after receipt of notice from the secured creditor 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.

5.4.2 Manner and effect of takeover of management (Section 15)

Section 15 of the SARFAESI Act provides for the manner and effect of takeover of management. When the management of business of a borrower is taken over by a secured creditor it can appoint as many persons as it thinks fit to be the directors, where the borrower is a company, or the administrators of the business of the borrower, in any other case. The secured creditor is required to publish 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.

On the publication of the notice all persons who were directors of the company or administrators of the business, as the case may be, are deemed to have vacated their office. It also has the effect of termination of all contracts entered into by the borrower with such directors or administrators.

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 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.

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.

5.4.3 No compensation to directors for loss of office (Section 16)

Irrespective of anything 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. However any such managing director or any other director or manager or any such person in charge of management has the right to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

5.4.4 Application against measures to recover secured debts (Section 17)

Section 17 of the Act provides that any borrower or any other person aggrieved by the action of the secured creditors can file an appeal to the concerned Debt Recovery Tribunal (DRT).

Such appeal can also be filed by any person aggrieved by the action of the secured creditor without being required to deposit any amount with the DRT. Such provisions will take care of any third party interest in the secured assets which need to be considered before sale of securities. Any person aggrieved by the order of DRT, may prefer an appeal to the Appellate Tribunal within thirty days from the date of receipt of the order of Debt Recovery Tribunal.

5.4.5 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.

5.4.6 Appeal to Appellate Tribunal (Section 18)

Section 18 provides that any person aggrieved, by any order made by the Debts Recovery Tribunal under section 17, may prefer an appeal to an Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal. 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 (51 of 1993) and rules made thereunder.

It may be noted 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. Appellate Tribunal may, for the reasons to be recorded in writing, reduce the amount but not less than twenty five per cent of debt referred above.

5.4.7 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 the amendments made to sections 17 and 18 of this Act by sections 10 and 12 of the said Act were in force at all material times.

5.4.8 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.

5.4.9 Right to lodge a caveat (Section 18C)

Section 18C of the Act deals with Right to lodge a caveat. Section 18C (1) stated that where an application or an appeal is expected to be made or has been made under section 17 or section 17A or section 18 or section 18B, the secured creditor or any person claiming a right to appear before the Tribunal or the Court of District Judge or the Appellate Tribunal or the High Court, as the case may be, on the hearing of such application or appeal, may lodge a caveat in respect thereof.

5.4.10 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.

5.4.11 Setting up of Central Registry

Under Section 20 of the Act, the Central Government is empowered to setup by notification a registry to known as Central Registry with its own seal for the purpose of registration of transactions of securitisation and reconstruction of financial assets and creation of security interest under this Act. The head office and the branches of the central registry shall be at such places as the Central Government may specify. The territorial limits with in which the registry can exercise its functions shall be specified by the Central Government. The Central Government will appoint a person called the Central Registrar who will exercise the powers granted to the Central Registry. Also the Central Government shall appoint other officials who shall discharge their functions under the directions of the Central Registrar.

STUDY NOTE : 5

LAW RELATING TO BANKING SECTOR

PART – C: THE PREVENTION OF MONEY LAUNDERING ACT, 2002

This Study Note Includes:

C : 5.1 The Prevention of Money Laundering Act, 2002

C : 5.2 Role of Cost Accountants in Anti- Money Laundering (AML) Audits to check tax evasion and transfer of funds

C : 5.1 THE PREVENTION OF MONEY LAUNDERING ACT, 2002

5.1.1 Overview

The globalization process, driven by advancements in communications and information technology, have made the international system more interactive, integrated, interrelated, and interconnected. This dynamic has unleashed the floodgates of opportunities for criminals to expand, widen and deepen their reach, become more sophisticated in their operations, and intensify their level and pace of transactions.

Because of the opportunities and needs created by the global dimension of business, crimes such as fraud, counterfeiting, corruption and embezzlement have opportunities to shift from individual or family ambit to more organized and competitive global structures.

The problem of money-laundering is no longer restricted to the geo political boundaries of any country. It is a global menace that cannot be contained by any nation alone. In view of this, India has become a member of the Financial Action Task Force and Asia Pacific Group on money-laundering, which are committed to the effective implementation and enforcement of internationally accepted standards against money-laundering and the financing of terrorism.

The Prevention of Money Laundering Act (PMLA), 2002 was enacted in January, 2003. The Act along with the Rules framed thereunder have come into force with effect from 1st July, 2005. The Act extends to the whole of India including the state of Jammu & Kashmir. The Act was amended by the Prevention of Money Laundering (Amendment) Act 2009 w.e.f. 01.06.2009. The Act was further amended by the Prevention of Money - Laundering (Amendment) Act, 2012 w.e.f. 15-02-2013.

The Prevention of Money-laundering Act, 2002 addresses the international obligations under the Political Declaration and Global Programme of Action adopted by the General Assembly of the United Nations to prevent money laundering.

5.1.2 Objects of the Act

As per the Preamble to the Prevention of Money Laundering Act, 2002, the objects sought to be achieved under the Act are:

(a) To prevent and control money laundering.

(b) To confiscate and seize the property obtained from the laundered money. and

(c) To deal with any other issue connected with money laundering in India.

The Directorate of Enforcement in the Department of Revenue, Ministry of Finance is responsible for investigating the cases of offence of money laundering under Prevention of Money Laundering Act, 2002. Financial Intelligence Unit - India (FIU-IND) under the Department of Revenue, Ministry of Finance is the central national agency responsible for receiving, processing, analysing and disseminating information relating to suspect financial transactions to enforcement agencies and foreign FIUs.

5.1.3 Scheme of the Act

The Prevention of Money Laundering Act, 2002 consists of ten chapters containing 75 sections and one Schedule divided into five parts. Chapter I containing section 1 and 2 deals with short title, extent and commencement and definitions. Chapter II containing sections 3 and 4 provides for offences and punishment for money laundering. Chapter III (Section 5-11) provides for attachment, adjudication and confiscation and Chapter IV (Sections 12-15) deals with obligations of banking companies, financial institutions and intermediaries. Chapter V (Sections 16-24) relates to Summons, Searches and Seizures etc.

The Act provides for establishment of Appellate Tribunal and thus sections 25-42 under Chapter VI provides for composition, procedure, power, jurisdiction etc. of the Appellate Tribunal. Chapter VII (Sections 43-47) deals with Special Courts, and Chapter VIII (Sections 48-54) provides for various authorities under the Act, their appointment, powers, jurisdiction etc. Chapter IX (Sections 55-61) deals with reciprocal arrangement for assistance in certain matters and procedure for attachment and confiscation of property. Chapter X containing Sections 62-75 deals with miscellaneous provisions including punishment for, vexatious search, false information etc., cognizance of offences, and offences by companies, among others.

5.1.4 What is Money Laundering?

The goal of a large number of criminal activities is to generate profit for an individual or a group. Money laundering is the processing of these criminal proceeds to disguise their illegal origin. Illegal arms sales, smuggling, and other organized crime, including drug trafficking and prostitution rings, can generate huge amounts of money. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and create the incentive to "legitimize" the ill-gotten gains through money laundering. The money so generated is tainted and is in the nature of 'dirty money'. Money Laundering is the process of conversion of such proceeds of crime, the 'dirty money', to make it appear as 'legitimate' money.

In the PMLA, 2002, money laundering has been defined as "any process or activity connected with proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property".

5.1.5 How does Money Laundering actually take place?

The process of Money Laundering generally involves the following three stages:

(a) Placement: The Money Launderer, who is holding the money generated from criminal activities, introduces the illegal funds into the financial systems. This might be done by breaking up large amount of cash into less conspicuous smaller sums which are deposited directly into a Bank Account or by purchasing a series of instruments such as Cheques, Bank Drafts etc., which are then collected and deposited into one or more accounts at another location.

(b) Layering: The second stage of Money Laundering is layering. In this stage, the Money Launderer typically engages in a series of continuous conversions or movements of funds, within the financial or banking system by way of numerous accounts, so as to hide their true origin and to distance them

from their criminal source. The Money Launderer may use various channels for movement of funds, like a series of Bank Accounts, sometimes spread across the globe, especially in those jurisdictions which do not co– operate in anti Money Laundering investigations.

(c) Integration: Having successfully processed his criminal profits through the first two stages of Money Laundering, the Launderer then moves to this third stage in which the funds reach the legitimate economy, after getting inseparably mixed with the legitimate money earned through legal sources of income. The Money Launderer might then choose to invest the funds into real estate, business ventures & luxury assets, etc. so that he can enjoy the laundered money, without any fear of law enforcement agencies.

The above three steps may not always follow each other. At times, illegal money may be mixed with legitimate money, even prior to placement in the financial system. In certain cash rich businesses, like Casinos (Gambling) and Real Estate, the proceeds of crime may be invested without entering the mainstream financial system at all.

5.1.6 What is the offence of Money Laundering?

Sec. 3 of PMLA defines offence of money laundering as whosoever directly or indirectly attempts to indulge or knowingly assists 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. It prescribes obligation of banking companies, financial institutions and intermediaries for verification and maintenance of records of the identity of all its clients and also of all transactions and for furnishing information of such transactions in prescribed form to the Financial Intelligence Unit-India (FIU-IND). It empowers the Director of FIU-IND to impose fine on banking company, financial institution or intermediary if they or any of its officers fails to comply with the provisions of the Act as indicated above.

5.1.7 What is a 'scheduled offence'?

The offences listed in the Schedule to the Prevention of Money Laundering Act, 2002 are scheduled offences in terms of Section 2(1)(y) of the Act. The scheduled offences are divided into two parts - Part A & Part C.

In part A, offences to the Schedule have been listed in 28 paragraphs and it comprises of offences under Indian Penal Code, offences under Narcotic Drugs and Psychotropic Substances, offences under Explosive Substances Act, 1908, offences under Unlawful Activities (Prevention) Act, 1967, offences under Arms Act, 1959, offences under Wild Life (Protection) Act, 1972, offences under the Immoral Traffic (Prevention) Act,1956, offences under the Prevention of Corruption Act, 1988, offences under the Explosives Act, 1884 and offences under Antiquities & Arts Treasures Act, 1972 etc.

Part 'C' deals with trans-border crimes, and is a vital step in tackling Money Laundering across International Boundaries.

Prior to 15th February, 2013, i.e., the date of notification of the amendments carried out in PMLA, the Schedule also had Part B for scheduled offences where the monetary threshold of rupees thirty lakhs was relevant for initiating investigations for the offence of money laundering. However, all these scheduled offences, hitherto in Part B of the Schedule, have now been included in Part A of Schedule w.e.f 15.02.2013. Consequently, there is no monetary threshold to initiate investigations under PMLA.

5.1.8 What is a Predicate Offence?

Every Scheduled Offence is a Predicate Offence. The Scheduled Offence is called Predicate Offence and the occurrence of the same is a pre requisite for initiating investigation into the offence of money

laundering.

5.1.9 Punishment for the Offence of Money Laundering

Chapter II comprises of Sections 3 and 4. Section 3 deals with the offence of money laundering which has been discussed in the definition part above. Section 4 provides for the punishment for Money-Laundering. Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine. But where the proceeds of crime involved in money-laundering relate to any offence specified under paragraph 2 of Part A of the Schedule, the maximum punishment may extend to ten years instead of seven years.

5.1.10 What are the major Acts covered in the Schedule?

(a) Indian Penal Code, 1860.

(b) NDPS Act, 1985.

(c) Unlawful Activities (Prevention) Act, 1967.

(d) Prevention of Corruption Act, 1988.

(e) Customs Act, 1962.

(f) SEBI Act, 1992.

(g) Copyright Act, 1957.

(h) Trade Marks Act, 1999.

(i) Information Technology Act, 2000.

(j) Explosive Substances Act, 1908.

(k) Wild Life (Protection) Act, 1972.

(l) Passport Act, 1967.

(m) Environment Protection Act, 1986.

(n) Arms Act, 1959.

PMLA empowers certain officers of the Directorate of Enforcement to carry out investigations in cases involving offence of money laundering and also to attach the property involved in money laundering. PMLA envisages setting up of an Adjudicating Authority to exercise jurisdiction, power and authority conferred by it essentially to confirm attachment or order confiscation of attached properties. It also envisages setting up of an Appellate Tribunal to hear appeals against the order of the Adjudicating Authority and the authorities like Director FIU-IND.

PMLA envisages designation of one or more courts of sessions as Special Court or Special Courts to try the offences punishable under PMLA and offences with which the accused may, under the Code of Criminal Procedure 1973, be charged at the same trial.

The Act provides for reciprocal arrangements for processes/assistance with regard to accused persons. In order to enlarge the scope of this Act and to achieve the desired objectives, the Act provides for bilateral agreements between countries to cooperate with each other and curb the menace of money laundering. These agreements shall be for the purpose of either enforcing the provisions of this Act or for the exchange of information which shall help in the prevention in the commission of an offence under this Act or the corresponding laws in that foreign State.

PMLA allows Central Government to enter into an agreement with Government of any country outside India for enforcing the provisions of the PMLA, exchange of information for the prevention of any offence under PMLA or under the corresponding law in force in that country or investigation of cases relating to any offence under PMLA.

Special Courts have been set-up in a number of States / UTs by the Central Government to conduct the trial of the offences of money laundering. The authorities under the Act like the Director, Adjudicating Authority and the Appellate Tribunal have been constituted to carry out the proceedings related to attachment and confiscation of any property derived from money laundering.

In certain cases the Central Government may seek/ provide assistance from/to a contracting State for any investigation or forwarding of evidence collected during the course of such investigation.

The Government has constituted the Financial Intelligence Unit, India, in November, 2004, headed by Director in the rank of a Joint Secretary to the Government of India. The organization has become functional and has started receiving Cash Transaction Reports and Suspicious Transactions Reports from the banking companies etc. in terms of Section 12 of the PMLA. The organization is also in the process of seeking membership of Egmont Group of FIUs which is an umbrella group of FIUs of various countries.

Powers of investigation and prosecution for offences under the Act have been conferred on the Director, Enforcement Directorate.

In addition, the Adjudicating Authority in terms of section 6 of the Act and the Appellate Tribunal under section 25 of the Act have also been constituted and have become functional.

5.1.11 ED (Enforcement Directorate)

The Directorate of Enforcement was established in the year 1956 with its Headquarters at New Delhi. It is responsible for enforcement of the Foreign Exchange Management Act, 1999 (FEMA) and certain provisions under the Prevention of Money Laundering Act. Work relating to investigation and prosecution of cases under the PML has been entrusted to Enforcement Directorate. The Directorate is under the administrative control of Department of Revenue for operational purposes. the policy aspects of the FEMA, its legislation and its amendments are within the purview of the Department of Economic Affairs. Policy issues pertaining to PML Act, however, are the responsibility of the Department of Revenue. Before FEMA became effective (1 June 2000), the Directorate enforced regulations under the Foreign Exchange Regulation Act, 1973.

Functions:

(a) To collect, develop and disseminate intelligence relating to violations of FEMA, 1999, the intelligence inputs are received from various sources such as Central and State Intelligence agencies, complaints etc.

(b) To investigate suspected violations of the provisions of the FEMA, 1999 relating to activities such as "hawala" foreign exchange racketeering, non-realization of export proceeds, non-repatriation of foreign exchange and other forms of violations under FEMA, 1999.

(c) To adjudicate cases of violations of the erstwhile FERA, 1973 and FEMA, 1999.

(d) To realize penalties imposed on conclusion of adjudication proceedings.

(e) To handle appeals and prosecution cases under the erstwhile FERA, 1973.

(f) To process and recommend cases for preventive detention under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act (COFEPOSA).

(g) To undertake survey, search, seizure, arrest, prosecution action etc. against offender of PMLA offence.

(h) To provide and seek mutual legal assistance to/from contracting states in respect of attachment/ confiscation of proceeds of crime as well as in respect of transfer of accused persons under PMLA.

5.1.12 Financial Intelligence Unit - India (FIU-IND)

'Financial Intelligence Unit – India was set by the Government of India during November 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes. FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.

5.1.13 Obligations of banking companies, financial Institutions and intermediaries [Section 12].

(a) Every reporting entity have to maintain a record of all transactions covered as per the nature and value of which may be prescribed, in such manner as to enable it to reconstruct individual transactions.

(b) They shall furnish to the Director (FIU) within such time as may be prescribed information relating to such transactions, whether attempted or executed, the nature and value of which may be prescribed.

(c) They shall verify the identity of its clients in such manner and subject to such conditions as may be prescribed.

(d) They shall identify the beneficial owner, if any, of such of its clients, as may be prescribed.

(e) They shall maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients for a period of five years in case of record and information relating to transactions, and

(f) They shall maintain the same for a period of five years after the business relationship between a client and the reporting entity has ended or the account has been closed, whichever is later.

Here 'Reporting Entity' means a banking company, financial institution, intermediary or a person carrying on a designated business or profession [Section 2(1)(wa)].

5.1.14 Adjudicating Authority

In terms of sub-section (1) of section 6 of Preventions of Money Laundering Act, 2002, an Adjudicating Authority under PMLA has been constituted to exercise jurisdiction, powers and authority conferred by or under the said Act.

5.1.15 Composition of Adjudicating Authority

The Authority comprises three Members, one each from the fields of 'Law', 'Administration' and 'Finance or accountancy'. Further, one of the Members is appointed as Chairperson of the Adjudicating Authority. It functions within the Department of Revenue, Ministry of Finance of the Central Government with its headquarter at New Delhi.

5.1.16 Functions of Adjudicating Authority

Adjudicating Authority exercise jurisdiction, powers and authority conferred by or under the PMLA. Where the Adjudicating Authority decides that any property is involved in money-laundering, Adjudicating

Authority shall, by an order in writing confirm the attachment of the property made or retention of property or record seized (under sec. 5 of PMLA).

5.1.17 Applellate Tribunal

Under Section 25 of the Prevention of Money-laundering Act, 2002, the Central Government has established an Appellate Tribunal. Section 28(4) of the PMLA provides that the Chairperson or a Member holding a post as such in any other Tribunal, established under any law for the time being in force, in addition to his being the Chairperson or a member of that Tribunal, may be appointed as the Chairperson or a Member, as the case may be, of the Appellate Tribunal under this Act.

5.1.18 Composition of Appellate Tribunal

The Tribunal consists of a Chairperson and two other Members. The Chairman and one Member of Appellate Tribunal for Forfeited Property (ATFP) holds additional charge of the post of Chairman and Member of Tribunal under PMLA.

5.1.19 Functions of Appellate Tribunal

Appellate Tribunal has been constituted to hear appeals against the orders of the Adjudicating Authority and the authorities under the said Act.

5.1.20 Special Courts

For trial of offence punishable under section 4 of PMLA, 2002, the Central Government, in consultation with the Chief Justice of the respective High Courts, by notification, has designated one or more Courts of Session as Special Court or Special Courts for such area or areas or for such case or class or group of cases as specified in the notifications. While trying an offence of money laundering under PMLA,2002, a Special Court has also to try the offences, with which the accused may, under the Code of Criminal Procedure, 1973 (2 of 1974), be charged at the same trial [Section 43].

5.1.21 Offences triable by special Courts under PMLA, 2002

Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), an offence of money laundering punishable under Section 4 of PMLA, 2002 and any scheduled offence connected to the offence of money laundering, shall be triable by the Special Court constituted for the area in which the offence has been committed.

5.1.22 STR (Suspicious Transaction Reports)

The Prevention of Money laundering Act, 2002 and the Rules made there under require every banking company to furnish details of suspicious transactions whether or not made in cash. Suspicious transaction means a transaction whether or not made in cash which, to a person acting in good faith:

(a) Gives rise to a reasonable ground of suspicion that it may involve the proceeds or crime, or

(b) Appears to be made in circumstances of unusual or unjustified complexity. or

(c) Appears to have no economic rationale or bonafide purpose.

5.1.23 Tackling Black Money and Money Laundering

Detection of black Money

Recognizing various limitations under the existing legislation [Income-tax Act, 1961, etc.], the Government

enacted a new law; 'The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015' to specifically and effectively tackle the issue of black money stashed away abroad. This has, inter alia, provided for more stringent provisions of penalties and prosecutions in respect of black money stashed away abroad. Further, under this law, for the first time the offence of willful attempt to evade tax, etc. in relation to undisclosed foreign income/assets has been made a Scheduled Offence for the purposes of the Prevention of Money-laundering Act, 2002 (PMLA). This enables attachment and confiscation of the proceeds of crime of willful attempt to evade such tax, etc., eventually leading to recovery of such undisclosed foreign income and assets/black money stashed away abroad. The new law came into force w.e.f. 01.07.2015. Thus, the first assessment year (A.Y.) in respect of the new law is A.Y. 2016-17 which began only on 01.04.2016.

There is no official estimation regarding black money of Indians stacked abroad. However, before the cases involving black money stashed away abroad were subjected to more stringent provisions of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, a one-time three months' compliance window closing on 30th September 2015 was provided under the new law wherein 648 declarations involving undisclosed foreign assets worth `4164 crore were made. The amount collected by way of tax and penalty in such cases is about `2476 crore.

Sharing of information of black money by foreign countries

Under the provisions of direct taxes laws, the Government has entered into tax treaties with a number of countries/ jurisdictions which obliges them to provide information for tax purposes. These tax treaties are:

(a) Double Taxation Avoidance Agreements (DTAAs).

(b) Tax Information Exchange Agreements (TIEAs).

(c) Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention).

(d) SAARC Multilateral Agreement. India has tax treaties with 139 countries/jurisdictions as on 30.06.2016.

Besides the above, the Common Reporting Standards (CRS), developed in response to the G20 request and approved by the Organisation for Economic Co-operation and Development (OECD) Council, calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. A key element of successful implementation of CRS is putting in place an international framework that allows automatic exchange of CRS information between jurisdictions. This framework is known as CRS Multilateral Competent Authority Agreement (MCAA). While over 100 jurisdictions have committed to exchanging information under the CRS, 83 jurisdictions have signed the MCAA till June 2016.

Appropriate action against tax evasion including in respect of unaccounted income stashed in foreign countries, is an on-going process. Such action under direct tax laws includes searches, surveys, enquiries, assessment of income, levy of taxes, penalties, etc. and filing of prosecution complaints in criminal courts, wherever applicable.

The Government has taken several steps to effectively tackle the issue of black money, particularly black money stashed away abroad. Such measures include policy-level initiatives, more effective enforcement action on the ground, putting in place robust legislative and administrative frameworks, systems and processes with due focus on capacity building and integration of information and its mining through increasing use of information technology. Recent major initiatives in this regard include:

(1) Constitution of the Special Investigation Team (SIT) on Black Money under Chairmanship and Vice-Chairmanship of two former Judges of Hon'ble Supreme Court,

(2) Enactment of a comprehensive law; 'The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015' which has come into force w.e.f. 01.07.2015 to specifically and more effectively deal with the issue of black money stashed away abroad,

(3) Constitution of Multi-Agency Group (MAG) consisting of officers of Central Board of Direct Taxes (CBDT), Reserve Bank of India (RBI), Enforcement Directorate (ED) and Financial Intelligence Unit (FIU) for investigation of recent revelations in Panama paper leaks,

(4) Proactively engaging with foreign governments with a view to facilitate and enhance the exchange of information under Double Taxation Avoidance Agreements (DTAAs)/Tax Information Exchange Agreements (TIEAs)/Multilateral Conventions,

(5) According high priority to the cases involving black money stashed away abroad for investigation and other follow-up actions including prosecutions in appropriate cases,

(6) While focusing upon non-intrusive measures, due emphasis on enforcement measures in high impact cases with a view to prosecute the offenders at the earliest for credible deterrence against tax evasion/black money,

(7) Proactively furthering global efforts to combat tax evasion/black money, inter alia, by joining the Multilateral Competent Authority Agreement in respect of Automatic Exchange of Information (AEOI) and having information sharing arrangement with USA under its Foreign Account Tax Compliance Act (FATCA),

(8) Renegotiation of DTAAs with other countries to bring the Article on Exchange of Information to International Standards and expanding India's treaty network by signing new DTAAs and TIEAs with many jurisdictions to facilitate the exchange of information and to bring transparency,

(9) Enabling attachment and confiscation of property equivalent in value held within the country where the property/proceeds of crime is taken or held outside the country by amending the Prevention of Money-laundering Act, 2002 through the Finance Act, 2015,

(10) Introduction of the Benami Transactions (Prohibition) Amendment Bill, 2015 to amend the Benami Transactions (Prohibition) Act, 1988 with a view to, inter alia, enable confiscation of Benami property and provide for prosecution,

(11) Initiation of the information technology based 'Project Insight' by the Income Tax Department for strengthening the non-intrusive information driven approach for improving tax compliance and effective utilization of available information.

These measures have equipped the Government better in curbing the menace of black money stashed away abroad. Further, sustained and prompt action taken by the Income Tax Department in various cases involving black money has resulted into assessment of substantial amounts of undisclosed income, levy of concealment penalty and filing of criminal prosecution complaints for various offences in appropriate cases.

C : 5.2 ROLE OF COST ACCOUNTANTS IN ANTI- MONEY LAUNDERING (AML) AUDITS TO CHECK TAX EVASION AND TRANSFER OF FUNDS

5.2.1 Background

Twin issues of corruption and black money have attracted unprecedented public attention in the past few months in India. Political debates in Parliament and outside, media news and campaigns, public demonstrations, dharnas and fasts, Hon'ble Supreme Court's attention and

observations and the general public discourse, has been focused on these issues for more than past two years now. A host of cases relating to corruption have surfaced, such as 2G spectrum allocation, CWG, Medical Council of India, illegal mining in Jharkhand, Karnataka, Odisha, etc. While in many of these cases, action was taken suo motu by the law enforcement agencies, in some cases action came after Hon'ble Supreme Court intervened in Public Interest Litigations (PILs) filed before it. A number of cases relating to money kept abroad also surfaced, such as Hassan Ali Khan and associates, accounts in LGT Bank of Liechtenstein (information received from German tax authorities), and recently accounts in HSBC Bank (information received from the Government of France) which are still under investigation.

Keeping these developments in view, government has taken various steps. The government announced its five-pronged strategy formulated to deal with the problem of black money kept abroad. A study was commissioned by the government, after a gap of 25 years, to estimate the quantum of black money inside and outside the country. The study is being conducted by three top national-level institutions viz. National Institute of Public Finance and Policy (NIPFP), National Institute of Financial Management (NIFM) and National Council of Applied Economic Research (NCAER). Law enforcement agencies have investigated several high-profile corruption cases, putting an unprecedented number of persons charged of offences behind bars.

Here, the Cost Accountants play an important role while conducting the Cost Audits and Anti-Money Laundering (AML) Audits to check tax evasion and transfer of funds. He should be well versed with the process of money laundering and the 'modus operandi' involved in transfer of funds, so that he may be in a position to report while conducting anti- money laundering (AML) audits for tackling the black money and to check tax evasion and transfer of funds.

5.2.2 Causes and Methods Adopted for Generation of Black Money

(a) Suppression of receipts, inflation of expenditure, etc.

(b) Land and real estate transactions

(c) Corruption

(d) Financial market transactions

(e) Bullion & jewellery transactions

(f) Cash economy and use of counterfeit currency

(g) NPO Sector

(h) Participatory Notes

(i) Trade Based Money Laundering

5.2.3 Trade Based Money Laundering

(a) Financial Action Task Force (FATF) defines Trade Based Money Laundering (TBML) as the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origins. In simpler terms, TBML is the process of transferring / moving money through trade transactions. In practice, this can be achieved through the misrepresentation of the price, quantity or quality of imports or exports.

The international trade system is subject to a wide range of risks and vulnerabilities, which provide unscrupulous entities the opportunity to launder money. The relative attractiveness of the international trade system is associated with:

(1) The enormous volume of trade flows, which obscures individual transactions and provides abundant opportunity to transfer value across borders.

(2) The complexity associated with (often multiple) foreign exchange transactions and recourse to diverse financing arrangements.

(3) The additional complexity that can arise from the practice of mingling illicit funds with the cash flows of legitimate businesses.

(4) The limited recourse to verification procedures or programmers in order to exchange customs data between countries, and

(5) The limited resources that most customs agencies have to detect illegal trade transactions.

Differing tax rates create incentives for corporations to shift taxable income from jurisdictions with relatively high tax rates to jurisdictions with relatively low tax rates in order to minimize income tax payments. For example, a foreign parent company could use internal "transfer prices" to overstate the value of the goods and services that it exports to its foreign affiliate in order to shift taxable income from the operations of the affiliate in a high-tax jurisdiction to its operations in a low-tax jurisdiction. Similarly, the foreign affiliate might understate the value of the goods and services that it exports to the parent company in order to shift taxable income from its high-tax jurisdiction to the low-tax jurisdiction of its parent. Both of these strategies would shift the company's profits to the low-tax jurisdiction and, in doing so, reduce its worldwide tax payments. It could also be attributed to anonymity to avoid overpricing due to identification of interest of large corporate in new business area.

Companies and individuals also shift money from one country to another to diversify risk and protect their wealth against the impact of financial or political crises. A common technique used to circumvent currency restrictions is to 'over-invoice' imports or 'under-invoice' exports. The primary method used is the falsification of import and export invoices. By comparing discrepancies between the value of exports reported by a country and the value of imports reported by its key trading partners, the quantum of money transferred from that country through the use of the international trade system can be estimated.

In the case of transfer pricing, the reference to over- and under-invoicing relates to the legitimate allocation of income between related parties, rather than customs fraud. In many cases, this can also involve abuse of the financial system through fraudulent transactions involving a range of money transmission instruments, such as wire transfers. In practice, strategies to 'launder' money usually combine several different techniques. Often these involve abuse of both the financial and international trade systems.

(b) The basic techniques of trade-based money laundering include:

(1) '**Over-Invoicing' and 'Under-Invoicing' of Goods and Services:** Money laundering through the over-invoicing and under-invoicing of goods and services, which is one of the oldest methods of fraudulently transferring value across borders, remains a common practice today. The key element of this technique is the misrepresentation of the price of the good or service in order to transfer additional value between the importer and exporter. Over-invoicing of exports is one of the most common trade-based money laundering techniques used to move money. This reflects the fact that the primary focus of most customs agencies is to stop the importation of contraband and ensure that appropriate import duties are collected.

(2) Multiple-Invoicing of Goods and Services: Another technique used to 'launder' funds involves issuing more than one invoice for the same trade transaction. By invoicing the same good or service more than once, a money launderer or terrorist financier is able to justify multiple payments for the same shipment of goods or delivery of services. Unlike over-invoicing and under-invoicing, it should be noted that there is no need for the exporter or importer to misrepresent the price of the good or service on the commercial invoice.

(3) Over-Shipment and Under-Shipment of Goods and Services: In addition to manipulating export and import prices, a money launderer can overstate or understate the quantity of goods being shipped or services being provided. In the extreme, an exporter may not ship any goods at all, but simply collude with an importer to ensure that all shipping and customs documents associated with this so called "phantom shipment" are routinely processed. Banks and other financial institutions may unknowingly be involved in the provision of trade financing for these phantom shipments.

(4) Falsely Described Goods and Services: In addition to manipulating export and import prices, a money launderer can misrepresent the quality or type of a good or service. For example, an exporter may ship a relatively inexpensive good and falsely invoice it as a more expensive item or an entirely different item. This creates a discrepancy between what appears on the shipping and customs documents and what is actually shipped. The use of false descriptions can also be used in the trade in services, such as financial advice, consulting services and market research.

5.2.4 Measures to Tackle Black Money

There are two dimensions of the issue of black money – first, its generation and, second, its consumption and use, including laundering of black money back to mainstream economy. Dealing with this menace has to cover both these aspects. So far as generation of black money from crime or corruption is concerned, its remedy does not lie merely in legislative or enforcement domains but also in finding much deeper socio-economic solutions. We have touched upon some of these aspects. However, generation of black money from legitimate activities has been dealt with extensively, and we make several recommendations in this regard.

Further, consumption and laundering of black money, if effectively tracked and controlled, may have the 'squeeze effect' on the overall activities resulting in creation and sustenance of black economy. While there may not be any need to have new law to especially deal with black money and black economy, various existing laws need to be comprehensively reviewed by the

concerned administrative ministries on a regular basis keeping in view the changing economic scenario, and provisions dealing with violations need to be strengthened accordingly.

5.2.5 Strategy to tackle black money

The Committee has identified following strategy to tackle black money:

(a) Preventing generation of black money.

(b) Discouraging use of black money.

(c) Effective detection of black money.

(d) Effective investigation & adjudication.

(e) Other steps.

5.2.6 Preventing generation of black money

India must ensure transparent, time-bound & better regulated approvals / permits, single window delivery of services to the extent possible and speedier judicial processes. The Electronic Delivery of Services Bill, 2011 that seeks to provide for electronic delivery of public services by the government to all persons to ensure transparency, efficiency, accountability, accessibility and reliability in delivery of such services has been tabled before the Parliament in December, 2011.

The fight against the monstrosity of black money has to be at ethical, socio-economic and administrative levels. At the ethical level, we have to reinforce value / moral education in the school curriculum and build good character citizens, particularly highlighting the ills of tax evasion and black money. At the socio-economic level, the thrust of public policy should be to discourage conspicuous & wasteful consumption / expenditure, encourage savings, frugality and simplicity, and reduce the gap between the rich and the poor.

The Government is also considering legislating public procurement law. The Public Procurement Bill, 2012 intends to regulate public procurement by all ministries and central government departments. It aims at ensuring transparency, fair and equitable treatment of bidders, promote competition, and enhance efficiency and economy in the public procurement process.

In order to ensure transparent and efficient allocation of natural and man-made resources, oversight in the form of comprehensive regulations and ombudsman for grievance redressal, particularly for scarce resources as in land, minerals, forests, telecom, etc. – need to be introduced and implemented expeditiously.

Social sector schemes involving huge public expenditure under various programmes reportedly suffer from possible manipulations and leakages. Direct transfers to the accounts of beneficiaries can provide a solution, as it would prevent manipulations like bogus muster rolls, etc. While efforts such as UID and direct transfer of subsidies will stop leakages in some sectors, in other sectors the problem will have to be addressed differently. We, accordingly, recommend that social audit be made mandatory for all social sector schemes that do not involve direct transfer of credit to the bank account of the beneficiary, at the district / field level, and a second and subsequent AG audit at the HQ level. We also recommend that a system of random inspections

by teams of sponsoring Ministry / Department / Agency may monitor utilization of public funds for social sector schemes.

There should be a dedicated training center for all law enforcement agencies dealing with financial crimes and offences, as this requires special skills.

Oversight in the private sector is almost absent, except for some professionally managed companies. It mainly consists of self-regulation, and audit under the Company and Income Tax laws. That the system of professional audit may be quite ineffective even in professionally managed enterprises is aptly demonstrated by the Satyam case. We are of the view that the burden of dual audit should be reduced to single audit (for both company and tax law) and the audit system be detached from the management and control of the business. We, therefore, recommend that the central government establish a regulator (under Company law / Income Tax law) to empanel auditors in different grades and randomly assign them to the private sector firms, based on category and payment capacity, with mandatory rotation and maximum tenure of two years.

The proposed national level GST regime should be expeditiously implemented, as the spin-off from its implementation would provide adequate resources to more than compensate the loss apprehended by certain state governments.

At present, no government agency has complete database of nonprofit organizations (NPOs). CBDT has the largest database about this sector. There may be information with other agencies such as Ministry of Home Affairs (MHA), Central Economic Intelligence Bureau (CEIB), etc. It is desirable that CBDT be assigned the role of a centralized agency with which every NPO would require to be registered and would be allotted a unique number. This would be in line with the decision taken by the Government in the light of possible misuse of the sector in undesirable activities. There are suggestions made by the NPO Sector Assessment Committee, an Inter-ministerial body, which should be accepted and the office of DGIT (Exemption) appropriately strengthened in terms of manpower, infrastructure and capacity building.

Accountability of both public and private offices needs to be enhanced. As we are mainly concerned here with public sector accountability, we recommend that apart from good practices being followed such as Fiscal Responsibility and Budget Management (FRBM) Act and outcome budget, performance-linked appraisal system of rewards and punishments, already under consideration, should be expeditiously implemented.

To reduce the element of black money in transactions relating to immovable properties, provision for NOC should be introduced in the Income Tax law with safeguards to reduce administrative complications and increased ease of compliance, so that an appropriate and uniform data-base is also set up, and a proper national-level regulation is put in place. The new system should be computer driven with minimal interface between the tax authorities and the tax-payer, and enforced by a dedicated unit within the investigative machinery of the Income Tax Department on the basis of pre-determined parameters and standard operating procedures. The electronically generated NOC, within a specified period, would also act as a tax clearance certificate.

The Accounting Standard No.7 should be modified by the ICAI to be made applicable to real estate developers also. AS-7 and AS-9 should be notified under the Income Tax Act, 1961.

There is no uniformity in the matter of levy of agricultural income tax among states. Agriculture generates around 14 per cent of the country's GDP. Giving credit to agricultural income for income tax purposes without verification of claim allows an avenue for bringing black money into the financial system as agricultural income. State governments may consider levy of agricultural income tax with facility for computerized processing and selective verification. This will on the one hand enhance revenues of state governments, and on the other hand prevent laundering of black money in the garb of agricultural income.

5.2.7 Effective detection of black money

The regulation and enforcement of KYC norms in the co-operative sector may be strengthened by the State Governments as well as the Central Government. Responsibility may be fixed for any lapse in this regard, as well as for any subsequent failure to alert authorities as regards any suspicious transactions in such accounts.

The RBI could consider stricter implementation of KYC norms and limit number of accounts that can be introduced by a single person, the number of accounts that can be maintained in the same branch by any entity and alerts about same address being used for opening accounts in different names. Stricter adherence to, and enforcement of, KYC norms is needed for ensuring proper compliance by banks and financial institutions. The Government, as well as the RBI, also need to put a better regulatory framework in place and act promptly against errant persons / institutions.

The Ministry of Corporate Affairs, which already has a centralized data-base of all companies, may examine placing a cap on the number of companies operating from the same premises and number of companies in which a person can become director.

The government may consider introducing alternative financial instruments to reduce the attraction of gold as savings instrument. It may also consider revising customs duties, as also graded wealth tax, on gold and jewellery to discourage investments in unproductive assets. The taxation structure on bullion and jewellery, including VAT / Sales Tax should be harmonized.

Better reporting / monitoring systems are to be put in place to trace the dealings in bullion / jewellery through the Income Tax / Customs / Sales Tax Acts. While the Income Tax Department has made it mandatory to obtain PAN or Form-60 / Form-61 for purchase of bullion above `5 lakh, similar rules should be framed for purchase / sale of bullion / jewellery, and collection of tax at source on purchases especially in cash.

Use of banking channels and credit / debit cards should be encouraged, while trade practices such as cheque discounting should be discouraged. The validity period of cheques / DDs has been reduced from 6 to 3 months w.e.f. 1st April 2012, which will discourage discounting of negotiable instruments. Payments by debit / credit cards through e-service intermediaries will simplify and encourage payments in these modes and reduce the cash economy. It is imperative that payment of wages and salaries in the private sector should also be through banking channels and become cash-less, in line with the government objective of financial inclusion.

Income Tax Department, which has a large data-base of financial transactions, should immediately set up the Directorate of Risk Management for proper data mining and risk

analysis. The third-party reporting mechanism of the Income Tax Department should be made computer-driven and cover most high-value transactions in the financial sector.

Foreign remittances using corporate structures and the formal financial sector instruments may be a popular method of transferring funds (even of illegal origin) to foreign jurisdictions or for routing back to India through Foreign Institutional Investors (FII). There is a need to create a robust database of such remittances and carry out an analysis of their backward and forward linkages in order to understand the nature and legitimacy of the transmitted funds. FIU-IND may be empowered by law to receive reports (similar to other reports submitted to FIU-IND) on all international fund-transfers through the Indian financial system. The FIUs of Australia and Canada are already mandated to receive such reports.

SEBI by a circular issued in January 2011 has introduced changes in the reporting formats that capture details of downstream issuances of PNs during the month. From March 2012, these detailed reports are to be filed on a monthly basis but have a lag of six months. Though such details would be useful in identifying suspicious transactions, the six month lag in the information available is likely to reduce the strength of corrective action that can be taken by SEBI.

Foreign entities, banks, financial institutions, fund transfer entities, etc., have set up businesses in India. It has been found that Indian tax residents have been having substantial monetary transactions through these entities or with their branches abroad. Some countries have implemented laws to make it obligatory to furnish information of all transactions undertaken abroad. We recommend that India may also insist on entities operating in India to report all global transactions above a threshold limit. For this purpose, appropriate law, rules or contractual / licensing arrangement with these entities may be framed and implemented.

In India, there is no law to protect informants / whistle-blowers, nor does any department have effective witness protection program. As a result, credible information is not forthcoming and witnesses either do not turn up or turn hostile resulting in acquittals in prosecution cases. Apparently, the National Investigative Agency runs a program, and the recently created Directorate of Criminal Investigation (DCI) in the CBDT has been empowered to run such a program. Accordingly, we recommend that a witness protection law may be enacted expeditiously and witness protection program should be implemented by all law enforcement agencies.

Institutions of the Lok Pal and Lokayukta may be put in place at the earliest, in the centre and states, respectively, to expedite investigations into cases of corruption and bring the guilty to justice.

While on the lengthy discussion with regard to black money, mention must be made of the scheme announced by the Government of India for declaration of black money or unaccounted money upto 30th September, 2016 under Income Declaration Scheme 2016upon payment of taxes of 45%. This is an attempt to unearth black money. The declaration is required to be made latest by 30th September 2016 and the taxes to be paid in 3 instalments upto 30th September, 2017.

5.2.8 Effective investigation & adjudication

Government must consider ways to mitigate the manpower shortage issues which are seriously

hampering the functioning of various agencies particularly the CBDT and CBEC. Further, both Boards have submitted proposals for restructuring of their respective field formations. These need to be taken up and implemented on a fast track basis to show the Government's resolve to tackle the issue of black money.

Simultaneously, more administrative and financial autonomy must be expeditiously devolved on CBDT and Central Board of Excise and Customs (CBEC) for formulating tax policies in keeping with the overall government views on economic growth and development, for better tax administration and for providing tax-payer services as per best international practices. This has consistently been recommended by many earlier Committees and Commissions on Tax Administration.

With the emergence of complex legal matrix, infraction of one law invariably leads to infraction of another. Inter-agency coordination is critical in the fight against black money. There is a need to evolve an effective coordination mechanism that identifies the laws violated, the law violators, and a permanent joint mechanism to investigate all such cases. Some developed countries have an approach of joint task force and de-confliction programs to deal with this issue. It is time we study how this approach and program functions, adapt it to Indian conditions and implement it.

Intelligence sharing is one of the most critical areas for effective law enforcement. For this purpose, there should be a platform for more effective sharing of intelligence/information between central and state agencies. Information exchange among various economic law enforcement / intelligence organizations should become technology driven, preferably through a common technology platform. At the same time data-security should be ensured to prevent unauthorized access to information both technologically and through access control, and periodical security audit.

Diverse activities are covered by 'primary' enactments to regulate sale receipts, actual production, charging amount in excess of statutory amounts, etc. In some cases, investigation by income tax authorities reveals infringement of state laws. In such cases, the courts admit evidence 'accepted' by state authorities. Provision may be considered for enactment in the law of evidence or the income-tax law to the effect that even if evidence is produced under the primary law, where no independent verification is made, it will not be conclusive proof for tax purposes.

As taxation is a highly specialized subject, most reversals in court rulings are to be found in tax jurisprudence. Government may consider creating an all-India judicial service for specialized judiciary in different laws to achieve uniformity of application.

The National Tax Tribunal is yet to come into existence. Rapidly developing specialized institutions with requisite domain knowledge, to deal with complex problems confronting the country, is a priority. A professional National Tax Tribunal, with representation from the tax administration also, should be immediately formed to deal with all tax litigation.

Improvements in the matter of reporting, analysis and communication need to be achieved by further upgrading the computerization programme of the judicial system. It will enable the law enforcement agencies in taking well informed decisions.

We further recommend that for criminal trial of economic offences, the High Courts may

consider setting up exclusive economic offences courts with special summary procedure. Judicial officers posted in these courts could take refresher courses in taxation laws to properly equip them in dealing with complex tax cases.

Under economic laws, different punishments are prescribed for different offences Minimum punishments should also be prescribed for economic offences, to have greater deterrence. Different law enforcement agencies may consider lowering the punishment of 3 years to 2 years to facilitate speedier trial through summary procedure. Maximum punishments under the NDPS Act are 10 and 20 years. Under the NDPS Act, a second serious offence is punishable with death. Certainly, corruption cannot be treated as less diabolical than drug-related offences or money-laundering. Therefore, maximum punishment in serious cases of corruption should be enhanced to 10 years. Similarly, the minimum punishment for different offences of corruption should be enhanced from present 6 months, 1 year and 2 years to 1 year, 2 years and 3 years – at par with PMLA or Customs Act. Enhanced punishment, at par with other serious economic offences, is likely to provide more effective deterrence against corruption.

5.2.9 Other steps

Directorate of Currency (DoC) may be strengthened to introduce coins and currencies that would be machine readable, to enable routing of cash transactions through banks easy, user friendly and reduce the menace of FICN. This will go a long way in enabling the banks to not discourage cash deposits, thus reducing cash economy. The DoC needs to be strengthened to achieve these objectives.

To prevent misuse of 'off-market', and 'Dabba-trading' or trading outside the recognized stock exchanges, amendment to income tax law may be introduced to allow losses in off-market share transactions to be set off only against profits derived from such transactions.

As housing finance companies and the property buyers are provided fiscal incentives, it also leads to speculation and flipping transactions. To prevent this, Section 54 of the Income Tax Act should be amended to provide for availing this benefit only twice by a taxpayer in his lifetime.

The period of limitation for reopening income tax assessments should be enhanced from present six years to sixteen years for bringing to tax undisclosed assets held abroad.

One of the ways to get assets / money held abroad into the national mainstream is through a compliance scheme. The Committee is of the view that if the above recommendations are implemented properly, it would be possible to get information regarding assets held abroad as well as check the generation of black money within the country and its illicit transfer abroad. Already there are provisions in the Income Tax Act to waive prosecution and reduce penalties in genuine cases of inadvertent infraction of tax laws. Such taxpayers can always avail of the benefits under these provisions and declare any undisclosed income/assets in India or abroad.

5.2.10 Reporting of frauds by auditors [Section 143(12)]

In terms of Section 142 of the Companies Act, 2013 if an auditor of a company in the course of performance of his duties as auditor, has reason to believe that a offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government immediately but not later than 60 days of his knowledge and after following the procedure as

prescribed in Rule 13 of the Companies (Audit and Auditors) Rules, 2014.

Auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within 45 days;

On receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days of receipt of such reply or observations;

In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.

The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same.

The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number.. The report shall be in the form of a statement as specified in Form ADT-4.

According to Section 143 (14) of the Companies Act, 2013 the provision of section 143 shall 'mutatis mutandis' apply to the cost accountant in practice conducting cost audit under section 148.

5.2.11 Penalty for non compliance of section 143(12)

If any auditor, the cost accountant in practice conducting cost audit under section 148 do not comply with the provisions of section 143(12) (reporting about the offence to the Central Government), he shall be punishable with fine which shall not be less than ` 1 lakhs but which may extend to ` 25 lakhs. No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred above if it is done in good faith.

ANNEXURE I

SALIENT FEATURES OF THE GUIDELINES OF THE RESERVE BANK OF INDIA ANNOUNCED ON 1ST AUGUST, 2016

(I) Eligible Promoters

(i) Individuals/professionals who are 'residents' and have 10 years of experience in banking and finance at a senior level.

(ii) Entities/groups in the private sector that are 'owned and controlled by residents' [as defined in FEMA Regulations, as amended from time to time] and have a successful track record for at least 10 years, provided that if such entity/group has total assets of `50 billion or more, the non-financial business of the group does not account for 40 per cent or more in terms of total assets/ in terms of gross income.

(iii) Existing non-banking financial companies (NBFCs) that are 'controlled by residents' and have a successful track record for at least 10 years. For the sake of clarity, it is added here that any NBFC, which is a part of the group that has total assets of ` 50 billion or more and that the non-financial business of the group accounts for 40 per cent or more in terms of total assets/in terms of gross income, is not eligible.

(II) 'Fit and Proper' criteria

Promoter/promoting entity/promoter group should have a past record of sound financials, credentials, integrity and have a minimum 10 years of successful track record.

(III) Corporate structure

The requirement of Non-Operative Financial Holding Company (NOFHC) is not mandatory for individual promoters or standalone promoting/converting entities who/which do not have other group entities. Individual promoters/promoting entities/converting entities that have other group entities, shall set up the bank only through an NOFHC. Not less than 51 per cent of the total paid-up equity capital of the NOFHC shall be owned by the Promoter/Promoter Group. Specialised activities would be permitted to be conducted from a separate entity proposed to be held under the NOFHC subject to prior approval from the Reserve Bank and subject to being ensured that similar activities are not conducted through the bank. No shareholder, other than the promoters/ promoter group, shall have significant influence and control in the NOFHC.

(IV) Minimum capital requirement

The initial minimum paid-up voting equity capital for a bank shall be ₹five billion. Thereafter, the bank shall have a minimum net worth of ₹ five billion at all times.

The promoter/s and the promoter group / NOFHC, as the case may be, shall hold a minimum of 40 per cent of the paid-up voting equity capital of the bank which shall be locked-in for a period of five years from the date of commencement of business of the bank. The promoter group shareholding shall be brought down to 15 per cent within a period of 15 years from the date of commencement of business of the bank.

(V) Foreign shareholding in the bank

The foreign shareholding in the bank would be as per the existing foreign direct investment (FDI) policy subject to the minimum promoter shareholding requirement indicated in paragraph (IV) above. At present, the aggregate foreign investment limit is 74 per cent.

(VI) Corporate governance, prudential and exposure norms

The bank shall comply with the provisions of Banking Regulations Act, 1949 and the existing guidelines on prudential norms as applicable to scheduled commercial banks. The bank is precluded from having any exposure to its promoters, major shareholders who have shareholding of 10 per cent or more of paid-up equity shares in the bank, the relatives of the promoters as also the entities in which they have significant influence or control.

(VII)Business plan for the bank

The business plan submitted by the applicant should be realistic and viable and address how the bank proposes to achieve financial inclusion.

Self Assessment Questions

1) What are the different forms of business in which banking companies may engage under the Banking Regulation Act, 1949?

2) What are the restrictions on banking companies as to loans and advances?

3) What is the various powers of the Reserve Bank for regulation of Banking companies and in what manner the powers are exercised by the Reserve Bank of India?

4) What are the restrictions under the Banking Regulation Act 1949 in regard to voting powers?

5) How the Reserve Bank of India controls the composition of the Board of Directors including the Chairmen of Banking companies?

6) What is the criteria to grant banking licence by the RBI? Also give the gist of requirements announced during the year 2016 by the Reserve Bank of India.

7) Explain the provisions of as to winding up of the Bank companies under the Banking Regulation Act, 1949.

8) Explain provisions of 'right to appeal' under Sec.17 of the SARFAESI Act, 2002.

9) Write short notes on:

   a) Central Registry under SARFAESI Act, 2002.

   b) Cancellation of certificate of registration.

10) Explain the procedure for registration of securitisation or reconstruction companies under SARFAESI Act, 2002.

11) What do you mean by "money laundering"? What is the role of RBI in curbing of Money Laundering?

12) What are the obligations of Banking Companies, Financial Institutions and Intermediaries under PMLA?

13) What are the provisions for enforcement of security interest under SARFAESI Act, 2002?

14) Explain the latest development in the field of Banking laws and further how the same would be a game changer.

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STUDY NOTE : 6

LAWS RELATED TO INSURANCE SECTOR

PART – A : THE INSURANCE ACT, 1938

This Study Note Includes:

A : 6.1 Introduction

A : 6.2 Principles of Insurance Law

A : 6.3 Important Definitions

A : 6.4 Provisions Related to Insurance

A : 6.1 INTRODUCTION

The Concept of Insurance

Insurance is a method of spreading over a large number of persons a possible financial loss too serious to be conveniently borne by an individual. Therefore, the fundamental function of insurance is to shift the loss suffered by a sole individual to a willing and capable professional risk-bearer in consideration of a comparatively small contribution called the premium. Insurance thus reduces the fears of future risk to the individual insured and by capital formation it helps the growth of industry, accelerates production, lubricates the machinery of production and distribution and improves economy of the nation. It mobilizes the resources, accelerates and stabilizes growth and helps in the establishment of a welfare state.

The Constitution of India is federal in nature in as much there is division of powers between the Centre and the States. Insurance is included in the Union List, wherein the subjects included in this list are of the exclusive legislative competence of the Centre. The Central Legislature is empowered to regulate the insurance industry in India and hence the law in this regard is uniform throughout the territories of India.

The concept of insurance has been prevalent in India since ancient times amongst Hindus. Overseas traders practised a system of marine insurance. The joint family system, peculiar to India, was a method of social insurance of every member of the family on his life. The law relating to insurance has gradually developed, undergoing several phases from nationalisation of the insurance industry to the recent reforms permitting entry of private players and foreign investment in the insurance industry.

Prior to 1912, there was no insurance law in India. The Insurance companies were governed by the provisions of the Indian Companies Act 1882. In the beginning of the twentieth century, many companies sprang up but many of them were unsound. So these demanded a legislation to control the insurance companies. In 1912, the Indian Life Insurance Companies Act and the Provident Insurance Societies Act were passed to control life insurance only. The Indian Life Insurance Companies Act 1912, was based on the model of the English Insurance Companies Act of 1909. The Indian legislation dealt with only life insurance while the English Act governed life insurance as well as non-life insurance. The Indian Life Insurance Companies Act, 1912 had some defects. The unhealthy concerns were not checked from the irregularities. There was no restriction imposed on the investment of their funds. The unsound concerns could not be investigated. The foreign companies were exempted from submitting particulars regarding their Indian business.

Persistent demands were made by various important public bodies in the country for statutory provisions which would provide for disclosure and publication of the business carried on in India by foreign companies. In 1925, a comprehensive piece of insurance legislation was to be passed but it was postponed because the Government of India thought it fit to watch the course of new legislation on Insurance Law in England. Mr A.C. Clauson K.C. was appointed to revise the insurance legislation in that country.

The enquiry of the Clauson Committee was not immediately followed by and has not yet resulted in legislation in England. In the meantime, the Government of India passed the legislation in 1928 with the main object of collecting statistics regarding insurance matters so that the information collected would be of value when the time would come to pass a comprehensive Act. The statistics to be collected were pertaining to total business in force, new business, amount of claims paid and a summary of classified assets held by all life insurance companies operating in India. In 1935 the Government decided to proceed with the reform of the insurance law and without waiting for the enactment of legislation in England. Mr. Sushil Chandra Sen, a well-known Calcutta solicitor was assigned a special duty to report on the amendments necessary to modernize insurance legislation in India. An Advisory Committee was also appointed by the Government of India to consider the report of Mr. Sen. The Committee made several changes and the Government of India introduced the Bill in the Legislative Assembly in 1937 which emerged as the Insurance Act of 1938. It was enforced since July 1, 1939. A comprehensive amendment was made in 1950. The life insurance business was nationalized in 1956 and therefore the Life Insurance Corporation of India Act, 1956 was passed. The Life Insurance Corporation of India came into existence from September 1, 1956. This Act is effective and comprehensive to govern the life insurance business in India. The marine Insurance Act of 1963 was enacted to govern and regulate marine insurance in India. The general insurance business has been nationalized in 1972 and an Act to that effect has been passed in 1972 known as The General Insurance Business (Nationalisation) Act, 1972.

FDI in Insurance Sector in India

Insurance market in India was opened up for private sector in 2000 with the enactment of Insurance Regulatory and Development Authority of India (IRDAI) Act, 1999. Before opening up of the sector for the private players, the industry consisted of only two state insurers: Life Insurers (Life Insurance Corporation of India, LIC) and General Insurers (General Insurance Corporation of India, GIC). GIC had four subsidiary companies. Industry has seen a gradual growth over the last 15 years in terms of product innovation, vibrant distribution channels, penetration and density.

As on March, 19 2016, there are 52 insurance companies operating in India, of which 24 are in the life insurance business and 28 in general insurance. Up to 26 per cent FDI is permitted through the automatic approval route. For FDI up to 49 per cent, the approval of the Central Government is required.

However, presently foreign investment proposals up to 49 per cent of the total paid up equity of the Indian insurance company shall be allowed on the automatic route subject to verification by the Insurance Regulatory and Development Authority of India instead of 26 per cent earlier.

The Insurance Laws (Amendment) Act, 2015

The Insurance Laws (Amendment) Act, 2015 received the assent of the President on the 20th March, 2015 paved the way for major reform related amendments in the Insurance Act, 1938, the General Insurance Business (Nationalization) Act, 1972 and the Insurance Regulatory and Development Authority (IRDA) Act, 1999. This Act is deemed to have come into force on 26th December 2014.

Highlights of the Insurance Laws (Amendment) Act, 2015

The amendment Act paved way for removing archaic and redundant provisions in the legislations and incorporates certain provisions to provide Insurance Regulatory and Development Authority of India (IRDAI) with the flexibility to discharge its functions more effectively and efficiently. It also provides for enhancement of the foreign investment cap in an Indian Insurance Company from 26% to an explicitly composite limit of 49% in automatic route with the safeguard of Indian ownership and control.

In addition to the provisions for enhanced foreign equity, the amended law will enable capital raising through new and innovative instruments under the regulatory supervision of IRDAI. Greater availability of capital for the capital intensive insurance sector would lead to greater distribution reach to under / un-served areas, more innovative product formulations to meet diverse insurance needs of citizens, efficient service delivery through improved distribution technology and enhanced customer service standards. The Rules to operationalize the new provisions in the Law related to foreign equity investors have already been notified on 19th February 2015 under powers accorded by the Ordinance.

The four public sector general insurance companies, presently required as per the General Insurance Business (Nationalisation) Act, 1972 (GIBNA, 1972) to be 100% government owned, are now allowed to raise capital, keeping in view the need for expansion of the business in the rural and social sectors, meeting the solvency margin for this purpose and achieving enhanced competitiveness subject to the Government equity not being less than 51% at any point of time.

Further, the amendments to the laws will enable the interests of consumers to be better served through provisions like those enabling penalties on intermediaries / insurance companies for misconduct and disallowing multilevel marketing of insurance products in order to curtail the practice of mis-selling. The amended Law has several provisions for levying higher penalties ranging from up to ` 1 Crore to ` 25 Crore for various violations including mis-selling and misrepresentation by agents / insurance companies. With a view to serve the interest of the policy holders better, the period during which a policy can be repudiated on any ground, including mis-statement of facts etc., will be confined to three years from the commencement of the policy and no policy would be called in question on any ground after three years. The amendments provide for an easier process for payment to the nominee of the policy holder, as the insurer would be discharged of its legal liabilities once the payment is made to the nominee. It is now obligatory in the law for insurance companies to underwrite third party motor vehicle insurance as per IRDAI regulations. Rural and Social sector obligations for insurers are retained in the amended laws.

The Act will entrust responsibility of appointing insurance agents to insurers and provides for IRDAI to regulate their eligibility, qualifications and other aspects. It enables agents to work more broadly across companies in various business categories; with the safeguard that conflict of interest would not be allowed by IRDAI through suitable regulations. IRDAI is empowered to regulate key aspects of Insurance Company operations in areas like solvency, investments, expenses and commissions and to formulate regulations for payment of commission and control of management expenses. It empowers the Authority to regulate the functions, code of conduct, etc., of surveyors and loss assessors. It also expands the scope of insurance intermediaries to include insurance brokers, re- insurance brokers, insurance consultants, corporate agents, third party administrators, surveyors and loss assessors and such other entities, as may be notified by the Authority from time to time. Further, properties in India can now be insured with a foreign insurer with prior permission of IRDAI; which was earlier to be done with the approval of the Central Government.

The amendment Act defines 'health insurance business' inclusive of travel and personal accident cover and discourages non-serious players by retaining capital requirements for health insurers at the level of ₹ 100 Crore, thereby paving the way for promotion of health insurance as a separate vertical.

The amended law enables foreign reinsurers to set up branches in India and defines „re-insurance to mean "the insurance of part of one insurer's risk by another insurer who accepts the risk for a mutually acceptable premium", and thereby excludes the possibility of 100% ceding of risk to a re-insurer, which could lead to companies acting as front companies for other insurers. Further, it enables Lloyds and its members to operate in India through setting up of branches for the purpose of reinsurance business or as investors in an Indian Insurance Company within the 49% cap.

The Life Insurance Council and General Insurance Council have now been made self regulating bodies by empowering them to frame bye-laws for elections, meetings and levy and collect fees etc. from its members. Inclusion of representatives of self-help groups and insurance cooperative societies in insurance councils has also been enabled to broad base the representation on these Councils.

Appeals against the orders of IRDAI are to be preferred to SAT as the amended Law provides for any insurer or insurance intermediary aggrieved by any order made by IRDAI to prefer an appeal to the Securities Appellate Tribunal (SAT).

A : 6.2 PRINCIPLES OF INSURANCE LAW

Where there is a positive enactment of the Indian legislature, the language of the statute is applied to the facts of the case. However, the common law of England is often relied upon in consideration of justice, equity and good conscience.

6.2.1 Good Faith

A contract of insurance is a contract 'uberrimea fidei' i.e., a contract of utmost good faith. This is a fundamental principle of insurance law. Both the parties to the contract are required to observe utmost good faith and should disclose every material fact known to them. There is no difference between a contract of insurance and any other contract except that in a contract of insurance there is a requirement of utmost good faith [General Assurance Society Ltd. v. Chandumull Jain AIR 1966 SC 1644]. The burden of proof to show non-disclosure or misrepresentation is on the insurance company [Life Insurance Corporation of India v. Smt. G.M.Channabasamma (1991) 1 SCC 357] and the onus is a heavy one [Life Insurance Corporation of India v. Parvathavardhini Ammal AIR 1965 Mad 357]. The duty of good faith is of a continuing nature in as much no material alteration can be made to the terms of the contract without the mutual consent of the parties [United India Insurance co. Ltd v. M.K.J Corpn. (1996) 6 SCC 428.] Just as the assured has a duty to disclose all the material facts, the insurer is also under an obligation to do the same. The insurer cannot subsequently demand additional premium [Hanil Era Textiles Ltd. v. Oriental Insurance Co. Ltd. (2001) 1 SCC 269] nor can he escape liability by contending that the situation does not warrant the insurance cover [United India Insurance Co ltd. v. M.K.J. Corporation (1996) 6 SCC 428].

6.2.2 Misrepresentation

Representations are statements, made by one party to the other, either prior to or while entering into an insurance contract, of some matter or circumstances relating to it and which is not an integral part of the contract [Behn v. Burness, (1863) 3 B&S 751]. These statements are said to have fulfilled their obligations when the final acceptance on the policy is conveyed [Pawson v. Watson, (1778) 98 ER 1361].

A mere recital of representations made at the time of entering into the contact will not make then warranties. [Wheelton v. Haristy, (1857) 8 E and B 232]. However, if representations are made an integral part of the contract they become warranties, and, in case of their being untrue, the policy can be avoided, even if the loss does not arise from the fact concealed or misrepresented. A policy of life insurance cannot be called in question on the ground of misrepresentation after a period of two years from the commencement of the policy.

In dealing with representations as circumstances invalidating a contract, consideration should be paid as to whether such representations are wilful or innocent and whether they are preliminary or for part of the contract. The Insurance Act lays down three conditions to establish that the misrepresentation was wilful; (a) the statement must be on a material matter or must suppress facts which it was material to disclose; (b) the suppression must be fraudulently made by the policy holder; and (c) the policy- holder must have known at the time of making the statement that it was false or that it suppressed facts which it was material to disclose.

6.2.3 Warranties

A warranty may be distinguished from a representation in as much a representation may be equitably and substantially answered but a warranty must be strictly complied with. A breach of warranty will avoid the policy, although it may not relate to a matter material to the risk insured. Warranties may be express or implied, if it is condition implied by law. However, implied warranties are mostly confined to marine insurance. The Marine Insurance Act defines a warranty as a promise whereby the assured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or affirms or negatives the existence of a particular state of facts.

The statements must be true in fact without any qualification of judgment, opinion or belief [New Castle Fire Insurance Company v. Mac Morram and Co., (1815) 3 ER 1057]. The warranty should be in the policy or must be incorporated by reference. If any of the statements or representations made by the assured in the proposal have been made the "basis" of the contract and they are found to be untrue, the contract of insurance would be void and unenforceable in law, irrespective of the question whether the statement, concerned is of a material nature or not.

However, non-compliance of a warranty is excused when, by reason of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract, or when compliance with the warranty is rendered unlawful by any subsequent law or when such a warranty has not been mentioned in the policy.

6.2.4 Conditions

Conditions are terms which prescribe the limitations under which an insurance policy is granted and which specify the duties of the assured. They can be either conditions precedent or subsequent. Conditions precedent are those, which are essential for the creation of a valid contract, the non- satisfaction of which makes the contract void ab initio. Conditions subsequent relate to the continuance of a valid contract, the non-fulfilment of which leads to the avoidance of the contract from the date of the breach.

They can be further classified into express conditions and implied conditions. Implied conditions are those, which are implied by law to apply to every contract of insurance irrespective of any specific inclusion or reference to them such as insurable interest, good faith etc. A condition, which seeks to reduce or curtail the period of limitation and prescribes a shorter period than that prescribed by law is void. However, the insured is absolved once it is shown that he has done everything in his power to keep, honour and fulfil the promise and he himself is not guilty of a deliberate breach. An insurer cannot take recourse to a condition, which has not been mentioned in the policy to reduce his liability [Modern Insulators Ltd. v. Oriental Insurance Company Ltd. (2000) 2 SCC 1014]. However, an insurance policy may not curtail the right but may merely provide for forfeiture or waiver of any such right and such a right would be enforceable against either party [National Insurance Company Ltd. v. Sujir Ganesh Nayak and Company, AIR 1997 SC 2049].

6.2.5 Indemnity and Subrogation

Most kinds of insurance policies other than life and personal accident insurance are contracts of indemnity whereby the insurer undertakes to indemnify the insured for the actual loss suffered by him as a result of the occurring of the event insured against. Even within the maximum limit, the insured cannot recover more than what he establishes to be his actual loss [Vania Silk Mills (P) Ltd. v. CIT (1991) 4 SCC 22]. A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the insured to the extent agreed upon.

Although the insured is to be placed in the same position as if the loss has not occurred, the amount of indemnity may be limited by certain conditions:

(a) Injury or loss sustained by the insured has to be proved.

(b) The indemnity is limited to the amount specified in the policy.

(c) The insured is indemnified only for the proximate causes.

(d) The market value of the property determines the amount of indemnity.

6.2.6 Proximate Cause

The doctrine of proximate cause is expressed in the maxim 'Causa Proxima non remota spectator', which means that the proximate and not the remote cause, shall be taken as the cause of loss. The insurer is thus has to make good the loss of the insured that clearly and proximately results, whether directly or indirectly, from the event insured against in the policy [Stanley V. Western Insurance company (1868) L.R. 371]. The burden of proof that the loss occurred on account of the proximate cause, lies on the insured.

As per the Marine Insurance Act, unless the insurance policy states otherwise, the insurer is liable for any loss proximately caused by a peril insured against, but he is not liable for any loss which is not proximately caused by a peril insured against. An insurer would therefore be exempted from liability when the cause of loss falls within the exceptions of the policy. The Marine Insurance Act further states that the insurer is not liable for any wilful misconduct of the insured i.e. the assured cannot recover for a loss where his own deliberate act is the proximate cause of it. Further, in the event of loss caused by the delay of the ship, the insurer cannot be held liable, irrespective of the proximity of the cause.

6.2.7 Insurance and Consumer Protection

The Consumer Protection Act, 1986 ("Consumer Protection Act") is one of the most important socio-

economic legislation for the protection of consumers in India. The provisions of this Act are compensatory in nature, unlike other laws, which are either punitive or preventive. Insurance services fall within the purview of the Consumer Protection Act, in as much, any deficiency in service of the insurance company would enable the aggrieved to make a complaint. Disputes between policyholders and insurers generally pertain to repudiation of the insurance claim or the matters connected with admission of the claim or computation of the amount of claim. In the case of assignment of all rights by the insured to the insurer, the consumer forum and he courts generally refuse to accept the 'locus standi' of the insured.

The courts have held that insurance companies do not fall under the definition of "consumer" under the Consumer Protection Act, as no service is rendered to them directly. Neither the subrogation nor the transfer of the right of action would confer the legal status of a 'consumer' on the insurer, nor can the insurer be regarded as any beneficiary of any service [New India Assurance Company Ltd. v. B. N. Sainani (1997) 6 SCC 383]. Therefore, the remedy available to the insurer is to file a suit in a civil court for recovery of the loss.

However, if a company/individual taken insurance to hedge his risk, he will be considered to be a consumer under the Consumer Protection Act, even when he is a doing business (commercial purpose).

6.2.8 Insurable Interest

To constitute insurable interest, it must be an interest such that the risk would by its proximate effect cause damage to the assured, that is to say, cause him to lose a benefit or incur a liability. The validity of an insurance contract, in India, is dependent on the existence of an insurable interest in the subject matter. The person seeking an insurance policy must establish some kind of interest in the life or property to be insured, in the absence of which, the insurance policy would amount to a wager and consequently void in nature.

The test for determining if there is an insurable interest is whether the insured will in case of damage to the life or property being insured, suffer pecuniary loss [New India Insurance Company Ltd. v. G.N. Sainani, (1997) 6 SCC 383]. A person having a limited interest can also insure such interest.

Insurable interest varies depending on the nature of the insurance. The controversy as to the existence of an insurable interest between spouses was settled by the court, which held that such an interest could exist as neither was likely to indulge in any 'mischievous game'. The same analogy may be extended to parents and children. Further, the courts have also held that such an insurable interest would exist for a creditor (in a debtor) and for an employee (in an employer) to the extent of the debt incurred and the remuneration due, respectively.

The existence of insurable interest at the time of happening of the event is another important consideration. In case of life and personal accident insurance it is sufficient if the insurable interest is present at the time of taking the policy. However, in the case of fire and motor accident insurance the insurable interest has to be present both at the time of taking the policy and at the time of the accident. The case is completely different with marine insurance wherein there need not be any insurable interest at the time of taking the policy.

6.2.9 Commencement of policy

The general rule on the formation of a contract, as per the Indian Contract Act, is that the party to whom the offer has been made should accept it unconditionally and communicate his acceptance to the person making the offer. Whether the final acceptance is to be made by the insured or insurer really depends on the negotiations of the policy.

Acceptance should be signified by some act as agreed upon by the parties or from which the law raises a presumption of acceptance. The mere receipt or retention of premium until after the death of the applicant or the mere preparation of the policy document is not acceptance. Nonetheless, acceptance may be presumed upon the retention of the premium. However, mere delay in giving an answer cannot be construed as acceptance. Also, silence does not denote consent and no binding contract arises until the person to whom an offer is made says or does something to signify his acceptance.

When the policy is of a particular date, it would cover the liability of the insurer from the previous midnight preceding the same date [New India Assurance Company. Limited. vs. Ram Dayal & Others, (1990) 2 SCC 680.]. However, where there is a special contract to the contrary in the policy, the terms of the contract would prevail [National Insurance Company Limited. vs. Jikubhai Nathuji Dabhi (Smt) and Others, 1997(1) SCC 66]. Hence where the time of the issue of the insurance policy is mentioned, then the liability would be covered only from the time when it was issued.

A : 6.3 IMPORTANT DEFINITIONS

(a) Actuary: Section 2(1): Actuary" means an actuary as defined in clause (a) of sub-section (1) of section 2 of the Actuaries Act, 2006.

(b) Authority: Section 2(1A): Authority means the Insurance Regulatory and Development Authority of India established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999.

(c) Policy Holder: Section 2 (2): "Policy holder" includes a person to whom the whole of the interest of 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.

(d) Banking Company: Section 2 (4A): "Banking Company" and "Company" shall have the meanings respectively assigned to them in clauses (c) and (d) of subsection (1) of section of the Banking Companies Act, 1949 (10 of 1949).

(e) Controller of Insurance: Section 2 (5B): "Controller of Insurance", means the officer appointed by the Central Government under section 2B 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.

(f) Court: Section 2 (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.

(g) General Insurance Business: Section2 (6B): "General insurance business" means fine, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them.

(h) Health Insurance Business: Section 2(6C): "Health Insurance Business" means the effecting of contracts which provide for sickness benefits or medical, surgical or hospital expense benefits, whether in-patient or out-patient travel cover and personal accident cover.

(i) Government Security: Section 2 (7) "Government Security" means a Government Security as defined in the Public Debt Act 1944 (18 of 1944).

(j) Indian Insurance Company: Section 2(7A): "Indian insurance company" means any insurer, being a company which is limited by shares, and;

(1) which is formed and registered under the Companies Act, 2013 as a public company or is converted into such a company within one year of the commencement of the Insurance Laws (Amendment) Act, 2015.

(2) in which the aggregate holdings of equity shares by foreign investors, including portfolio investors, do not exceed forty-nine per cent of the paid up equity capital of such Indian insurance company, which is Indian owned and controlled, in such manner as may be prescribed.

Explanation: For the purposes of this sub-clause, the expression "control" shall include the right to appoint

a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.

(1) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business or health insurance business. Insurer: Section 2(9): "Insurer" means:

a) an Indian Insurance Company, or

b) a statutory body established by an Act of Parliament to carry on insurance business, or

c) an insurance co-operative society, or

d) a foreign company engaged in re-insurance business through a branch established in India. The expression "foreign company" shall mean a company or body established or incorporated under a law of any country outside India and includes Lloyd's established under the Lloyd's Act, 1871 (United Kingdom) or any of its Members.

(k) Insurance Agent: Section 2(10): "insurance agent" means an insurance agent 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.

(l) Investment Company: Section 2 (10A): "Investment Company" means a company whose principal business is the acquisition of shares, stocks, debentures or other securities.

(m) Life Insurance Business: Section 2(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 contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include:

a) the granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance.

b) the granting of annuities upon human life, and

c) the granting of superannuation allowances and benefits payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons.

Explanation: For the removal of doubts, it is hereby declared that "life insurance business" shall include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a component of investment and a component of insurance issued by an insurer referred to in clause (9) of this section.

(n) Re-insurance: Section 2(16B): "Re-insurance" means the insurance of part of one insurer's risk by another insurer who accepts the risk for a mutually acceptable premium.

A : 6.4 PROVISIONS RELATED TO INSURANCE

(a) Indian properties not to be insured with foreign insurers (section 2CB) without the permission of the IRDAI, no person shall take out or renew any policy of insurance in respect of any property in India or any ship or other vessel or aircraft registered in India with an insurer whose principal place of business is outside India.

(b) Requirements as to Capital (Section 6)

No insurer [not being an insurer as defined in sub-clause (d) of clause (9) of section 2] carrying on the business of life insurance, general insurance, health insurance or re-insurance in India or after the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall be registered unless he has minimum paid up capital as prescribed below:

Type of Insurance Business	Minimum Paid-up equity capital required (with a provision for further enhancement & Paid-up equity excludes preliminary expenses incurred during formation and registration)
Life insurance or general insurance	₹ 100 Crore
Health insurance (exclusively)	₹ 100 Crore
Re-insurer (exclusively)	₹ 200 Crore (besides re-insurer shall not be registered unless he has net owned funds of not less than ₹ 5,000 Crore)

Provided that the insurer, may enhance the paid-up equity capital, as provided in this section in accordance with the provisions of the Companies Act, 2013, the Securities and Exchange Board of India Act, 1992 and the rules, regulations or directions issued there under or any other law for the time being in force:

Provided further that in determining the paid-up equity capital, any preliminary expenses incurred in the formation and registration of any insurer as may be specified by the regulations made under this Act, shall be excluded.

No insurer, as defined in sub-clause (d) of clause (9) of section 2, shall be registered unless he has net owned funds of not less than rupees five thousand Crore.

6.4.1 Further Conditions (Section 6A)

To carry on the business of life or general or health or re-insurance the following further requirements are to be satisfied by such companies:

(a) that the capital of the company shall consist of equity shares each having a single face value and such other form of capital, as may be specified by the regulations.

(b) that the voting rights of shareholders are restricted to equity shares.

(c) 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.

(d) The aforesaid conditions shall not apply to a public company which before the commencement of the Insurance (Amendment) Act, 1950, has issued any shares other than ordinary shares each of which has a single face value or shares, the paid-up amount whereof is not the same for all them for a period of three years from such commencement.

6.4.2 Audit of accounts of insurance companies (Section 12) & Submission of returns (Section 15)

Unless subject to audit under the Companies Act, 2013, the balance sheet, profit and loss account, revenue account and profit and loss appropriation account of every insurer, in respect of all insurance business transacted by him, shall 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 147 of the Companies Act, 2013.

The audited accounts and statements 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. 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 principal officer of the company and, if the company has a managing director by that managing director and one shall be signed by the auditor who made the audit or the actuary who made the valuation, as the case may be.

6.4.3 Actuarial Valuation/Report (section 13)

At least once a year, every insurer carrying on life insurance business shall cause an investigation 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 made in accordance with the regulations. The Authority may, having regard to the circumstances of 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. If the investigation 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.

6.4.4 Record of Policies and claims (Section 14)

Every insurer, in respect of all business transacted by him, shall maintain:

(a) a record of policies, in which shall be entered, in respect of every policy issued by the insurer, the name and address of the policyholder, the date when the policy was effected and a record of any transfer, assignment or nomination of which the insurer has notice.

(b) a record of claims, 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 thereof.

(c) a record of policies and claims may be maintained in any such form, including electronic mode, as may be specified by the regulations made under this Act.

(d) Every insurer shall, in respect of all business transacted by him, endeavour to issue policies above a specified threshold in terms of sum assured and premium in electronic form, in the manner and form to be specified by the regulations made under this Act.

6.4.5 Investment of Assets (Section 27)

Every insurer shall invest and at all times keep invested assets equivalent to not less than the sum of the amount of his liabilities to holders of life insurance policies in India on account of matured claims, and the amount required to meet the liability on policies of life insurance maturing for payment in India, less 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 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 following manner namely:

(a) 25% 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

(b) the balance in any of the approved investments as may be specified by the regulations subject to the limitations, conditions and restrictions specified therein.

In the case of an insurer carrying on general insurance business, 25% of the assets in Government Securities, a further sum equal to not less than ten per cent of the assets in Government Securities or other approved securities and the balance in any other investment in accordance with the regulations of the Authority and subject to such limitations, conditions and restrictions as may be specified by the Authority in this regard.

No insurer carrying on life insurance business shall invest or keep invested any part of his controlled fund and no insurer carrying on general business shall invest or keep invested any part of his assets otherwise than in any of the approved investments as may be specified by the regulations subject to such limitations, conditions and restrictions therein. (Section 27A).

All assets of an insurer carrying on general insurance business 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 section 27. (Section 27B).

An insurer may invest not more than five per cent in aggregate of his controlled fund or assets in the companies belonging to the promoters, subject to such conditions as may be specified by the regulations. (Section 27C) (f) Prohibition of loans (Section 29).

No insurer shall grant loans or temporary advances either on hypothecation of property or on personal security or otherwise, except loans on life insurance policies issued by him within their surrender value, to any director, manager, actuary, auditor or officer of the insurer, if a company or to any other company or firm in which any such director, manager, actuary or officer holds the position of a director, manager, actuary, officer or partner. This shall not apply to such loans made by an insurer to a banking company, as may be specified by the Authority.

Further this shall not be applicable from granting such loans or advances to a subsidiary company or to any other company of which the company granting the loan or advance is a subsidiary company if the previous approval of the Authority is obtained for such loan or advance. The provisions of section 185 of the Companies Act, 2013 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.

6.4.6 Liability of directors for contravention (Section 30)

If by reason of a contravention of any of the provisions of section 27, 27A, 27B, 27C, 27D or section 29, any loss is sustained by the insurer or by the policyholders, every director, manager or officer 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.

6.4.7 Obligations of Insurers in respect of third party risks of motor vehicles (Section 32D)

Every insurer carrying on general insurance business shall, after the commencement of the Insurance Laws (Amendment) Act, 2015, underwrite such minimum percentage of insurance business in third party risks of motor vehicles as may be specified by the regulations: The Authority may, by regulations, exempt any insurer who is primarily engaged in the business of health, re-insurance, agriculture, export credit guarantee, from the application of this section. 105B. If an insurer fails to comply with the provisions of section 32B, section 32C and section 32D, he shall be liable to a penalty not exceeding twenty-five crore rupees. (Section 105B).

6.4.8 Power of investigation and inspection by authority (Section 33)

The Authority may, at any time, if it considers expedient to do so by order in writing, direct any person ("Investigating Officer") specified in the order to investigate the affairs of any insurer or intermediary or insurance intermediary, as the case may be, and to report to the Authority on any investigation made by such Investigating Officer: The Investigating Officer may, wherever necessary, employ any auditor or actuary or both for the purpose of assisting him in any investigation under this section. Notwithstanding anything to the contrary contained in section 210 of the Companies Act, 2013, the Investigating Officer 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 the books of account of any insurer or intermediary or insurance intermediary, as the case may be, and the Investigating Officer shall supply to the insurer or intermediary or insurance intermediary, as the case may be, a copy of the report on such inspection.

It shall be the duty of every manager, managing director or other officer of the insurer including a service provider, contractor of an insurer where services are outsourced by the insurer, or intermediary or insurance intermediary, as the case may be, to produce before the Investigating Officer directed to make the investigation or inspection, all such books of account, registers, other documents and the database in his custody or power and to furnish him with any statement and information relating to the affairs of the insurer or intermediary or insurance intermediary, as the case may be, as the Investigating Officer may require of him within such time as the said Investigating Officer may specify. The Investigating officer shall make a report to the Authority on such inspection and the Authority may after giving such opportunity to the insurer or intermediary to make a representation. All expenses incidental to any investigation shall be

defrayed by the insurer or intermediary or insurance intermediary and shall have priority over the debts due from the insurer and shall be recoverable as an arrear of land revenue.

6.4.9 Prohibition of payment by way of commission or otherwise for procuring business (Section 40)

No person shall, 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 in such manner as may be specified by the regulations. No insurance agent or intermediary or insurance intermediary shall receive or contract to receive commission or remuneration in any form in respect of policies issued in India, by an insurer in any form in respect of policies issued in India, by an insurer except in accordance with the regulations specified in this regard.

6.4.10 Appointment of insurance agents (Section 42)

An insurer may appoint any person to act as insurance agent for the purpose of soliciting and procuring insurance business. Such person should not suffer from any of the disqualifications. Further no person shall act as an insurance agent for more than one life insurer, one general insurer, one health insurer and one of each of the other mono-line insurers: The Authority shall, while framing regulations, ensure that no conflict of interest is allowed to arise for any agent in representing two or more insurers for whom he may be an agent.

6.4.11 Prohibition of insurance business through principal agent, special agent and multilevel marketing (Section 42A)

No insurer shall, on or after the commencement of the Insurance Laws (Amendment) Act, 2015, appoint any principal agent, chief agent, and special agent and transact any insurance business in India through them. No person shall allow or offer to allow, either directly or indirectly, as an inducement to any person to take out or renew or continue an insurance policy through multilevel marketing scheme. The Authority may, through an officer authorised in this behalf, make acomplaint to the appropriate police authorities against the entity or persons involved in the multilevel marketing scheme. "multilevel marketing scheme" means any scheme or programme or arrangement or plan (by whatever name called) for the purpose of soliciting and procuring insurance business through persons not authorised for the said purpose with or without consideration of whole or part of commission or remuneration earned through such solicitation and procurement and includes enrolment of persons into a multilevel chain for the said purpose either directly or indirectly.

6.4.12 Policy not to be called in question after three years (Section 45)

No policy of life insurance shall be called in question on any ground whatsoever after the expiry of three years from the date of the policy, i.e., from the date of issuance of the policy or the date of commencement of risk or the date of revival of the policy or the date of the rider to the policy, whichever is later. A policy of life insurance may be called in question at any time within three years from the date of issuance of the policy or the date of commencement of risk or the date of revival of the policy or the date of the rider to the policy, whichever is later, on the ground of fraud. The insurer shall have to communicate in writing to the insured or the legal representatives or nominees or assignees of the insured the grounds and materials on which such decision are based.

A policy of life insurance may be called in question at any time within three years from the date of issuance of the policy or the date of commencement of risk or the date of revival of the policy or the date of the rider to the policy, whichever is later, on the ground that any statement of or suppression of a fact material to the expectancy of the life of the insured was incorrectly made in the proposal or other document on the basis of which the policy was issued or revived or rider issued:

Provided that the insurer shall have to communicate in writing to the insured or the legal representatives or nominees or assignees of the insured the grounds and materials on which such decision to repudiate the policy of life insurance is based: Provided further that in case of repudiation of the policy on the ground of misstatement or suppression of a material fact, and not on the ground of fraud, the premiums

collected on the policy till the date of repudiation shall be paid to the insured or the legal representatives or nominees or assignees of the insured within a period of ninety days from the date of such repudiation.

Explanation: For the purposes of this sub-section, the misstatement of or suppression of fact shall not be considered material unless it has a direct bearing on the risk undertaken by the insurer, the onus is on the insurer to show that had the insurer been aware of the said fact no life insurance policy would have been issued to the insured.

Nothing in this section shall prevent the insurer from calling for proof of agent 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.

6.4.13 Agent/intermediary not to be a director (Section 48A)

No insurance agent or intermediary or insurance intermediary shall be eligible to be or remain a director in insurance company. Any director holding office at the commencement of the Insurance Laws (Amendment) Act, 2015 shall not become ineligible to remain a director by reason of this section until the expiry of six months from the date of commencement of the said Act. The Authority may permit an agent or intermediary or insurance intermediary to be on the Board of an insurance company subject to such conditions or restrictions as it may impose to protect the interest of policyholders or to avoid conflict of interest.

6.4.14 Prohibition of business on dividing business (Section 52)

No insurer shall commence 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 result of a distribution of certain sums amongst policies becoming claims within certain time-limits, or on the principle that the premiums payable by a policyholder depend wholly or partly on the number of policies becoming claims within certain time-limits: This does not 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.

6.4.15 Councils of Life and General Insurance (Section 64C)

On and from the date of commencement of this Act, the existing Life Insurance Council, a representative body of the insurers, who carry on the life insurance business in India; and the existing General Insurance Council, a representative body of insurers, who carry on general, health insurance business and reinsurance in India, shall be deemed to have been constituted as the respective Councils under this Act.

6.4.16 Surveyors or loss assessors (Section 64UM)

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 Laws (Amendment) Act, 2015, unless he possesses such academic qualifications as may be specified by the regulations made under this Act; and is a member of a professional body of surveyors and loss assessors, namely, the Indian Institute of Insurance Surveyors and Loss Assessors. In the case of a firm or company, all the partners or directors or other persons, who may be called upon to make a survey or assess a loss reported, as the case may be, shall fulfill the same requirements. Every surveyor and loss assessor shall comply with the code of conduct in respect of his duties, responsibilities and other professional requirements, as may be specified by the regulations made under the Act.

6.4.17 Assets and liabilities how to be valued (Section 64V)

Assets shall be valued at value not exceeding their market or realisable value and certain assets may be excluded by the Authority in the manner as may be specified by the regulations made in this behalf. A proper value shall be placed on every item of liability of the insurer in the manner as may be specified by the regulations made in this behalf. Every insurer shall furnish to the Authority along with the returns

required to be filed under this Act, 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 each year within such time as may be specified by the regulations.

6.4.18 Sufficiency of assets (Section 64V)

Every insurer and re-insurer shall at all times maintain an excess of value of assets over the amount of liabilities of, not less than fifty per cent of the amount of minimum capital as stated under section 6 and arrived at in the manner specified by the regulations. An insurer or re-insurer, as the case may be, who does not comply with shall be deemed to be insolvent and may be wound-up by the court on an application made by the Authority. The Authority shall by way of regulation made for the purpose, specify a level of solvency margin known as control level of solvency on the breach of which the Authority shall act in accordance with without prejudice to taking of any other remedial measures as deemed fit.

Thus, the amendment Act incorporates enhancements in the Insurance Laws in keeping with the evolving insurance sector scenario and regulatory practices across the globe. The amendments will enable the Regulator to create an operational framework for greater innovation, competition and transparency, to meet the insurance needs of citizens in a more complete and subscriber friendly manner. The amendments are expected to enable the sector to achieve its full growth potential and contribute towards the overall growth of the economy and job creation.

STUDY NOTE : 6

LAWS RELATED TO INSURANCE SECTOR

PART – B: THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY ACT, 1999

This Study Note Includes:

B : 6.1 Introduction

B : 6.2 The Insurance Regulatory and Development Authority Act, 1999

B : 6.3 Function of IRDA

B : 6.4 Important definitions

B : 6.5 Insurance Regulatory and Development Authority of India (Sections 3-12)

B : 6.6 Duties, Powers and Functions of Authority (Section 14)

B : 6.7 FINANCE, ACCOUNTS AND AUDIT: (SECTIONS 15 – 17)

B : 6.8 OTHER MATTERS: (SECTIONS 18 – 32)

B : 6.1 INTRODUCTION

The Insurance Regulatory and Development Authority (IRDA) was established in the year 1999 by the Indian Government, for two significant reasons to safeguard the interest of the policy holders and for the up gradation of the entire insurance sector right from the approach adopted by the existing insurance companies towards their shareholders to the eradication of the shortcomings of the industry. The organization was set up under the guidelines of the Insurance Regulatory and Development Authority Act, 1999. The IRDA Act also carried out a series of amendments to the Act of 1938 and conferred the powers of the Controller of Insurance on the IRDA. The Insurance Laws (Amendment) Act 2015, is expected to remove archaic and redundant provisions in the insurance legislations in India and incorporates certain provisions to provide Insurance Regulatory and Development Authority of India (IRDAI) with the flexibility to discharge its functions more effectively and efficiently. It also provides for enhancement of the foreign investment cap in an Indian Insurance Company from 26% to an explicitly composite limit of 49% with the safeguard of Indian ownership and control.

B : 6.2 INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

IRDA has been authorized to register the new insurance companies in India. The list of new insurance companies also includes the collaborations of the renowned insurance companies overseas with the existing Indian companies. The insurance companies in India are required to approach the Insurance Regulatory and Development Authority for the purpose of renewal of the insurance registration. The Insurance Regulatory and Development Authority are allowed to withdraw registration of the companies and even cancel the registration of a company if required. It is also authorized to modify the registration procedure for a company.

B : 6.3 FUNCTION OF IRDA

The Functions of Insurance Regulatory and Development Authority are as follows:

(a) Nomination by Policyholders.

(b) Settlement of insurance claim.

(c) Practical training for Insurance agents and other intermediaries.

(d) Insurable Interest.

(e) Surrender value of Policyholders.

(f) Code of conduct of Insurance intermediaries.

(g) Assistance in gaining correct information about policies.

(h) Creation of management information system.

(i) Promotion of Self regulation within the insurance sector.

B : 6.4 IMPORTANT DEFINITIONS

(a) Appointed Day: Sec. 2 (a): Appointed day means the date on which the Authority is established under sub -section (1) of Sec – 3.

(b) Authority: Sec. 2 (b): "Authority" means the Insurance Regulatory and Development Authority of India established under Sub-Section (1) of Sec. 3.

(c) Chairperson: Sec. 2 (c): "Chairperson" means the Chairperson of the Authority.

(d) Fund: Sec. 2 (d): "Fund" means the Insurance Regulatory and Development Authority Fund constituted under Sub–Section (1) of Section 16.

(e) Interim Insurance Regulatory Authority: Sec. 2 (e): "Interim Insurance Regulatory Authority" means that Insurance Regulatory Authority set up by the Central Government through Resolution No. 17 (2) /94 Ins – V, dated , the 23rd January, 1996.

(f) Intermediary or Insurance Intermediary: Sec. 2 (f): "Intermediary or Insurance Intermediary" includes insurance brokers, reinsurance brokers, Insurance Consultants, corporate agents, third party administrator, surveyors and loss assessors and such other entities, as may be notified by the Authority from time to time.

(g) Members: Sec. 2 (g) "Member" means a whole time or part-time member of the "Authority" and includes the Chairperson.

B : 6.5 INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY OF INDIA: (SECTIONS 3-12)

The Central Government by notification appoint such Authority in the nature of body corporate enjoying all the characteristics of such entity along with contractual powers.

The Head Office of such Authority is to be decided by the Central Government.

The members of such Authority appointed by the Central Government depending upon their expertise and experience in the field of Insurance, Law, Economic Accountancy, etc.

The member consists of:

(a) Chairman.

(b) Five Whole Time members (maximum)

(c) Four Part – Time members (maximum)

One of these members should have knowledge in Life Insurance, General Insurance and Actuarial Science.

The Chairperson shall hold office for a term of five years until he reaches sixty five years. And he is eligible for re–appointment. A whole time member however can hold office for up to sixty - two years.

Moreover a member can relinquish his membership by giving three month prior notice to the Central Government or he can be removed from office under provision of Sec.6. A member may be removed from office if he became insolvent or insane or convicted for offence involving moral turpitude or illegally established financial interest in the

Authority or acting contrary to public interest.

The remuneration for each member shall be as per prescribed Law.

The chairperson and the Whole–time member shall within two years from the date of appointment, cannot hold office under Central Government or State Government or any Insurance Sector.

All decisions regarding administrative matters are taken by the Chairperson.

The procedural aspect of the meetings of the Authority may be determined by regulations, Resolutions are passed by simple majority and chairperson may use casting vote in case of a tie. In case, chairperson unable to attend any meeting then members attending may appoint chairperson among themselves. Any act of the Authority cannot be invalidated simply because of any defect in appointing a member or procedural irregularity. From time to time, authority may appoint employees and officers for efficiency in their work.

Transfer of Assets, liabilities, etc. of Indian Insurance Regulatory Authority (IIRA) to Insurance Regulatory Development Authority (IRDA) (Section 13)

On any appointed day, all assets and liabilities shall stand transferred from IIRA to IRDA. Here, the assets may be movable or immovable. Along with it also includes attached rights and powers. Before this, books of accounts, documents and other papers are also included.

All contractual obligations entered by IIRA with third parties till before the appointed day shall automatically transferred to IRDA.

Similarly all debts owed to IIRA also stands transferred to IRDA.

Also, legal proceedings including suits whether instituted by or against IIRA shall stand transferred to IRDA.

B : 6.6 DUTIES, POWERS AND FUNCTIONS OF AUTHORITY: (SECTION 14)

The Authority shall have the duty to regulate, control, promote and ensure healthy development of insurance and re–insurance business. The powers and functions of the Authority includes inter-alia:

(a) Issue, modify, cancel, etc, of Registration certificate to the applicant.
(b) Safeguarding the interests of the policyholders like insurable interests, settlement of claim, surrender value of the policy, etc.
(c) Specifying code of conduct of the Surveyors.
(d) Determining qualifications and training aspect of agents and intermediary.
(e) Levying fees and charges for their work.
(f) Conducting investigations and enquiries relating to issues concerning insurance business.
(g) Regulating and controlling business not controlled by Tariff Advisory committee under section 64 of Insurance Act 1938.
(h) Regulatory investment funds by the Insurance Companies.
(i) Regulating maintenance of margin of solvency.
(j) Adjudicating and settling disputes between intermediaries and insurers.
(k) Supervising the functioning of Tariff Advisory Committee.

B : 6.7 FINANCE, ACCOUNTS AND AUDIT: (SECTIONS 15 – 17)

(a) The Central Government grants funds necessary for such Authority. The fund shall be called as "IRDA of India

Fund". And it includes:

(1) Governmental Grants, fees and charges.

(2) Money received by the Authority from other sources specified by the Central Government.

(b) The above funds shall be applied for

(1) meeting salaries and allowances of members, officers and employees of the authority.

(2) meeting other legitimate expenses of the authority.

The 'Authority' has to maintain Books of Accounts and prepare Annual Financial Statements as per norms prescribed by Central Government in consultation with CAG.

The accounts of the 'Authority' shall be audited by the CAG according to their schedule and the expenditure required for such audit has to be borned by the 'Authority'.

Any other person appointed by CAG may enjoy same privileges and have assess to books, documents and other relevant papers.

The certified accounts of the 'Authority' whether audited by CAG or person appointed by CAG, to be put forward to the Central Government and the same be laid before the Parliament by such Union Government.

B : 6.8 OTHER MATTERS: (SECTIONS 18 – 32)

The 'Authority' is bound by the action of the Central Government regarding policy matters. However, the Authority has the leverage of operating independently relating to technical and administrative matters.

The Central Government may if situation warrants like, the Authority persistently defaulting directions of them or in public interest, may supercede the Authority for not more than six month duration, through notification and appointing a person as controller of Insurance under section 2B of the Insurance Act 1938. However, while prior to such notification, doctrine of Natural Justice has to be observed.

From the date of publication of the notification, the chairperson and other members cease to hold office and all powers, functions and duties vests on the Central Government. And also all properties shall vest on the Central Government.

The Central Government may then appoint fresh chairperson and other members before the expiration of the term of the super session. The notification and the Action Taken Report has to be placed before the Parliament at the earlier possible opportunity.

From time to time the Authority has to furnish returns, statements and other particulars regarding to any existing or proposed programme, to the Central Government.

The members and employees of the Authority shall be deemed to be public servants under section 21 of IPC while discharging their official duties. And their actions while performing their official duties are insulated from any legal proceedings, provided they have acted in good faith.

The Authority may by prior notification, establish Insurance Advisory Committee. This Committee consists of twenty-five members (maximum) excluding existing members.

The chairperson shall be the ex-officio chairperson and other existing members shall be ex-officio members of Insurance Advisory Committee. The Committee advices the 'Authority' on various matters, including under Section 26.

The 'Authority' may by general or special order delegate powers and functions to any of its members or officers or employees.

The Central Government may by notification make rules relating to salary and allowances of the members, Annual

Statements of Accounts, matters relating to furnishing of documents under Section 20 (1) and also matters relating to Insurance Advisory Committee under Section 25 (1).

The 'Authority' may after consulting the committee by notification, make regulations particularly addressing the procedural aspect in conducting meetings, determining terms and conditions of the services of the officers and employees, delegating powers to the committee and other miscellaneous matters.

Each rule and regulation made under this Act to be placed before Upper House and Lower House of Parliament for thirty days, while the Parliament is in session.

Each rule or regulation shall be subjected to any modification or amendment within such period.

This Act supplements all existing Acts made with relation to Insurance Business.

The Central Government has right to remove any difficulties or impediments by making notification in the Official Gazette within two years from the appointed da y.

Section 30 deals with various amendments made with respect to Insurance Act 1938 stated in the First Schedule.

Section 31 deals with amendments made with respect to Life Corporation of India Act 1956 and which is specified in the Second Schedule. Section 32 deals with various amendments made in General Insurance Business (Nationalisation) Act 1972 which were specified in the Third Schedule.

Self Assessment Questions

1. Explain the historical perspectives leading to enactment of the Insurance Act, 1938.
2. Explain the salient features of the Insurance Law (Amendment) Act, 2015.
3. What are the provisions regarding Foreign Direct Investment in insurance sector in India.
4. Explain the provisions regarding appointment of Insurance Agents under the Insurance Act, 1938.
5. Write short notes on:
    a. Controller of insurance.
    b. Insurance Agent.
6. Explain the powers and functions of IRDA.
7. Write short notes on the following:
    a. General Insurance business.
    b. Health Insurance business.
    c. Life Insurance business.
8. Explain the term 'Re-insurance' and provisions with regard 'Re-insurance' under the Insurance Act, 1938.

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STUDY NOTE : 7

CORPORATE GOVERNANCE

This Study Note Includes:

7.1 Overview-Issues and Concepts

7.2 Corporate Governance Practices/Codes in India

7.3 Corporate governance in family business

7.4 Corporate governance in state-owned business – the MOU system

7.1 OVERVIEW-ISSUES AND CONCEPTS

Corporate Governance (CG) refers to the set of policies that are created for directing a company on the tenets of accountability, transparency's and ethical practices. It is an overview of rules and regulations for the people in-charge for regulating the functioning of the company with the objective of enhancing its value.

The state of corporate governance can have an important effect on the availability and cost of capital for companies and good corporate governance of companies is essential for fostering financial stability and healthy economic growth. Good corporate governance frameworks help firms and countries improve accountability, more efficiently use capital and attract quality and long term investors at lower costs. These, in turn, contribute to a country's competitiveness and thereby its development.

Corporate Governance has been gaining momentum across the world due to various corporate failures, unethical business practices and insufficient disclosure etc.

The topic of Corporate Governance has gained attention since the 1980's and more so after the code of corporate governance issued by the Cadbury committee. In line with the Cadbury committee, the Kumara Mangalam Birla Committee in India suggested a code of corporate governance for companies in India. According to the Kumara Mangalam Birla Committee:

"Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting."

The governance structure of a country protects the investors from expropriation by managers and large shareholders. In different jurisdictions, rules protecting investors come from different sources, including company, security, bankruptcy, takeover and competition laws and also from stock exchange regulations and accounting standards.

7.1.1 Legal Framework of Corporate Governance

The companies in India have to comply with the provisions of the Companies Act, 2013 the SEBI guidelines, the Kumara Mangalam Birla report on corporate governance, the Accounting Standards issued by the ICAI and the listing agreements with the stock exchanges in which they are listed. The Companies Act, 2013 is the relevant statute in India that governs the incorporation and, functioning of the companies. The ordinary business activities like declaration of dividends, appointment of directors, acceptance of the financial statements and appointment of auditors requires the consent of 51% of the shareholders, whereas all other business activities (other than routine business activities) requires the approval of 75% of the shareholders. If a company wants to start a new business it requires the approval of 75% shareholders,

which means that the board of a widely held company should be able to persuade the shareholders about their strategy to pass the special resolution. Whereas, the board of a closely held company will not find it difficult to pass such a resolution, because the shareholders are usually the managers in such cases.

However the Kumara Mangalam Birla report (KMB report) required that in case of appointment/ reappointment of directors, shareholders should be provided a resume, information regarding functional expertise and number of directorships held in other companies. KMB report mentioned that the board shall consist of at least 50% of non-executive directors. And if the chairman is an executive director then at least half of the board of directors shall be independent and in other case at least one-third of the total directors shall be independent. The KMB report has taken a more stringent view that the directors shall not be members of more than 10 committees or chairman of more than 5 committees across all companies.

The remuneration payable to managerial personnel under the Act, if there is only one such person, shall not exceed 5% of its net profit and in case of more than one managerial personnel it shall not exceed 10% of its net profit except with prior permission of the Central Government. In case of companies, which incurred a loss in the current financial year the limits on the salaries and perquisites to be paid to the Managing personnel.

The minority shareholders are protected under the Act and the members holding at least 10% of the share capital can make an application for relief to the concerned authorities in the cases of oppression and mismanagement. The minority shareholders have a provision to appoint representative director on the board. There is no special provision under the companies to protect the creditors. If the company makes default then the creditors have to move the civil court for realization of dues, which demands more time and money to be spent around the courts.

The Securitization and Reconstruction of Financial Assets and Enforcement of Securities Act, 2002 [SARFAESI Act] was enacted to regulate securitization and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The Institute of Chartered Accountants of India is the concerned authority to issue Accounting Standards, which are mandatory in most of the cases. These Standards provide guidelines for disclosures of financial information to ensure uniformity between companies.

The Securities and Exchange Board of India is the regulatory authority, which issues regulations, rules and guidelines to companies to ensure protection of investors. The companies whose shares are listed on the stock exchanges should comply with additional requirements as mentioned in the listing agreement on a regular basis.

7.1.2 Pre-liberalization

During the initial years Indian organizations were bound by colonial rules and most of the rules and regulations catered to the whims and fancies of the British Employers. The companies act was introduced in the year 1866 and was gradually revised in 1882, 1913 and 1932. Indian Partnership act was introduced for the first time in 1932. The various agendas which were on its focus were managing agency model to corporate affair as individuals/business firms entered into legal contract with joint stock companies. It was characterized by abuse/misuse of responsibilities by managing agent due to dispersed ownership. The issues of profit generation and control were dilapidated leading to various conflicts.

The period of 1950s and 1960s was a period of setting up of industrial activities and cost plus regime. The genesis was the demand for very many products for which the Government administered Fair Prices. This was the time when the Tariff Commission and the Bureau of Industrial Costs and Prices were set up by the Govt. 1951 – India's development Regulation Act 1956 – Companies Act came into existence. Development and Banking institutions came into existence. The period between 70's to mid eighties was an era of Cost, Volume and Profit analysis, as an integral part of the Cost Accounting function.

7.1.3 Post-Liberalization

After liberalization, India has been keenly looked upon by the organizations/companies worldwide for the purpose of creating new markets. Progressive firms in India have made an attempt to put the systems of good corporate governance in place. There have been number of discussions and events leading to

the development of Corporate Governance. The basic minimal code for corporate governance was proposed by the Chamber of Indian Industries (CII), 1998. The guiding definition proposed by CII:

"Corporate Governance deals with laws, procedures, practices and implicit rules that determines a company's ability to take managerial decisions vis-a-vis its claimants – in particular its shareholders, creditors, customers, the state and the employees."

7.1.4 The First Phase of India's Corporate Governance Reforms : 1996-2008

India's corporate governance reform efforts were initiated by corporate industry groups, many of which were instrumental in advocating for and drafting corporate governance guidelines. Following vigorous advocacy by industry groups, SEBI proceeded to adopt considerable corporate governance reforms. The first phase of India's corporate governance reforms were aimed at making boards and audit committees more independent, powerful and focused monitors of management as well as aiding shareholders, including institutional and foreign investors, in monitoring management. These reform efforts were channeled through a number of different paths with both SEBI and the MCA playing important roles.

7.1.4.1 1998 - Confederation of Indian Industry (CII) - Desirable Corporate Governance – A Code

In 1996, CII took a special initiative on corporate governance, the first institutional initiative in Indian Industry. The objective was to develop and promote a code for companies, be in private sector, public sectors, Banks or financial Institutions, all of which are corporate entities. The initiatives by CII flowed from Public concerns regarding the protection of investor interest, especially the small investor; the promotion of transparency within business and industry; the need to move towards international standards in terms of disclosure of information by the corporate sector, and through all of this to develop a high level of public confidence in business and industry. The completed final draft of this code came out in April 1998.

7.1.4.2 1999- Report of the Committee (Kumar Manglam Birla) on Corporate Governance

SEBI, appointed Kumar Manglam Birla – as chairman to give a comprehensive view of the issues related to insider trading to protect the rights of various stakeholders. The heart of the committee's report is the set of recommendations which distinguishes the responsibilities and obligations of the board and the management in instituting the systems for good corporate governance and emphasizes the rights of shareholders in demanding corporate governance. Many of the recommendations are mandatory. These recommendations are expected to be enforced on the listed companies for initial and continuing disclosures in a phased manner within specified dates, through the listing agreement. The companies will also be required to disclose separately in their annual reports, a report on corporate governance delineating the steps they have taken to comply with the recommendations of the committee. These will enable shareholders to know, where the companies, in which they have invested, stand with respect to specific initiatives taken to ensure robust corporate governance.

7.1.4.3 November 2000 - Report of the task force on Corporate Excellence through Governance

Department of Company Affairs (now MCA), prepared a report on achieving corporate excellence through governance. Depending upon the size and capabilities of the companies as well the requirements of the market place, the task force recommended phased implementations of the essential measures.

7.1.4.4 2000 - Enactment of Clause 49

Shortly after introduction of the CII Code, SEBI appointed the Committee on Corporate Governance (the Birla Committee). In 1999, the Birla Committee submitted a report to SEBI to promote and raise the standard of Corporate Governance for listed companies. The Birla Committee's recommendations were primarily focused on two fundamental goals improving the function and structure of company boards and increasing disclosure to shareholders. With respect to company boards, the committee made specific recommendations regarding board representation and independence that have persisted to date in Clause 49. The committee also recognized the importance of audit committees and made many specific recommendations regarding the function and constitution of board audit committees. The Birla Committee also made several recommendations regarding disclosure and transparency issues, in particular with respect to information provided to shareholders. Among other recommendations, the

Birla Committee stated that a company's annual report to shareholders should contain a Management Discussion and Analysis (MD&A) section and that companies should transmit certain information, such as quarterly reports and analyst presentations, to shareholders.

SEBI implemented the Birla Committee's proposals less than five months later, in February 2000. At that time, SEBI revised its Listing Agreement to incorporate the recommendations of the country's new code on corporate governance. These rules contained in Clause 49, a new section of the Listing Agreement took effect in phases between 2000 and 2003. The reforms applied first to newly listed and large companies, then to smaller companies and eventually to the vast majority of listed companies.

7.1.4.5 March 2001 – RBI – Report of the advisory group on Corporate Governance: Standing Committee on International Financial Standards and Code

The governance mechanism differs in each country and is shaped by its political, economic and social history as also by its legal framework. With keen interest shown by organizations like World Bank, Asian Development Bank etc., Organization for Economic Cooperation and Development (OECD) developed a set of principles of Corporate Governance which are internationally recognized to serve as good benchmarks.

They are discussed below:

(a) The Basis of an Effective Corporate Governance Framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law, and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

(b) Rights of Shareholders and Key Ownership Functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights. Seven core principles in this category spell out the various rights of shareholders and call for effective shareholder participation in key corporate governance decisions.

(c) Equitable Treatment of Shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

(d) Role of Stakeholders in Corporate Governance

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and should encourage active cooperation between corporations and stakeholders in creating wealth, jobs and sustainability of financially sound enterprises.

(e) Disclosure and Transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters with respect to the corporation, including the financial situation, performance, ownership, and governance of the company.

(f) Responsibilities of the Board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board and the board's accountability to the company and the shareholders.

The advisory group on CG attempted to compare the status of corporate governance in India vis-a-vis the internationally recognized best standards and suggested to improve corporate governance

standards in India.

7.1.4.6 April 2001 – RBI – Report of the consultative Group of Directors of Banks/Financial Institutions

The Consultative group of directors of banks and financial institutions was set up by reserve bank to review the supervisory role of boards of banks and financial institutions and to obtain feedback on the functioning of the boards vis-a-vis compliance, transparency, disclosures, audit committees etc and make recommendations for making the role of board of directors more effective with a view to minimizing risks and over exposure. Following the best international practices as recommended by Basel Committee on Banking Supervision, the committee recommended a review of the existing framework governing the constitution of the boards of banks and financial institutions.

7.1.4.7 December 2002 –Report of the committee (Naresh Chandra) on Corporate Audit and Governance Committee

The Department of Company Affairs (DCA) under the ministry of finance and company affairs appointed a committee under the chairmanship of Naresh Chandra to examine various corporate governance issues. The committee took upon the task to analyze, and recommend changes in diverse areas like: the statuary auditor, company relationship, procedure for appointment of auditors and determination of audit fee, restrictions, if required on non-auditory fee, measures to ensure that management and companies put forth a 'true and fair' statement of financial affairs of company. It also reflected on other measures such as certification of accounts and financial statement by the management and directors. The committee intended to study and build upon its report following the benchmarks set by Sarbanes Oxley Law (SOX).

7.1.4.8 February 2003 (N. R. Narayan Murthy) – SEBI report on Corporate Governance

The Securities and Exchange Board of India (SEBI), in its effort to improve the governance standards constituted a committee to study the role of independent directors, related parties, risk management, directorship and director compensation, codes of conduct and financial disclosures. The committee based its recommendations on various parameters like fairness, accountability, transparency, ease of implementation, verifiability and enforceability.

7.1.4.9 July, 2003 (Naresh Chandra Committee II) Report of the committee on regulation of private companies and partnerships

The Companies Act, 1956 had its base in environment encompassing the license and permit raj in India. The act has undergone amendments more than two dozen occasions, keeping in view the various changes in the business environment. As large number of private sector companies was coming into picture there was a need to revisit the law again. In order to build upon this framework, government constituted a committee in January, 2003, to ensure a scientific and rational regulatory environment. The main focus of this report was on:

(a) The Companies Act; 1956.

(b) The Indian Partnership Act, 1932.

The final report was submitted in July 23, 2003.

7.1.4.10 Clause 49 Amendments

The Murthy Committee paid particular attention to the role and responsibilities of audit committees. It recommended that audit committees be composed of financially literate members, provided a greater role for the audit committee and stated that whistleblowers should have access to the audit committee without first having to inform their supervisors. Further, the committee required that companies should annually affirm that they have not denied access to the audit committee or unfairly treated whistleblowers generally.

In 2004, SEBI further amended Clause 49 in response to the Murthy Committee's recommendations.

However, implementation of these changes was delayed until January 1, 2006 due primarily to industry resistance and lack of preparedness to accept such wide-ranging reforms. While there were many changes to Clause 49 as a result of the Murthy Report, governance requirements with respect to corporate boards, audit committees, shareholder disclosure and CEO/CFO certification of internal controls constituted the largest transformation of the governance and disclosure standards of Indian companies.

Clause 49, as currently in effect, includes the following key requirements:

(a) Board: Independence Boards of directors of listed companies must have a minimum number of independent directors. Where the Chairman is an executive or a promoter or related to a promoter or a senior official, then at least one-half the board should comprise independent directors; in other cases, independent directors should constitute at least one-third of the board size.

(b) Audit Committees: Listed companies must have audit committees of the board with a minimum of three directors, two-thirds of whom must be independent; in addition, the roles and responsibilities of the audit committee are specified in detail.

(c) Disclosure: Listed companies must periodically make various disclosures regarding financial and other matters to ensure transparency.

(d) CEO/CFO certification of internal controls: The CEO and CFO of listed companies must:

(i) certify that the financial statements are fair, and

(ii) accept responsibility for internal controls.

(e) Annual Reports: Annual reports of listed companies must carry status reports about compliance with corporate governance norms.

Kotak Committee Recommendation in June, 2017: SEBI had formed a committee for improving standards of corporate governance of listed companies in India under the charimanship of Shri Uday Kotak. Committee made 80 recommendation in October, 2017, which cover composition, role of Board and its Committee, promoter related agreement, enhancing transparancy and disclosure, strenthening financial reporting and audit etc.

SEBI has accepted most of the recommendations, some without and some with modifications. Some recommendations have been referred to other regulatory bodies and the balance have been considered as voluntary compliance. The mandatory compliance comming out of the recommendations are being introduced in phases allowing the companies to implement the changes step by step.

7.1.4.11 OECD Principles of Corporate Governance

(a) In response to a call by its council, the OECD issued the OECD Principles of Corporate Governance in 1999 after extensive consultations. These were later revised in 2004 following a comprehensive survey of corporate governance practices in and outside the OECD area. Since their launch, the principles have formed the basis for corporate governance initiatives in both OECD and non-OECD countries alike. They represent the minimum standard that countries with different traditions have agreed on, being applicable to countries with a civil and common law tradition without being unduly prescriptive.

The principles have been devised with four fundamental concepts in mind: responsibility, accountability, fairness and transparency and enabling diversity of rules and regulations. They outline the following:

(1) the basis for an effective corporate governance framework.

(2) the rights of shareholders.

(3) equitable treatment of shareholders.

(4) the role of stakeholders in corporate governance.

(5) disclosure and transparency, and

(6) the responsibilities of the board.

(b) The 2004 revisions covered four main areas:

(1) a new set of principles on the development of regulatory framework to underpin corporate governance mechanisms for implementation and enforcements.

(2) additional principles to strengthen the exercise of informed ownership by shareholders that call on institutional investors to disclose their corporate governance policies and to strengthen the rights of shareholders when choosing Board members.

(3) strengthened principles to reinforce Board oversight and enhance Board members' independent judgment, and

(4) new and strengthened principles to contain conflicts of interest through enhanced disclosure and transparency (for example, on related party transactions), thus making auditors more accountable to shareholders and promoting auditors' independence.

7.1.5 The Second Phase of Reform: Corporate Governance After Satyam

India's corporate community experienced a significant shock in January 2009 with damaging revelations about board failure and colossal fraud in the financials of Satyam. The Satyam scandal also served as a catalyst for the Indian government to rethink the corporate governance, disclosure, accountability and enforcement mechanisms in place. As described below, Indian regulators and industry groups have advocated for a number of corporate governance reforms to address some of the concerns raised by the Satyam scandal. Industry response shortly after news of the scandal broke, the CII began examining the corporate governance issues arising out of the Satyam scandal. Other industry groups also formed corporate governance and ethics committees to study the impact and lessons of the scandal. In late 2009, a CII task force put forth corporate governance reform recommendations. In its report the CII emphasized the unique nature of the Satyam scandal, noting that 'Satyam is a one-off incident'. The overwhelming majority of corporate India is well run, well regulated and does business in a sound and legal manner.

In addition to the CII, the National Association of Software and Services Companies (NASSCOM, self-described as the premier trade body and the chamber of commerce of the IT-BPO industries in India) also formed a Corporate Governance and Ethics Committee, chaired by N. R. Narayana Murthy, one of the founders of Infosys and a leading figure in Indian corporate governance reforms. The Committee issued its recommendations in mid-2010, focusing on stakeholders in the company. The report emphasizes recommendations related to the audit committee and a whistleblower policy. The report also addresses improving shareholder rights. The Institute of Company Secretaries of India (ICSI) has also put forth a series of corporate governance recommendations. Government response Satyam prompted quick action by both SEBI and the MCA.

7.1.6 SEBI actions

In September 2009 the SEBI Committee on Disclosure and Accounting Standards issued a discussion paper that considered proposals for:

(a) appointment of the Chief Financial Officer (CFO) by the audit committee after assessing the qualifications, experience and background of the candidate.

(b) rotation of audit partners every five years.

(c) voluntary adoption of International Financial Reporting Standards (IFRS).

(d) interim disclosure of balance sheets (audited figures of major heads) on a half-yearly basis, and

(e) streamlining of timelines for submission of various financial statements by listed entities as required under the Listing Agreement.

In early 2010, SEBI amended the Listing Agreement to add provisions related to the appointment of the

CFO by the audit committee and other matters related to financial disclosures. However, other proposals such as rotation of audit partners were not included in the amendment of the Listing Agreement.

7.1.7 MCA actions

Inspired by industry recommendations, including the influential CII recommendations, in late 2009 the MCA released a set of voluntary guidelines for corporate governance. The Voluntary Guidelines address a myriad of corporate governance matters including:

(a) independence of the boards of directors.

(b) responsibilities of the board, the audit committee, auditors, secretarial audits.

(c) mechanisms to encourage and protect whistle blowing.

(d) Important provisions include: Issuance of a formal appointment letter to directors.

(e) Separation of the office of chairman and the CEO.

(f) Institution of a nomination committee for selection of directors.

(g) Limiting the number of companies in which an individual can become a director.

(h) Tenure and remuneration of directors.

(i) Training of directors.

(j) Performance evaluation of directors.

(k) Additional provisions for statutory auditors.

In discussing the voluntary nature of the guidelines, the then Corporate Affairs Secretary, R. Bandyopadhyaya, stated that the MCA did not want to enact a rigid, mandatory law. However, the MCA also indicated that the guidelines are first step and that the option remains open to perhaps move to something more mandatory.

7.1.8 Impact of Clause 49 on IT Governance

Most Indian corporate entities have witnessed a heavy penetration of IT in the running of business processes. Corporate majors have gone in for massive state-of-the-art enterprise resource planning (ERP) implementations across their geographically dispersed business locations, reaping in the bargain online recording of transactions and availability of information at the click of the mouse. Major ERP vendors have come out with India-specific versions to service their expanding Indian clientele. Adding momentum to this development is the increasing offshore (and often intercontinental) acquisitions of business units by most of the top business houses over the last year, in services and manufacturing verticals. The cumulative impact of all these developments boils down to the fact that the road to corporate governance definitely lies through achieving IT governance. Many of the Indian corporate entities have started recognizing the importance of having a Chief Information Officer (CIO) working independently and reporting directly to the board of directors, in place of the traditional reporting structure of working under and reporting to the CFO. This has lent a sense of urgency to giving the IT function its rightful place in the management scheme of things.

IT in Corporate Governance (IT Governance) ensures right decisions and accountability framework for encouraging desirable behaviour in the use of IT. IT Governance reflects broader corporate governance principles while focusing on management and use of IT to achieve corporate performance goals. Because IT outcomes are often hard to measure, firms must assign responsibility for desired outcomes and assess how well they achieve them. IT Governance should not be considered in isolation because IT is linked to other key enterprise assets (i.e. human, financial, intellectual property, physical and relationships). Thus, IT Governance might share mechanisms with other governance processes, thereby coordinating enterprise-wise decision making processes. When a carefully designed and implemented governance structure is

missing there is no harmony and the enterprise is left to chance. Governance should include an approach to exception handling and continuous improvement.

A good corporate governance regime is central to the efficient use of capital. First, it promotes market confidence; helps to attract additional long term capital, both domestic and foreign; and fosters market discipline through appropriate disclosure and transparency. Second, good corporate governance helps to ensure that corporations take into account the interests of a wide range of constituencies, particularly when the board recognizes that corporate social responsibility can mutually benefit the company and its operating environment. Those actions, in turn, help to ensure that corporations operate for the benefit of society as a whole, and induce stable business development and growth, lower risk, and sustainability. The experiences of economic transition and all too frequent financial crises in developing and emerging market economies have confirmed that a weak institutional framework for corporate governance is incompatible with sustainable financial markets and private sector development. As a result, good governance structures are valued increasingly highly by investors, particularly those seeking to diversify their portfolios to include stakes in developing countries. They also mitigate the risks posed by weak institutions. Furthermore it is expected that poor corporate governance is going to a become critical foreign policy issue as cross boarder investors and the importance of securing their rights gain more importance.

7.2 CORPORATE GOVERNANCE PRACTICES / CODES IN INDIA

7.2.1 The Companies Act 2013 - Key Initiatives

The passing of the long awaited Companies Act in 2013 is probably the single most important development in India's history of corporate legislation. While significant improvements have been effected in required standards of corporate governance, there is also some concern regarding overly increasing compliance and regulatory costs and efforts for companies as well as their independent directors. Among the major provisions of the Act are those of restraining voting rights of interested shareholders on related party transactions, recognition of board accountability to stakeholders besides shareholders, and extension of several good governance requirements to relatively large unlisted corporations.

These initiatives are discussed under five thematic categories, those relating to:

(a) corporations and society.

(b) absentee shareholder primacy and protection.

(c) boards and their processes.

(d) disclosure and transparency in reporting, and

(e) unlisted company governance.

7.2.1.1 Corporations and Society

Two key themes relating to business and society emerge out of the Initiatives: the first concerns obligations relating to Corporate Social Responsibility (CSR) and the second concerns recognition of stakeholders' interests in corporate governance.

(a) **Corporate Social Responsibility**

The positioning of the business corporation in the larger frame of society has been a subject of contentious debate for decades with views ranging from total denial of any corporate responsibility to society as long as operating under prescribed law through to overriding accountability to society on pain of losing the sanction and license to operate, with several shades of mix in between. It is fair to observe, though, that in recent decades, there have been signs of a measure of corporate recognition of some responsibility towards society, as evidenced by increasing number of corporations reporting

on their sustainability Initiatives. The acceptance of social responsibility is arguably embedded in the Indian business psyche although modern day competitive commercialism may have whittled it down in numerous instances; this inherent conviction is reflected in a large number of business people voluntarily engaging in some form of social response based on their perceptions and convictions, even while aggressively pursuing profit objectives and personal gain.

In the arena of government intervention in this domain, virtually every country around the world has a record of activism in varying degrees: this manifests itself in public interest legislation, gentle prodding through guidance for voluntary adoption, or specific mandatory directions imposing an obligation to socially respond as equivalent to taxing business. India has an impressive history of measures in the first two categories and with the 2013 initiatives has also moved towards the third, perhaps the first country to legislate prescriptive social responsibility on corporations.

The Act now requires every company having at least a net worth of ₹ 500 Crores or sales revenue of ₹ 1,000 Crores, or a net profit of ₹ 5 Crores during any year to do the following:

(1) Spend in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, on CSR activities.

(2) Give preference in spending to the local area and areas around it where it operates.

(3) In case of failure achieve the spend target, the Board shall, in its annual report to shareholders, explain the reasons why the required obligation to spend was not met.

(4) The board shall appoint a Corporate Social Responsibility Committee of three or more directors, at least one of them being independent; the Committee, its composition having to be reported in the directors' report to shareholders, is required to:

a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company.

b) recommend the amount of expenditure to be incurred on the activities, and

c) monitor the Corporate Social Responsibility Policy of the company from time to time.

(b) **The Stakeholder Issue**

Closely allied to the CSR debate has been the wider issue of corporate accountability to a range of relevant stakeholders that has been the subject of raging controversy in governance literature. Typical agency theory arguments have always stressed the 'residual claimant' status of shareholders and their risk-bearing as well as rights of allocation of corporate funds among business projects to establish their exclusive primacy in corporate accountability, over other stakeholder claims. On the other hand, protagonists of stakeholder claims have argued that such accountability cannot be the exclusive preserve of the shareholders, given the contribution that others make towards the operations of the corporation.

The 2013 Act makes a significant departure from previous legislative regimes by specific provisions in this regard. Thus, a director of a company is required to act 'in good faith in order to promote the objects of the company for the benefit of its members as a whole and in the best interests of the company, its employees, the shareholders and the community and for the protection of the environment.' This is again reiterated in the Code for Independent Directors which stipulates that independent directors shall 'safeguard the interests of all stakeholders (and) balance the conflicting interest of the stakeholders.'

A company with a financial stakeholder population of more than one thousand shareholders, debenture holders, deposit holders and any other security holders at any time during a financial year is now required to constitute of Stakeholders Relationship Committee as per section 178 of the

Companies Act, 2013 chaired by a non-executive director, to address the grievances of security holders of the company. Companies will still have to grapple with identifying their relevant stakeholders with clarity (for example, under the category 'community') in order to satisfactorily comply with these requirements.

Following this trend, the listing agreement also now mandates that the company should recognize 'the rights of stakeholders that are established by law or through mutual agreements are to be respected,' and 'encourage mechanisms for employee participation.'

7.2.1.2 Absentee Shareholder Primacy and Protection

A major downside of the corporate format from the absentee shareholders' viewpoint is their vulnerability to exploitation by those in operational control, notwithstanding the presence of the board of directors with fiduciary responsibility to protect and promote investor interest. This leads to a more compounded principal-principal problem (besides the traditional principal-agent problem) where some shareholders also do the mantle of controlling managers. Since conventional wisdom favored equality of voting at members' meetings despite apparent (but inevitable) inequalities in their proximity to management control and corporate decision making, such shareholders in control could get their way at members' meetings on matters where they may even be beneficiaries. This is further facilitated by the fact that attendance at members' meetings is usually very limited: individual or small investors may have neither the expertise nor the inclination to get involved (further exacerbated by geographical distances between their location and the meeting venue); institutional investors are generally constrained by costs of such monitoring and participation, or other pressures that interfere with their decision making on such matters. In either case, the result is a marked indifference to actively participate in major decisions at members' meetings, a 'rational reticence' that translates into a willingness to respond to governance proposals but not to proactively propose them.

Clearly, such possibilities also weighed on board members with reservations on some of the contentious management proposals that led them to refrain from acting on their concerns since their efforts were inevitably doomed to be in fructuous when such matters were put to vote at members' meetings. Such an approach on the part of directors, although theoretically untenable, cannot be wished away in practice and needed to be addressed through regulation, an objective the 2013 initiatives have largely met.

(a) **Restraints on Interested Shareholders' Voting Rights**

The most important reform from an investor protection perspective is the salutary provision restraining interested shareholders from voting on resolutions at members' meetings, in which they were interested parties; most related party transactions would fall under this category. First included as a far-ahead-of-its-time recommendation in a 1999 government committee report, this proposal belatedly received laudatory mention (as a "good corporate governance practice") in the Irani Committee report which however stopped short of recommending legislation on the issue. It was to be almost a decade and a half before this incredibly important and eminently equitable proposal for fair governance could find its way into the statute book. Section 188 (1) of the Act dealing with related party transactions now stipulates:

(1) No contract or arrangement shall be entered into except with the prior approval of the company by a special resolution.

(2) No member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party.

(3) These restrictions do not apply to transactions in the ordinary course of business concluded at an 'arm's length' basis (defined as transactions between two related parties conducted as if they were unrelated, so that there is no conflict of interest).

The implications of these provisions are that in case of related party transactions (which are potentially a major source of tunneling by promoters and executive management), those who stand to benefit

would have no say in the voting outcome on such resolutions at members' meetings, and further, a super majority (three-fourths) of the other shareholders would have to vote in favor of such resolutions to have them carried. These are indeed tough conditions and hopefully, will act as effective filters to allow only such proposals as are in the larger interests of the company and all its shareholders to go through to fruition. The concomitant imperative for such measures to succeed in their objective is for all the other shareholders 'negatively impacted' (to borrow a phrase from OECD) to actively participate in the evaluation and voting on such resolutions; institutional shareholders have a key role to perform in this regime, and if they do not measure up to the requirements, they will have only themselves to blame. Proxy advisory services, a rapidly emerging segment in the Indian capital market scene, have also a critical part to play in fairly and impartially counselling and guiding investors on such matters. The category of companies and the threshold materiality levels of such transactions attracting these restraining provisions prescribed by the government cover all listed corporations and other large unlisted public companies. The qualifying thresholds hopefully are such that they would not be too low to inflict disproportionate compliance costs on companies nor too high to allow unduly unfair enrichment of a few at the cost of the many.

Not unexpectedly, such far reaching reforms have had their detractors, some of whom have predicted a 'hung scenario' with managements being paralysed and dis-empowered from performing their legitimate executive functions. What is overlooked in such protestations is the imperative need to pre-empt potential corporate incursions and expropriations so that investor protection could be enhanced. Genuine related party transactions in the overall interests of the company are largely unlikely to be blocked by such minority shareholders, especially considering the migration trends in the country towards institutional shareholding away from too widely dispersed individual shareholdings. It should be possible for companies to carry conviction to such institutional block-holders given their smaller numbers and also their business and commercial expertise.

(b) **Containing Other Private Benefits of Control**

Literature and empirical experience are replete with a breath-taking range of measures and devices that people adopt to benefit themselves from their vantage positions of control, fully justifying the 'invisible hand' prognosis offered by Adam Smith some two-and-a-half centuries ago. While it is impossible to fully eliminate such tunnelling efforts in the corporate format of business, various measures have been adopted from time to time with some limited success. The 2013 Initiative s have added a few more regulatory preventive curbs in this direction. Thus:

(1) Directors and their connected parties may not acquire from or sell to the company any assets for consideration other than cash unless such purchase or sale is approved by members in general meeting. Clearly, most of these would likely be related party transactions and hence at least three-fourths of the other shareholders would have to be convinced that their interests were not adversely impacted to any material extent before they can be persuaded to vote in support of such transactions.

(2) Directors and Key Managerial Personnel may not engage in forward transactions in securities of the company, its holding, subsidiary or associate companies. Already there were provisions prohibiting market trading transactions during time windows before, during and immediately after board meetings where price sensitive matters were to be discussed but the Act provisions go much farther and stipulate among the prohibited dealings:

a) the right to call for delivery or the right to make delivery at specified prices and within a specified time, of a specified number of relevant shares or a specified amount of relevant debentures.

b) the right, at his option, to call for delivery or to make delivery on a similar basis.

(3) Directors and Key Managerial Personnel may not enter into 'insider trading,' defined as:

a) An act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in

any securities by any director or key managerial personnel or any other officer of a company either as a principal or agent if such a person can reasonably be expected to have access to any non-public price sensitive information in respect of securities of a company, or

b) Any act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person.

c) 'Price-sensitive information' has been defined to mean any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company.

d) Substantial penalties prescribed for breach of these provisions will arguably deter potential defaulters but the task of establishing insider trading evidence required for judicial conviction continue as before. The recent success stories of purposeful prosecution in the US, including in the case involving Rajat Gupta and Raj Rajratnam are useful pointers towards the pressing need for meticulous investigation and committed independent agencies (including experienced prosecutors) as well as suitable enabling legislative sanction to aid them in their efforts.

(c) **Containing the Perils of Pyramiding**

A common instrument of entrenchment and for enhancement of private benefits of control is the phenomenon of pyramiding that enables control of large economic empires with relatively limited investment and risk at the top. The Act now limits the investment tiers to no more than two layers, thereby limiting the potential for abuse of this structural mechanism. Due provisions have been made to exempt foreign company acquisitions from these restrictions.

Extensive pyramiding comprising constituent entities with varying levels of equity holdings by the promoters exposes corporations to the ills of a range of related party transactions where cash, profits and tangible and intangible assets can be routed away to the disadvantage of absentee shareholders in companies where promoter holdings are comparatively low. This limitation of no more than two layers of investment subsidiaries will help partially in containing the ill effects of tunneling on absentee shareholders.

It has been argued that these provisions are overly restrictive (even draconian) and likely to impair the legitimate freedom of corporations to structure their business operations as they deem appropriate. Clearly, these concerns overlook the basic fact that these restrictions do not apply to business or operational subsidiaries or affiliates, but only to 'investment companies' defined as those 'whose principal business is the acquisition of shares, debentures and other securities.' Besides, several exclusions have already been provided to cater to the specific and compliance needs of different business segments; also, these restrictions do not apply to overseas acquisitions of corporations with more than two layers of investment subsidiaries of their own. It should also be highlighted that non-investment companies in general have the flexibility to invest in other companies up to 60% of their own paid-up capital, reserves and securities premium, or up to 100% of their own free reserves and securities premium whichever is higher. There would thus seem to be substantial flexibility and freedom available to companies even after these restrictions, to structure their investments to their best advantage, but certainly no license as before to engage in unbridled pyramiding to the potential disadvantage of absentee shareholders.

7.2.1.3 Boards and Their Processes

Independent and objective boards committed to the welfare of the company and equitable treatment to all its shareholders is the cornerstone of good corporate governance. The 2013 Initiatives have strengthened many existing regulatory requirements and introduce some new ones too. The overall impact is one of considerably strengthened and more enabled board ambience that should help better performance in the service of the company and all its stakeholders including shareholders.

(a) **On Board Chair – CEO Duality**

In the context of the different roles and requirements of the two positions of board chair (monitoring) and chief executive (execution), best practice standards stipulate their separation. Notwithstanding the strong advocacy of this separation, the US predominantly continues to combine these two roles (with an independent senior or lead director in place as a compromise), although a glacial movement towards separation is noticeable in recent years. Indian regulation has not so far mandated such a requirement for listed companies though many companies have found it attractive to separate if only to qualify for a lower proportion of independent directors on their boards.

The Initiatives, for the first time, prescribe such separation in future in case of all listed and other large public companies. There is no mention however as to whether the board chair has to qualify as an independent director as well. Rather than including this requirement as part of the sections dealing with boards, directors, committees, and meetings, this separation provision is included as part of the sections dealing with Key Managerial Personnel.

There are exceptions provided for as well: this mandate will not apply if the company's Articles provide otherwise; it will not apply if the company operates several lines of business, each with its own chief executive. This latter exemption is presumably based on the distancing theory: as the respective CEOs of the businesses will be in charge of execution, the managing director will be distanced from operational responsibilities and assume an intermediary monitoring role which may not be wholly incompatible with the oversight role of the board chair. Clearly, this view is debatable: what indeed then is the role of such a managing director if he or she is not personally accountable to the board for the company's (as opposed to each constituent business unit's) performance? If the underlying logic of role separation is accepted (as it seems to have been) the exceptions do not seem defensible.

Evolution of these exceptions from the concept to the consummation stage of the legislative process is indicative of the multiple influences that shape the final product, often resulting in dilution of the original intent.

(b) **On Board Composition and Objectivity**

(1) Every listed company (and any other notified class of companies) should have at least three directors qualifying as independent in terms of prescribed criteria.

(2) For the first time, the Act enumerates the qualifying criteria both in affirmative and negative terms. Thus, the person should, in the board's opinion, be one of integrity and possess relevant expertise and experience or should possess such other prescribed qualifications (in other words, should be a 'fit and proper' person).

(3) Among the negative disqualifying criteria are the following:

a) Should not be (or have been) a promoter of the company or its holding, subsidiary or associate company, or related to promoters or directors of the company, its holding, subsidiary or associate companies; nor should he have (or have had) any pecuniary relationship with the company, its holding or subsidiary or associate companies or their promoters or directors during the current or immediately preceding two financial years.

b) None of his relatives should have (or have had) pecuniary relationships or transactions with the company, its holding or subsidiary or associate companies, or directors, amounting to more than 2% or more of its gross turnover or total income or fifty lakhs rupees or such higher amount as may be prescribed, whichever is lower, during the current or immediately preceding two years.

c) Neither he nor any of his relatives:

(4) should be holding (or have held in any of the three immediately preceding financial years) a

position of key managerial personnel, or an employee in the company, its holding, subsidiary or associate company.

(5) should have been an employee, or proprietor or partner in the three immediately preceding financial years, in a firm of auditors, company secretaries in practice, or cost auditors of the company or its holding, subsidiary or associate company; or any legal or consulting firm that has or has had any transaction with the company, its holding, subsidiary or associate company at a remuneration of 10% or more of such firm's gross turnover:

a) Should not, together with his relatives, hold 2% or more of the of the total voting power of the company.

b) Should not have been the CEO or director of any not-for-profit entity that receives 25% or more of its receipts from the company, any of its promoters, directors, its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company.

These extended criteria are an improvement over the extant requirements, both legislative and regulatory, and will hopefully enhance the objectivity potential of the boards.

Clause 49 of the listing agreement takes these requirements a step further: where the positions of board chair are not separated, and where even when separated the incumbent's non-alignment with the interests of the promoters and their associates is not established, the board is required to have one half of its members qualifying as independent.

(c) **On Making Board Independence Count**

Populating the board with a good proportion of independent directors, while certainly helpful in maintaining an appropriate balance and diversity, will by itself not be fully effective if their voice did not count for much in board discussions and decision making processes. It is satisfying to note that the presence of at least one independent director is now necessary under the Initiatives for any resolution to be deemed validly approved at a board meeting called at short notice of less than seven days; if none of the independent directors are present at such meetings, the resolutions will need to be circulated to all directors and will be deemed approved only if ratified by at least one independent director.

A major concern associated with the frustration of the institution of independent directors has been that unscrupulous managements and promoters could get important decisions approved by convening board meetings without reasonable notice and consequently with independent directors not being able to attend. This Initiative will likely minimise the potential for this abuse to some extent.

(d) **On Improving Independent Director Effectiveness**

Considering that external independent directors of large corporations are in most cases people in full time occupation as CEOs or senior directors or in professional practice with heavy demands on their time, concern has often been expressed that such directors may not always be able to devote the time and effort required to do justice to their independent directorships on boards.

Although the Initiatives have set a generous upper limit of twenty companies and of which no more than ten may be public companies (including private companies which are holding or subsidiary companies of public companies) on whose board a director may sit, it is arguably an improvement over the extant situation of virtually unlimited number of directorships overall including exempt directorships as alternates, and in private limited companies that are not holding or subsidiary companies of public companies, unlimited companies, and not-for-profit companies. It is noteworthy that the listing agreement requirements in this regard are more rigorous: the maximum number of listed company directorships has been pared down to seven and in case of serving whole time directors in a listed company, this has been further scaled down to three others. The limits set by the Act, it must be mentioned, still do not cover directorships or equivalents in other entities like Trusts, Cooperative

Societies, Partnerships and other organisational formats where a person may choose to get involved. Clearly there are limits to which legislative or regulatory provisions can (or even should) mandate; it should be up to the company and the individual concerned to evaluate whether the required time and attention would be possible in the circumstances and take an informed call on offering or accepting an additional directorship.

Independent director should be more and more acquainted with the operation and see people work and intract with them. This will help hem to understand the problem of the company.

(e) **On Enhancing Board Independence and Objectivity**

Ideally, board independence cumulatively should be more than the sum of its constituent parts, building on the synergies of individual members' independence and objectivity. Group interaction dynamics and mutual complementarities generally help in achieving this result which defies arithmetical logic, several components in the Initiatives potentially offer help in achieving this very desirable objective. For example:

(1) The Act requires listed companies to have at least a third of their board members qualifying as independent Section 149(6) of the Companies Act, 2013. Inclusion of this requirement in the statute enables wider applicability to larger unlisted companies as well. In case of listed companies, the regulatory requirements are even more rigorous and require a minimum of one half of the board to qualify as independent:

a) where the board chair and CEO positions are combined in one individual; and,

b) even where they are separated, if the non-executive chair happens to be the promoter or his/her relative, or a person related to another person occupying management positions at the board level or one level below:

(2) The provision to have at least one woman director on board Section 149(1) of the Companies Act, 2013 is a welcome initiative in the interests of board diversity, which should have been addressed by companies even without legislation because of not only its equitable claims but more importantly since such diversity enriches board capacity and leads potentially to better decisions.

(3) The Act visualises a term-based appointment of independent directors for a period of five years, renewable (by special resolution) for a similar second term, and not subject to retirement by rotation. This certainty of a reasonably long period in office should provide a measure of stability and continuity to this component of the board which can possibly pursue its agenda more consistently and effectively. Listed companies face stricter conditions: Independent directors who have already served for five years or more (as of October 2014) may now serve for only one more term of up to five years after the expiry of the current term. Although this is a transitional measure, the regulator's urgency in getting higher governance standards in place at the earliest is clearly evident.

(4) An innovative concept has been introduced in the Act to ensure the 'independence' of persons who wish to be re-appointed as such after serving two five year terms. They can be so appointed but only after a 'cool-off' period of three years and, this is important, during the three year break, the independent director 'shall not be appointed in or be associated with the company in any other capacity, either directly or indirectly.' One can only speculate as to why the applicability of this ban was limited to only the 'company' and not to others in the cluster such as 'its holding, subsidiary or associate company, or promoters' and so on as has been specified in so many other sections. If erosion of independence is considered to be a function of proximity and familiarity, as appears to be the case in drafting other sections on independence, it would have been consistent if the same phraseology had been used here as well. Perhaps, this would be covered under the 'directly or indirectly' caveat; maybe, the person would be disqualified anyway under the independence criteria I Section 149 (6) (c), (which holds only for two years and not three) of the Companies Act, 2013.

(5) The Act settles the vexed issue of the independence status of nominee directors on company boards appointed by financial institutions, government and such other bodies. They will not be deemed independent. With this "grey" element of independence now firmly out of the way, the other independent directors could enhance their effectiveness without any inhibition that may have been occasioned by the presence of their nominee colleagues and their influence on board issues.

(6) Executive compensation is an issue that corporate boards around the world are grappling with and the Act appropriately mandates a Nomination and Remuneration Committee (NRC) in all listed companies and other prescribed companies Section 178 of the Companies Act, 2013. By requiring at least one half of the NRC membership to be independent directors, the board is now equipped to play a more active and objective role in determination of CEO and other executive directors' pay and perquisites. Unlike before, boards and in particular their independent directors are in a position to influence these pay packages in the best interests of their companies, without being hamstrung by the debilitating realisation that the promoters will be able to get their way in any case at the members' meeting by virtue of their superior voting strength. With the promoter-CEOs and directors as interested parties restrained from voting on such proposals at shareholders' meetings, it is up to the independent directors to decide on such pay proposals as they feel appropriate and recommend to the other shareholders for their super-majority approval. If conscientiously applied in practice, boards would seem to have been unshackled from any real or imaginary inhibitions to their effectiveness in this matter and provided with an opportunity to display their objective assessment and act in the best interests of the company.

(7) Nomination and Remuneration Committees of listed and other large public companies are required to evolve and disclose their remuneration policies in respect of directors, key management personnel and other employees. Listed companies are required to disclose comprehensive details of remuneration including the break-up between fixed and variable pay, stock options, pension etc. Criteria of compensation to non-executive directors are also required to be published in the Annual Report of the companies. How such statutory and regulatory disclosures measure up to comparable requirements in developed markets like the US can be meaningfully assessed possibly after the first set of such reports by companies become available in mid-to-late 2015.

(8) The company and independent directors are required to "abide by the provisions specified in Schedule IV" of the Act, which provides a detailed Code for independent directors. This incorporates fundamental legal, ethical and procedural principles and best practices that will be of help to directors in their role as trustees and stewards for the company and its shareholders. Many companies provide their own customised Induction Kit to their newly appointed directors; it will be a good refresher to the more experienced directors as well if they are also provided updated versions, preferably with changes highlighted so that everyone on the board is up to speed on what is expected of them both by statute and regulation, and the company and its values.

(9) On the flip side of all these improvements to promote the importance and contribution of independent directors, some would argue the Act has overreached itself in making the institution of independent directors very difficult for the directors to do justice to. By definition, independent directors can only be part time contributors, counsellors and controllers. By and large, they are dependent upon executive management for most of their information inputs. While their trusteeship obligations to the company and its shareholders have long been recognised and established in terms of the broad duties of care and loyalty, their interpretation in many jurisdictions have always been principle-based and not bogged down by any set of inflexible rules. Some of the provisions of the Act tend to tilt the balance towards the latter structured format of do's and don'ts which may hinder rather than help independent directors efficient functioning.

Together with some of the provisions already in place and continued in the Act, the doors to more effective board performance appear to have been thrown open to a large extent. It is up to the boards and their directors to capitalise on this long-awaited opportunity and take their companies' governance to higher standards. And equally, it would be in the long term interest of

the promoters and managements to buy into these improvements and enhance the reputational and hence the market value of their companies.

7.2.1.4 Disclosure and transparency in reporting

The Act has also introduced and strengthened a number of other governance-related requirements; some of these themes are briefly discussed here:

(a) **On Financials, Disclosure and Reporting**

There has been a movement to harmonise Indian accounting Standards with the global Financial Reporting Standards (FRS) for some years now. The Act takes this forward. Schedule III of the Act sets out general instructions for preparation of balance sheet and statement of profit and loss of a company.

(1) Meeting a longstanding demand for overall group financials, holding companies are now mandatorily required to prepare consolidated financials incorporating financials of subsidiaries (including associates and joint ventures), following standard consolidating principles, in addition to their own stand-alone financials; they are also required to attach a separate statement setting out salient features of the financials of the such subsidiaries. There are at least two areas of concern with regard to this otherwise welcome initiative:

a) First, this requirement applies to intermediate holding companies as well, inflicting unnecessary additional costs especially if such entities are wholly-owned or with very few outside shareholders. In fact, at the other extreme, there are jurisdictions that do not even require separate independent audited financials of consolidated unlisted subsidiaries. There is perhaps a good case for granting exemptions from consolidation requirements to such intermediate entities, through subordinate legislation, which are fully owned and/or unlisted.

b) Second, Indian Tax regime does not as yet recognise the ultimate holding company as the exclusive taxable entity for the entire group; due consideration for concomitant tax reforms to in this regard may now be opportune.

(2) Recognising the need to formalise acceptable processes for reopening and restating the financials of a company as a fallout of fraud or mismanagement, the Act specifically provides for both voluntary (limited to three preceding years only) and involuntary (no laid down time limitation) revisiting of earlier financials.

(3) A National Financial Reporting Authority (NFRA) has been created charged with responsibilities for recommending accounting standards and overseeing their compliance by companies. This authority will now subsume the functions of the erstwhile National Advisory Committee on Accounting Standards.74 The government has retained its authority to prescribe accounting standards recommended by the Institute of Chartered Accountants of India (the standard setting authority with jurisdiction over its practicing members for compliance) as reviewed and endorsed by the NFRA.

(4) The financials of the company (including consolidated accounts, if any) are now to be signed by the Chief Financial Officer as well. With this statutory recognition, the CFOs position is vested with both onerous responsibilities and powerful authority to ensure accounting and reporting with integrity and transparency; it would be difficult for a CFO in future to hide behind hierarchical shields such as "acting under instructions of CEO" or "not responsible for certain key aspects of the function," and so on. On the other hand, this provides CFOs a great opportunity to perform according to professional standards and their own value systems in the best interests of the company and all its shareholders.

(5) Reporting requirements in the Directors' annual report to shareholders have been considerably extended by the Act. Thus, there will have to be a CSR Report, an expanded directors' responsibility

statement, a policy statement on criteria of appointment and remuneration of directors, statements on risk management policies and their implementation, on board performance evaluation policy and implementation, on related party transactions, just to mention a few.

(b) **On Audits, Auditors and Oversight**

Audit independence is an important pillar of good governance. Uninterrupted tenures tend to beget a measure of familiarity and complacency that may be injurious to the required levels of independence and objectivity (not unlike in the case of independent directors). Individuals and firms can now be appointed by shareholders of listed companies (on the recommendation of the audit committee and the board) for a fixed term of five years and two such terms of ten years in all respectively. After the expiry of their maximum terms, individual and firms will have to observe a five-year cool-off period before they can be considered for appointment again. There are certain pre-emptive measures to eliminate circumvention of these tenure prescriptions. For example, no firm will be eligible for appointment if they have one or more common partners in the exiting firm.

(1) Audit independence is sought to be further strengthened by requiring a super-majority special resolution to remove an auditor before expiry of the term. The Auditor will have an opportunity to be heard before he can be removed. An auditor resigning before his term is required to file with the Registrar a statement explaining the reasons for his resignation. If a retiring audit firm at the end of its first term is not to be reappointed for a second term, the retiring auditor has the right to make a representation that must be circulated to members, or filed with the Registrar.

(2) As well as protecting the auditor from any victimisation for doing his job, there are also some serious disincentives to pre-empt auditors failing to act professionally and independently as expected. For example, the Company law Tribunal, on its own or on the representation of any concerned person inquire in to and direct the company to change the auditor if it is satisfied that the auditor had acted in a fraudulent manner or abetted and colluded with the directors or the management of the company; in that case, the auditor will be banned from acting as an auditor of any company for a period of five years. The liability for such misdemeanours will impact both the partner concerned and his firm.

(3) Audit independence criteria, disqualifying a person, have also been tightened. For example:

a) A business relationship with the company, or its subsidiary, or its holding or associate company, or subsidiary of the holding company, or an associate company.

b) A relative is a director or employed as key management personnel.

c) A conviction for an offence within the ten years preceding.

d) A subsidiary or associate company or any other form of entity is engaged in prohibited consultancy or specialised services specified in Section 144 of the Act.

(4) The prohibited services set out to include services such as accounting and book keeping, internal audit, investment banking, internal audit, actuarial, investment advisory, management and outsourced financial services. The important point to note is that provision of such prohibited services even by specified associates of the auditor or audit firm will disqualify them for appointment as auditor of a company. Theses associates are:

a) In case of an individual auditor, his relatives or other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by the individual.

b) In case of a firm, the same connections as above, of the firm or any of its partners or through its parent, subsidiary or associate entity, or through any other entity, whatsoever, in which the firm or any partner has significant influence or control, or whose name or trade mark is

used by the firm or any of its partners The underlying objective behind all these complex provisions is simply that the "independent auditor" should not only be actually free from any economic or other influence that may militate against his ability to truly and fairly discharge his reputational obligations to the shareholders who appoint him but also be seen to be so. As in the case of independent directors, economic dependence on the audited company or group is presumed to be a potential factor eroding independence, whether or not such will be the result in every case. Since audit by itself is the least glamorous and remunerative part of an accountant's practice, over time it has been used more as an entry point to more lucrative services such accountants have the competencies to offer; often, audit revenue is reportedly a minor proportion of the revenues generated by other services. Any impairment of such revenues from a company or a group is thus, in theory, vulnerable to independence erosion, which the Act provisions seek to prevent.

c) On auditing practices and competencies, the profession has so far been guided by auditing standards issued by the Institute of Chartered Accountants of India and other international standard setting agencies. The Act now has assumed the authority to set these standards (generated by the professional body and reviewed and recommended by the NFRA) so that they are clothed with legislative sanctity to enable the auditor to meaningfully exercise his right of access to documents and information from the company.

d) NFRA has been vested with the authority to inquire into, and punish if proven, any alleged professional or other misconduct of a chartered accountant or a firm of such chartered accountants. This is a salutary and welcome provision since the extant system of disciplinary jurisdiction over its members being vested in the CA Institute is inherently vulnerable to conflicts of interest, as the Institute was (and is) the authority to conduct qualifying examinations, provide coaching and tuitions to the prospective candidates, certify them as chartered accountants, and also exercise disciplinary jurisdiction over them in case of misconduct. NFRA and its operating bodies by their constitution ought to be independent and broad based (and not limited only to fellow accountants) and hopefully should be able to take unbiased decisions on matters of professional discipline and conduct. In some respects, the concept follows the Public Company Accounting Oversight Board (PCAOB) established in the US as a private not-for-profit corporation under the Sarbanes-Oxley Act of 2002 and the Professional Oversight Board (POB) in the UK created by the Financial Reporting Council in 2006. There are of course significant differences between NFRA (jurisdiction not limited to listed companies) and PCAOB (jurisdiction only over publicly traded company accounts and auditors) or POB (with disciplinary action remaining with professional institutes exclusively). It is noteworthy that in the PCAOB, the five-member board is mandated not to have more than two certified public accountants (with no affiliations or practice for at least two years) and if the board chair is a CPA, he should have been away from active practice for at least five years. A clearer picture of NFRA's operating functions and procedural regimes will emerge once related rules and regulations are formulated, but this initiative is certainly to be commended as a step in the right direction.

(c) **On Prevention of Oppression and Mismanagement**

Extant company legislation already had provisions to protect absentee shareholders against oppression and mismanagement by incumbent management, whether promoter controlled or otherwise. Broadly these protection measures have been retained in the 2013 Initiatives. In addition, for the first time in the country, provision has also been made in the Act for "class" action by affected shareholders against the company, its directors and even against external constituents like statutory auditors or other experts and consultants in respect of any grievances relating to actions or inactions prejudicial to the aggrieved shareholders' interests.

Two key implications of the Act provisions need highlighting:

(1) This remedy available not only to the shareholders but also to 'depositors' of funds in the company.

Depositors have not been specifically defined but 'deposit' has been defined as "receipt of money by way of deposit or loan or in any other form by a company", subject to any exceptions that may be notified.

(2) The remedy is not limited to claims against the company, its board and management but is also extended to cover auditors, experts, consultants and any other persons for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct on their part. How this provision will work out in practice will be watched with great interest, especially given its wide import and application.

The minimum number of shareholders or depositors who can prefer such class action suits is one hundred or a percentage of the class as prescribed from time to time.

While these provisions are welcome as a countervailing measure against possible managerial abuse inimical to the shareholders (and depositors) and also as a reiteration of shareholder primacy over management in such abusive circumstances, one will have to wait and watch to see how these pan out in practice. Whether these will overly constrain managerial enterprise and execution of policies of value to the company and its members in general or whether these will lead to the desired objective of minimising managerial misadventures and malpractices to the detriment of the company and its shareholders, the impact of this well-intended experiment will be watched keenly by all concerned.

7.2.1.5 Unlisted Companies Governance

There is generally an incorrect perception that 'unlisted' or 'closely held' companies are small, mostly family-run and relatively insignificant part of the corporate sector when it comes to policymaking and regulation relating to their governance. Undoubtedly, this group includes a vast proportion of such small and medium size entities but it is also home to several very substantial corporations which qualify as unlisted only by virtue of their ownership structures notwithstanding their revenues, profits, employee population, customer and vendor base, and sourcing of funds from banks and financial institutions. Illustratively, a Reserve Bank of India study of finances of select private limited companies (covering 6.8% of the paid up capital of all private limited companies at work) as of March 2012 indicated that the ratio of total borrowings (including both long and short term funds)to equity was 74.1 to 25.9; in other words, three fourths of the finances of these companies were borrowed from banks and financial institutions, and as such there was nothing strictly private about these companies except their ownership that was closely held. Many of these private limited companies would be joint ventures, wholly owned subsidiaries, venture-capital or other investor assisted units, and so on. Several companies in these groups may well be aspiring for listed status in the near future; ironically, the group would also include companies that preferred to delist from stock exchanges for whatever reason. A major thrust of the Act has been to extend several good governance practices to the unlisted segment of corporate business. As of December 2012, there were 852,957 companies at work comprising 806,666 private limited companies and 66,291 public limited companies; of these, about 6500 (10%) public companies were listed on the two major Indian stock exchanges. Given their predominant contribution to a nation's economy and employment potential, not to mention their extensive use of borrowed funds to sustain their operation, adoption of good corporate governance practices voluntarily or by legislation will likely help to improve their performance and reputational perceptions. Recognising these imperatives, guidelines have already been issued for such companies in Europe and the UK. Due allowance has also been made to minimise the costs of governance by segregating smaller from the relatively larger unlisted companies in these guidelines.

In India, while SEBI over the last decade and more has gradually strengthened regulatory requirements in respect of listed companies, the vast unlisted segment has received virtually no major policy interventions in this regard. The 2013 Act has taken the first steps to bridge this enormous vacuum by extending several good governance practices to the unlisted companies segment.

The Act and the rules framed there under reckon several criteria thresholds for extending application of such governance practices to unlisted companies. Primarily, these are based on paid-up capital and net worth, sales revenue, profits after tax, number of shareholders, deposit holders and debt security holders, and the extent of bank and other borrowings. Threshold levels of course will have to be such that they ensure additional costs of governance are commensurate with desired levels of benefits to the companies themselves and their stakeholders. Exhibit 4 sets out some selected corporate governance requirements extended to unlisted public companies. There are daunting problems ahead: appropriate

capacity building exercises have to be undertaken, both in getting these companies' buy-in to the new measures (based on their value-add to them rather than on threat of punishment for non-compliance) and in enlarging the pool of independent directors, and other key management personnel to take up the relevant responsibilities.

How this interesting experiment works out in practice and to what extent it helps in upgrading the overall standards of corporate governance in the country will be keenly watched by investors, regulators, and company managements not only in India but elsewhere in the developing world as well.

(a) **Indian Corporate Governance Standards - Road Ahead to Achieve the Next Level of Excellence**

Important and pioneering as many of these Initiatives are, there are still miles to go before one can claim, if ever at all, to have scaled commanding heights in governance. Mary Schapiro, the former SEC Chair, very aptly portrayed the scene: 'when you've struggled up the side of an impressive ridge and paused to enjoy your achievement, only to look around and discover another hill ahead, another ascent to undertake'. Without detracting from the considerable merits of the Initiatives already launched, the following further thoughts seem worthy of pursuit if Indian corporate governance standards are to move up the scale to the next level of excellence.

(b) **On Empowering Board Independence**

From an Agency theory perspective, an independent, objective, non-aligned and trustworthy board of directors is an essential building block for the protection of shareholders' interests. Over the last decade and more, regulatory measures have been gradually strengthened to bring about a measure of board independence in case of listed corporations. The Act has also for the first time in Indian corporate legislative history provided a definition of independence and mandated the minimum proportion of directors on company boards who should qualify as independent. But as the Right Honourable Lord Justice Stephen Sedley pointed out a decade and a half ago in a different context, that the rule of law is a "necessary but not a sufficient" condition for a decent society, populating boards with adequate number of independent directors may be necessary but not sufficient to achieve the objective of board independence. One could ask what else needs to be done: clearly, having inducted independent directors on to the board, they should be enabled to act and their voice should count. Two measures might be helpful in this regard:

The quorum requirements for duly constituting a board or committee meeting should be modified to require that at least a minimum number of independent directors should be present bearing the same proportion of independent directors to the total number of board members. Thus if independent directors constitute one half of the board, then one half of the quorum requirement should comprise of such independent directors (rounded up to the next higher integer) or one independent director, whichever is higher, to form a due quorum. This principle of has already been recognised in the Act which lays down at least one independent director must be present at meetings summoned at short notice; what is being suggested is that it should be extended to all meetings and in due proportion.

In terms of approvals at board and committee meetings, the law should be modified to require affirmative votes in favour by at least a majority of independent directors present or participating through video-conferencing before a resolution can be deemed duly approved.

Measures such as these would enable the institution of independent directors to perform its assigned duties and meet expectations. If even after such enabling environment some independent directors do not wish to, or are unable to discharge their duties, they will have only themselves to blame for such failures.

(c) **On Strengthening Audit Independence**

The Act provisions are a significant improvement over extant requirements with regard to ensuring perceived objectivity and independence of audit and the auditors of listed companies. And yet, in search of further excellence in this field, three themes that look promising are explored here.

Auditor independence, to the extent one grants that as an achievable possibility, is vulnerable to erosion for a number of reasons, among them economic dependence, familiarity, complacency and gratitude. The Act sets out and prohibits many relevant situations that may lead to such erosion

of auditor independence. But all these are company-centric disqualifications. They would work well in case of stand-alone companies. But as is well known, dominant ownership by groups (of domestic, multinational or government parentage) is a prominent feature of the Indian corporate sector. It is not unusual for audit firms to be engaged for several companies in the group. While independence-eroding engagements in case of individual and group companies are largely addressed by the Act, appointments as statutory auditors of group companies and their fall-out on audit independence are yet to be fully addressed. If a ten-year ceiling is considered optimal for tenure as auditors without impairing their independence, would it not be a logical extension to compute the ten-year tenure not just for a company but for a group as a whole? In other words, the tenure clock would run from the year where the firm is appointed as statutory auditors for any company in the group; during that period, the same firm can be appointed as auditors for any other company in the group but the end-year will coincide with the tenth year of the first appointment for a group company. After this, a five-year cool off period will be observed before they can return as statutory auditors for companies in the group.

The second relates to any relationships between the auditors and the company or group during the cool-off period of five years before their return as statutory auditors for any company or group company. If the intention of the cool-off period is to achieve a measure of distancing between the parties so that independence levels are restored, it should follow that during that interregnum, the auditor should have no engagements for any kind of professional services with the company or the group. Failing this, the cool-off period has no real significance and may as well be written off as an in fructuous cosmetic measure.

The third relates to the process of appointment of independent auditors. The board (through its audit committee) chooses the auditors and recommends their appointment for shareholders approval. The question that needs addressing is which directors at board and committee meetings, and which shareholders at members' meetings should have the right to participate and vote on the appointment proposal. It would be prudent to remember that the accounts and reports are prepared by the executive and are based on their operations and activities during the period under reporting. Does it stand to reason that the very persons, whose work and financials are to be audited for reporting to the shareholders, should have a say in the appointment of the auditors who would be judging their financials? To stretch the point, would it be a tenable proposition for a defendant or accused in a trial to be given the authority to name a judge of his choice to hear the case? Pursuing this conceptual line of thinking, one could argue that only the independent directors should participate and vote on auditor choice at the audit committee and board meetings and any shareholders in operational control or acting in concert with them need to be barred from participating or voting on resolutions relating to appointment and remuneration of auditors at the general meeting of shareholders. There would of course be strong opposition to these proposals from both the controlling groups and the auditors themselves. The latter's resistance would largely be due to the dislocation and possible diminution in their professional practice but these fears can easily be allayed. All that would happen if these proposals were to go through would be a rejig of companies in the portfolio of the top ten to fifteen audit firms: instead of several group companies in their fold, each of these firms would find themselves having wider dispersal of companies from different groups, which is probably a more independence-promoting solution since their dependence on fewer groups would be diluted.

Controlling shareholders (promoters) would of course be unhappy that their rights as shareholders were being denied if they were not permitted to vote on audit appointments at members' meetings. This argument is not dissimilar to that advanced against the proposal to debar their voting on resolutions where they were interested or related parties; similar reasoning in case of related party transactions that eventually saw their voting rights curtailed by the Act would justify the present proposal as well: their rights as shareholders will not be denied if they were also not in executive management of the company; if they were in such executive management, then they should be open to be audited by a firm not necessarily of their choice. Even now, statutory auditors of public sector enterprises are appointed by the Comptroller and Auditor General of India, a constitutional authority independent of the Executive, and not by the boards or the government exercising their ownership rights as shareholders of those enterprises.

In practice, company managements with good governance will likely have no problem with these proposals. Also, this measure would further help auditors to feel more independent of the executive which can only be a good thing as far as absentee shareholders are concerned.

(d) **On Disclosure and Reporting**

A great deal of work has already been done for improving transparent reporting and disclosure by companies. There is perhaps one area that could do with some further regulatory intervention. This is to do with continuing disclosure of material related party arrangements and shareholder agreements. Current laws require disclosure of such material contracts and so on in the year they take place, or when the company goes for a public issue of its securities. The intention of such disclosure is to reduce asymmetry of information between and among shareholders inter se. If contracts have (as many of them do) continuing relevance to shareholders (including those who became shareholders subsequently), it would seem reasonable to ensure continuing disclosure of such arrangements in the annual reports of the companies. Illustratively, shareholder agreement provisions between joint venture partners or the promoting entrepreneurs may have a continuing relevance to the company's shareholders long after the contracts were entered into.

7.3 CORPORATE GOVERNANCE IN FAMILY BUSINESS

7.3.1 Background

The economic and social importance of family-owned business has become more widely recognized. Internationally these firms are the dominant form of business organization. By definition, a family business is one in which the majority of the stake is held by the person who has established or acquired the company (or by his or her parents, spouse, child or child's direct heir) and at least one representative of the family is involved in the management or administration of the 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.

Family Controlled Businesses included all enterprises that are owned, controlled or drastically influenced by a specific family or families and having a significant dominant position in firms' equity. 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.

Individual and family owned businesses are a vital part of our economy. Many of India's largest and most celebrated companies were nurtured by a small group of promoters and family members.

In India, family businesses range from the small mom-and-pop store (or kirana) to large conglomerates with equally varied business interests. As their growth has skyrocketed, many have stepped outside their zones to acquire companies in new industries and geographies. Their contribution to India's growth is also being increasingly recognised.

In the wake of the Satyam Computers scandal there has been a renewed interest in the management of family owned businesses in India. While that was a case in accounting fraud, bribery and investment in an unrelated family business; and the importance of good governance practises in family run businesses, including the issues of dominant ownership, (lack of) independence of board and collusion with the audit firm; there is, separately a rising concern on the issues pertaining to the succession issues in Indian family run businesses e.g. in the split of the Reliance Group between Anil and Mukesh Ambani after the demise of their father the creator of the group with a charismatic "rags to riches" story and acrimonious public mudsling between them as well as the much publicised debate over the lack of succession plans for Mr Ratan Tata when he turned 70.

7.3.2 Advantages of the Family Businesses over Non-Family Businesses

Family businesses identify a number of positive differences over non-family businesses. These include commitment and passion towards the success of the business, being able to make quick market focused

decisions, having a deep industry knowledge, etc. Some of the advantages that family businesses share over non-family enterprises include the following:

(a) Commitment, Passion and Dedication: It is believed that owners tend to take better care of their businesses as they have greater personal stakes involved. Family businesses are more appreciative of their talent.

(b) Agile decision-making abilities: Not having responsibilities towards any shareholders gives the Indian family businesses greater flexibility in terms of making decisions faster, improving the speed with which they launch new initiatives, change operations, evaluate new business opportunities, etc.

(c) Deep industry insight: Family businesses gain significant experience and expertise as they typically work in one industry for longer durations. This gives them the added advantage of understanding and appreciating the challenges faced in that industry much better than any non-family businesses.

(d) Mutual trust: Family businesses thrive on mutual trust and believe in maintaining long-term relationships by providing a conducive, supportive and trusting work environment.

7.3.3 Disadvantages of the Family Businesses over Non-Family Businesses

(a) Staff recruitment: External talent can be reluctant to join the family businesses as they would not enjoy the same freedom that the other businesses offer.

(b) Raising funds for growth: Access to capital is required to grow and evolve. However, it is difficult to raise the required funds for the family businesses than non-family businesses.

(c) Family conflicts: Conflict among the family members is the major setback for the family businesses.

(d) Ownership vs Management: Separating the ownership from the management and reaching a consensus on the roles of family members in the business are two important issues for the family businesses to address.

7.3.4 Managing Family Businesses – Challenges

In the initial stages, when the company is governed by the founder or his/her children, defiantly many aspects of family and business governance are informal. Any efforts to formalize relate mostly to the business itself by owner manager. First attempts at written policies usually are brief documents that state a general family vision and mission with respect to the company. In this stage founders decide and set their explicit regulation which reflects the personality of these owners and some time according to their social identification.

In the later stage, there is a need to develop a family employment policy to meet the growing needs. The family employment policy sets clear policies on terms and conditions of family employment within the firm. For some families, these rules instruct conditions of entry, retention and the way to exit from the business. The policy also should cover the treatment of family member employees vis-a-vis non-family employees.

In the third stage, fourth and succeeding generations, family businesses can scarcely survive unless full family governance policies are undoubtedly written and communicated within the family and the business, as well as to other outside stakeholders. The document covering all of these policies is commonly called a family constitution. "Family Creed" document expresses the family's ideology regarding the family loyalty to core values, vision, and mission of the business with it heart. It often defines the roles, compositions, and functions of family governance institutions and the company's own governance bodies, such as the shareholders' meeting, the board of directors, senior management position and non executive owners of the business who want to earn dividend only.

Though family businesses have always been in India, managing them has its own unique challenges:

(a) Managing the diverse opinions of family members in the business, solving internal issues and disputes, etc.

(b) Creating clear succession plans between siblings or cousins.

(c) Difficulties the younger generation may face in proving themselves to the former generation.

(d) Differing views between the older generation and the newer generation.

(e) Hiring external staff which may perceive that career advancement, freedom and decision making are solely the purview of family members.

(f) Regular and streamlined access to the capital to help grow and develop the business.

7.3.5 Corporate Governance in Family Business

Corporate governance is a blend of the internal and external corporate governance mechanisms. The external mechanisms include the managerial labour market, the capital market, takeover and legal protections/systems. The internal governance mechanisms include the board of directors and most important is ownership.

The governance of a family firm is in many ways more harsh and complex than the governance of a firm with no family involvement. Family relationships have to be managed in addition to business relationship usually. The investors in companies with controlling family ownership are at risk of unreliable degrees of expropriation, mainly through the family procuring confidential benefits at the price of the other shareholders, including related-party transactions on noncommercial terms and the transfer of the company's assets to other companies owned by the family. Research study of the Italian stock market reveals that the high risk of expropriation connected with concentrated ownership can negatively affect a company's value when the ultimate owner is either the state or a family.

Good corporate governance strengthens and elucidates the activities of the family Controlled firm while improving its competitiveness. Proper functioning and transparency of the roles and responsibilities of all organs in the firm are defiantly in the interest of the owners, other stakeholders and the whole company. But apart from the lengthy systems and processes that one puts in place, it is really the spirit of practice that defines the essence of the concept.

Family businesses range from Cluster Companies and Small and Medium sized companies to large Group of companies that operate in multi range industries and countries. Normally businesses are founded in small level and after the passage of time and getting value for its unique core values and become listed companies.

Some of the well-known family businesses include: Salvatore Ferragamo, Benetton, and Fiat Group in Italy; L'Oreal, Carrefour Group, LVMH, and Michelin in France; Samsung, Hyundai Motor, and LG Group in South Korea; BMW, and Siemens in Germany; Kikkoman, and Ito-Yokado in Japan; Tata, Reliance and Birla Groups in India, and Saigol, Dewan, Mansha and Hashu Groups in Pakistan and finally Ford Motors Co, and Wal-Mart Stores in the United States.

It is also a true fact and proved by research that most family businesses have short life length beyond their founder's stage and that some 95 per cent of family Controlled businesses do not survive to the third generation of ownership. This is often the consequence of a lack of grounding of the subsequent generations to handle the demands of a growing business and a much larger family in fact. Family Controlled Firms can improve their probability of survival by setting the good governance structures and by starting the edifying process of the subsequent generations in this era.

The need for sharp Governance has been amplified due to globalization which brings many opportunities on the cost of bulky risk aspect.

McKinsey studied and demonstrated the value creation process of Good Governance. According to the McKinsey report, investors in emerging markets are willing to pay as much as 30% more for shares in companies with good corporate governance. The report further emphasizes for creating sustainable

corporate and family governance, the first step is to plan for stable ownership, for instance by constraining shareholding rights and by creating exit mechanisms for family shareholders. The second step is to ensure inclusive and action oriented decision making, for which the business can leverage a variety of governance bodies. The last one is to manage the roles of family members in the business, which requires striking a balance between management and shareholding roles.

7.3.6 Governance Issues - Family Owned Business

Some of the Governance Issues that crop up in Family Owned Business are discussed below:

7.3.6.1 Role of the Board of Directors

Constitution of the Board place an important role in managing the Family Owned Businesses. The Board is expected to takes independent/unbiased decisions and the board members are the 'trustees' of the shareholders, especially the minority group. They should be in a position to provide transparent data and take decisions in the best interest of the shareholders.

When it comes to board membership, most family Controlled businesses reserve this right to members of the family and in a few cases to some well trusted non-family managers. This practice is generally used to keep family control over the direction of its business. Indeed, most decisions are usually taken by the family member directors. Family directors who are also managers in the business would naturally encourage reinvesting profits in the company so as to increase its growth potential. On the contrary, family directors who do not work in the business would rather make the decision of distributing the profits as dividends to family shareholders. These gainsay views can lead to major conflicts in the board and negatively impact its way of functioning.

7.3.6.2 Role of the CEO

In selecting the CEO of a company, one should want the organization to be run by the 'most competent' person with professional knowledge and experience.

Being employee of firm the CEO has accountability and responsibility to the organization and its shareholders. He or she should be able to be questioned by an 'independent' authority called the Board or Chairperson of the company. In a worst case situation if found unsuitable, he/she is asked to relinquish the position.

Practically, it is when the CEO is a family member; this becomes quite difficult and awkward which can create further unsuitable problems for management and as a whole business. This family CEO believes that being owner of majority share owner he has full right for different experiments as well to do according to their force.

7.3.6.3 Succession Plan

A change of guard or succession is a complex and stressful event for any business and in the case of family businesses it gets extra complicated.

On family business, there is a saying, "the first generation creates, the second inherits and the third destroys". Two words 'succession planning' seem so simple and easy to follow and yet it is so difficult because it means coming to terms with the fact that you are not indispensable.

7.3.6.4 Internal Control Formation

Weaknesses in Corporate governance structures of family businesses are most evident in internal controls, implementation of effective internal audit and realization of risk management. Since many families Controlled businesses are managed by the founders or their children, with their close supervisor the control environment is largely customized to their needs and according to their indulgent.

The problem come when controls do not grow along with the company, as the businesses grow with the

passage of time and situation becomes more complex. This space is a crucial spot of concern for external investors for their decision making and long term survival.

7.3.7 Family Constitution

Weaknesses Family constitution is a living document that evolves as the family and its business continue to grow. As a consequence, it is necessary to regularly update the constitution in order to reflect any changes in the family and/or the business.

In fact most family businesses don't have an appropriate constitution, they usually have an informal set of rules and customs that determine the rights, obligations, and expectations of family members and other governance bodies of the business. With the growth of family business, it becomes crucial to develop a written and formal constitution that is shared among all family members to shun the conflict among family members.

Family governance structures and institutions require a certain degree of formalization if they are to function well. As families adopt policies on the family's approach to the business and on governing the business, they will formalize these efforts with documents that will differ depending on their ownership stage.

7.3.8 Certain Challenges Remain

In today's competitive environment, innovation is an essential requirement to survive and thrive. Family businesses in India view continuous innovation as the most challenging aspect over the next five years. Talent issues, technology needs and complying with the regulations are additional challenges that family businesses will have to face over the next five years.

7.3.8.1 Innovation for a Competitive Advantage

According to the surveys conducted recently reveals that the family businesses in India view the need to continually innovate as a key challenge over the next five years. Innovation is critical maintain their relevance in the changing business environments. In order to innovate successfully, they need to combine their new strategies to broader business goals. In addition to this, these companies need to invest in innovation, promote a culture where mistakes are permitted and also instill in the ranks that innovation is crucial to survival.

7.3.8.2 Retaining Talent

This is important for any organisation. Family businesses believe that attracting the right talent and then retaining it is a challenge that will have to be faced in the medium term.

7.3.8.3 Efficient Succession Planning

Mentoring and developing the next generation of successors and leaders is crucial to the success of family businesses. Training and preparing the high-potential members of the staff to take up high-level decision making positions and the ability to survive succession is one of the major challenges awaiting them in the near future.

7.3.8.4 Need for New Technology

Technological advancements are redefining business models, strategies and the changing industry dynamics. Family businesses are acutely aware of the risks their businesses face if they are unable to either adapt to the new technological advancements or bring in new technologies to enhance the quality of products and services. Therefore, they believe that the need to constantly keep up with the fast-paced technology is taking in turning the older business models obsolete and the need to invest time and resources in research and development (R&D).

7.3.8.5 Challenges with Internationalisation

While international markets are exciting and laden with opportunities, there are some issues that the family businesses need to address while increasing their global presence. Indian businesses are aware of these challenges and are treading with caution and measured action. Family businesses consider the following four as their major challenges while conducting international operations:

(a) Exchange rate fluctuations.

(b) Understanding or complying with local regulations.

(c) Competition.

(d) Economic situations in other markets.

7.3.9 Conclusion

Family businesses in India will continue to play an integral part in the nation's growth story. However, with more and more family businesses looking to run their organisations professionally and with the corporates imbibing some of the ingredients which have helped family businesses succeed, the lines between the two categories are getting blurred. Family enterprises are now much more aware of their standing in the larger scheme of things. It is only a matter of time before family businesses start to collaborate rather than compete, and in the process positively influence government policies and actions in their favour. The government also has a crucial role to play in ensuring that fiscal policies as well as domestic systems support family firms. This includes providing a level playing field especially in terms of access to finance.

The ability to innovate and retain talent is likely to be a major challenge for family businesses along with adapting to the new technologies. As far as succession planning is concerned, these businesses are increasingly putting processes and procedures in place in order to ensure a smooth transition. Companies are looking beyond their families and hiring qualified and experienced professionals to manage their businesses. Family-run businesses can continue to be important drivers of India's overall growth if they are given the right support at the right time.

7.4 CORPORATE GOVERNANCE IN STATE-OWNED BUSINESS – THE MOU SYSTEM

7.4.1 Background

Most industrialised economies are characterised by open and competitive markets firmly rooted in the rule of law, with private enterprises as the predominant economic actors. However, in some other countries, including many emerging economies, state-owned enterprises (SOEs) represent a not insubstantial part of GDP, employment and market capitalisation. Even in countries where SOEs play only a minor role in the economy, they are often prevalent in utilities and infrastructure industries, such as energy, transport, telecommunications and in some cases also hydrocarbons and finance, whose performance is of great importance to broad segments of the population and to other parts of the business sector. Consequently, good governance of SOEs is critical to ensure their positive contribution to economic efficiency and competitiveness. Experience shows that market-led development is the most effective model for efficient allocation of resources. A number of countries are in the process of reforming the way in which they organise and manage their SOEs and have in many cases taken international best practices.

7.4.2 In the Global Context

Good governance of state-owned enterprises (SOEs) is essential for efficient and open markets at both the domestic and international level. In many countries SOEs are the main providers of key public services, including public utilities. This means that their operations have an impact on citizens' everyday life and on the competitiveness of the rest of the economy. SOEs are increasingly prominent actors in international markets. Ensuring that they operate in a sound competitive and regulatory environment is crucial to maintaining an open trade and investment environment that underpins economic growth.

7.4.2.1 OECD Guidelines

(a) The OECD Guidelines on Corporate Governance of State-Owned Enterprises (the Guidelines) are recommendations to governments on how to ensure that SOEs operate efficiently, transparently and in an accountable manner. They are the internationally agreed standard for how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention. The Guidelines were first developed in 2005 as a complement to the OECD Principles of Corporate Governance. They have been updated in 2015 to reflect a decade of experience with their implementation and address new issues concerning SOEs in the domestic and international context.

The Guidelines aim to:

(1) professionalise the state as an owner.

(2) make SOEs operate with similar efficiency, transparency and accountability as good practice private enterprises, and

(3) ensure that competition between SOEs and private enterprises, where such occurs, is conducted on a level playing field.

(b) The Guidelines do not address whether certain activities are best placed in public or in private ownership. However, if a government decides to divest SOEs then good corporate governance is an important prerequisite for economically effective privatisation, enhancing SOE valuation and hence bolstering the fiscal proceeds from the privatisation process.

The OECD guidelines focused on the following areas:

(1) Rationales for State Ownership

The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.

(2) The State's Role as an Owner

The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

(3) State-Owned Enterprises in the Marketplace

Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

(4) Equitable Treatment of Shareholders and other Investors

Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognise the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.

(5) Stakeholder Relations and Responsible Business

The state ownership policy should fully recognise SOEs' responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

(6) Disclosure and Transparency

State-owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

(7) The Responsibilities of the Boards of State-Owned Enterprises

The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

7.4.3 In the Indian context

7.4.3.1 The Concept of MOU

In India the Memorandum of Understanding is a negotiated document between the Government, acting as the owner of Public Sector Enterprise (PSE) and a specific PSE. It should contain the intentions, obligations and mutual responsibilities of the Government and the PSE. Further, MOU makes an attempt to move the management of PSEs from management by controls and procedures to management by results and objectives.

7.4.3.2 Institutional Arrangements for Implementing MOU Policy

The present institutional arrangement envisages to put in place an objective and transparent mechanism to evaluate the performance of the managements of the PSEs. It provides a system through which the commitments of both the parties to the MOU can be evaluated at the end of the year besides improving the technical inputs required to finalize the MOUs. The details of this institutional arrangement and their inter-linkages are as follows.

7.4.3.3 High Power Committee

At the apex of this institutional arrangement is the High Power Committee (HPC) consisting of following members:

(a) Cabinet Secretary, Chairman

(b) Finance Secretary, Member

(c) Secretary(Expenditure), Member

(d) Secretary(Planning Commission), Member

(e) Secretary(Programme Implementation), Member

(f) Chairman(Public Enterprises Selection Board), Member

(g) Chief Economic Adviser, Member

(h) Secretary(Public Enterprises), Member-Secretary

The functions of this committee are to review the draft MOUs before the final draft is signed and to make an end-of-the-year evaluation to judge how far the commitments made by both parties of the MOU have been met. Now, the power to approve the final MOUs has been delegated to TF/DPE and only in those cases where TF is not able to take a decision is referred to HPC.

7.4.3.4 Task Force

The main objective behind the creation of a Task Force was to provide technical expertise for MOU negotiations and evaluation. The main functions of the Task Force are to:

(a) examine the design of MOU at the beginning of the year. For this purpose the draft MOU agreed upon by the PSE and the relevant Administrative Ministry is examined by the Task Force. If Task Force has any comments or questions regarding the draft MOUs, they seek clarifications via MOU Division. Once the signatories to MOUs have responded to the concerns expressed by the Task Force on their draft MOUs, the MOU negotiation meetings are organized. These meetings are attended by the executives of PSEs, senior officials of the concerned Administrative Ministry and the representatives from the nodal agencies such as Planning Commission, Ministry of Statistics & Programme Implementation, Ministry of Finance, OCC, etc. The draft MOUs are discussed and finalized during these meetings.

(b) evaluate the determine the composite score for each enterprise at the end of the year.

The Task Force consists of retired civil servants, executives of public sector, management professionals and independent members with considerable experience. It was decided by the High Power Committee that no one belonging to the Government should be a member of this Task Force. This was considered essential to maintain objectivity and credibility of the Task Force.

7.4.3.5 MOU Division

The HPC and Task Force are assisted by the MOU Division in the Department of Public Enterprises. It also acts as the permanent secretariat to this HPC and Task Force. The main functions of this Division are to:

(a) provide logistical, technical and administrative support to the Task Force.

(b) act as buffer between the Task Force members and the two signatories to the MOUs - PSEs and Administrative Ministries.

(c) develop information and data base on MOU signing PSEs.

(d) assist the High Power Committee.

(e) monitor the progress of MOUs.

(f) advise and counsel to the MOU signatories on methodological and conceptual aspects of the MOU policy.

(g) coordinate research and training on various aspects of MOU policy.

(h) **Working of MOU System**

The process of signing of MOU is initiated with the issue of guidelines by the MOU Division for drafting of MOUs. These guidelines indicate the broad structure and the aspects to be covered in the draft MOU including the weights to be assigned to the financial parameters. These guidelines reflect the main concerns of the Government and contain the general direction to the PSEs.

On the basis of these Guidelines, the draft MOUs are prepared by PSEs and submitted to DPE after due discussions in Board and with the concerned Administrative Ministry/Department in the month of December. The draft MOUs received in DPE are examined in detail in consultation with Task Force. During the process of examination of these draft MOUs all possible relevant information/sources of information are utilized to ensure that the targets proposed in the draft documents are realistic. Wherever possible inter-firm comparison is carried out and the proposed targets are viewed in the context of the past performance of the PSE.

7.4.3.6 Objectives of MoU System

The specific objectives of the MoU system are to:

(a) Improve the performance of CPSEs though increased management autonomy.

(b) Remove the haziness in goals and objectives.

(c) Evaluate management performance through objective criteria; and

(d) Provide incentives for better future performance.

7.4.3.7 MOU Negotiation Meetings

Under the present system efforts are made to ensure that all the MOUs are signed well before the beginning of the financial year. In view of this, the draft MOUs submitted by the PSEs are discussed in the MOU negotiation meetings. Besides Task Force members, these meetings are attended by senior officials of the Administrative Ministries, top executives of PSEs and the representatives from the nodal agencies of the Government of India such as Planning Commission, Ministry of Finance & Dept. of Programme Implementation. As mentioned earlier, all possible inputs provided by the professionals, Ministries and the DPE are utilized to finalise the targets. In addition to this the general aspects of existing economic situation relating to the performance of the PSE are also discussed in detail before finalizing the targets. The parameters to measure the performance of the managements of the PSEs are selected after a great deal of thought and the weights are assigned to these performance parameters keeping in view their importance and the nature of operation of the PSE. The targets proposed by the PSEs are discussed freely and are finalized broadly on consensus basis. In fact, the MOU negotiation meeting also provide a forum to discuss certain good practices adopted in other PSEs and in a way these innovative ideas are disseminated through this process. The MOUs finalised during these meetings are signed by the Chief Executive of the PSE and the Secretary of the concerned Ministry before 31st of March.

7.4.3.8 Evaluation of MOU

Performance of MOU signing PSEs is evaluated with reference to their MOU targets twice in a year. First the performance is evaluated on the basis of provisional results and secondly on the basis of audited data. The performance evaluation exercise is also carried out in an extensive manner. As mentioned earlier this performance evaluation exercise is not carried out purely through a mechanical procedure. In fact, at the end of the year the review meetings are held which provides an opportunity to consider the proposals to adjust the criteria values for factors which were not predicted and could not have been predicted by either party. Thus, the MOU evaluation is finalised on the basis of the actual performance and the PSEs are graded as "EXCELLENT", "VERY GOOD", "GOOD", "FAIR" & "POOR".

7.4.3.9 Coverage of PSEs under the MOU System

The MOU system has grown over time from 4 MOUs signed in the year 1987-88, 199 MOU's were signed for the year 2014-2015.

7.4.3.10 Achievements of the MOU System

Viewed in the light of the objectives the effectiveness of the MOU system can be summarised as follows:

(a) The focus, under the MOU system, has shifted to achievements of results.

(b) Operational autonomy has also been encouraged and increased by delegation of more financial and administrative powers to the MOU signing PSEs.

(c) By laying stress on marketing effort and comparing with private sector enterprises MOU are helping PSEs to face competition.

(d) The quarterly performance review (QPR) meetings have become more focused since the introduction of MOUs. Discussion is confined to overall achievement as outlined in the MOUs.

7.4.3.11 Impact on the functioning of the MOU signed CPSEs

The MOU System has had a positive impact on the functioning of the CPSEs by not only increasing the top-and-bottom line performance but also increasing their net worth as stated above. Further, the MOU

System has also enabled the CPSEs to adapt to the business scenario changes that have come about due to the economic liberalization reforms undertaken in the country and the resultant enhanced coupling of India with the global economy.

The MOU system has enabled CPSEs to focus on achievements and results associated with increased operational autonomy and more financial and administrative powers. By laying stress on marketing effort and comparing with private sector enterprises MOU are helping CPSEs to face competition and lay bench marks of corporate performance.

Self Assessment Questions

1) Discuss about the challenges in exercising shareholder rights?

2) Who are the different Stakeholders and what is their role in Corporate Governance?

3) What do you understand by the term 'Corporate Governance' and explain the OECD principles of Corporate Governance.

4) Explain the historical perspectives of Corporate Governance in India with emphasis on second phase reforms of Corporate Governance after 'Satyam' scam.

5) What are the key initiatives of Corporate Governance under the Companies Act, 2013?

6) Explain the major hurdles in implementation of Corporate Governance principles in Family Businesses.

7) Explain the governance issues in Family Owned Businesses.

8) Explain the MoU mechanism in the State Owned Business Enterprises.

9) The governance of a family firm is in many ways different than the governance of a firm with no family involvement – Discuss this statement and state the essentials of Corporate Governance for family owned businesses.

10) Write short notes on:

    1. Role of Independent Director's in Corporate Governance.

    2. Role of Audit Committee in Corporate Governance.

    3. Disclosure and transparency in reporting.

11) Explain the main provisions of Clause 49 of the Listing Agreement with the Stock Exchanges regarding Corporate Governance.

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Study Note - 8

SOCIAL, ENVIRONMENTAL AND ECONOMIC RESPONSIBILITIES OF BUSINESS

This Study Note includes:

8.1 National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business

8.2 Corporate Social Responsibility – Nature of activities; Evaluation of CSR projects

8.3 E-governance

8.1 NATIONAL VOLUNTARY GUIDELINES ON SOCIAL, ENVIRONMENTAL AND ECONOMIC RESPONSIBILITIES OF BUSINESS

Business involvement in social welfare and development has been a tradition in India and its evolution from individuals' charity or philanthropy to Corporate Social Responsibility, Corporate Citizenship and Responsible Business can be seen in the business sector over the years. The concept of parting with a portion of one's surplus wealth for the good of society is neither modern nor a Western import into India. From around 600BC, the merchant was considered an asset to society and was treated with respect and civility as is recorded in the Mahabharata and the Arthashastra. Over the centuries, this strong tradition of charity in almost all the business communities of India has acquired a secular character. Also, many of India's leading businessmen were influenced by Mahatma Gandhi and his theory of trusteeship of wealth contributed liberally to his programmes for removal of untouchability, womens' emancipation and rural reconstruction.

Corporate governance in India gained prominence in the wake of liberalization during the 1990s and was introduced, as a voluntary measure to be adopted by Indian companies. It soon acquired a mandatory status in early 2000s through the introduction of Clause 49 of the Listing Agreement, as all companies (of a certain size) listed on stock exchanges were required to comply with these norms. In late 2009, the Ministry of Corporate Affairs has released a set of voluntary guidelines for corporate governance, which address a myriad corporate governance issues. Thereafter, these guidelines have been refined by the MCA during 2011.

8.1.1 National Voluntary Guidelines 2011

The Guidelines emphasize that businesses have to endeavour to become responsible actors in society, so that their every action leads to sustainable growth and economic development.

These Guidelines have been developed through an extensive consultative process by a Guidelines Drafting Committee (GDC) comprising competent and experienced professionals representing different stakeholder groups. The Guidelines are designed to be used by all businesses irrespective of size, sector or location and therefore touch on the fundamental aspects the 'spirit' of an enterprise. The Guidelines are applicable to all such entities, and are intended to be adopted by them comprehensively, as they raise the bar in a manner that makes their value creating operations sustainable.

The Guidelines have been articulated in the form of nine (9) Principles with the Core Elements to actualize each of the principles. A reading of each Principle, with its attendant Core Elements, should provide a very clear basis for putting that Principle into practice.

8.1.2 Principles and Core Elements

8.1.2.1 Principle 1: Businesses should conduct and govern themselves with Ethics, Transparency and Accountability

The principle recognizes that ethical conduct in all its functions and processes is the cornerstone of responsible business.

The principle acknowledges that business decisions and actions, including those required to operationalize the principles in these Guidelines should be amenable to disclosure and be visible to relevant stakeholders.

The principle emphasizes that businesses should inform all relevant stakeholders of the operating risks and address and redress the issues raised. The principle recognizes that the behavior, decision making styles and actions of the leadership of the business establishes a culture of integrity and ethics throughout the enterprise.

Core Elements

(a) Businesses should develop governance structures, procedures and practices that ensure ethical conduct at all levels and promote the adoption of this principle across its value chain.

(b) Businesses should communicate transparently and assure access to information about their decisions that impact relevant stakeholders.

(c) Businesses should not engage in practices that are abusive, corrupt or anti competition.

(d) Businesses should truthfully discharge their responsibility on financial and other mandatory disclosures.

(e) Businesses should report on the status of their adoption of these Guidelines as suggested in the reporting framework in this document.

(f) Businesses should avoid complicity with the actions of any third party that violates any of the principles contained in these Guidelines.

8.1.2.2 Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle

The principle emphasizes that in order to function effectively and profitably, businesses should work to improve the quality of life of people.

The principle recognizes that all stages of the product life cycle, right from design to final disposal of the goods and services after use, have an impact on society and the environment. Responsible businesses, therefore, should engineer value in their goods and services by keeping in mind these impacts.

Core Elements

(a) Businesses should assure safety and optimal resource use over the life cycle of the product from design to disposal and ensure that everyone connected with itviz., designers, producers, value chain members, customers and recyclers are aware of their responsibilities.

(b) Businesses should raise the consumers' awareness of their rights through education, product labelling, appropriate and helpful marketing communication, full details of contents and composition and promotion of safe usage and disposal of their products and services.

(c) In designing the product, businesses should ensure that the manufacturing processes and technologies required to produce it are resource efficient and sustainable.

(d) Businesses should regularly review and improve upon the process of new technology development, deployment and commercialization, incorporating social, ethical and environmental considerations.

(e) Businesses should recognize and respect the rights of people who may be owners of traditional knowledge and other forms of intellectual property.

(f) Businesses should recognize that over consumption results in unsustainable exploitation of our planet's resources and should therefore promote sustainable consumption, including recycling of resources.

8.1.2.3 Principle 3: Businesses should promote the well being of all employees

The principle encompasses all policies and practices relating to the dignity and wellbeing of employees engaged within a business or in its value chain.

The principle extends to all categories of employees engaged in activities contributing to the business, within or outside of its boundaries and covers work performed by individuals, including sub-contracted and home based work.

Core Elements

a. Businesses should respect the right to freedom of association, participation, collective bargaining and provide access to appropriate grievance redressal mechanisms.

b. Businesses should provide and maintain equal opportunities at the time of recruitment as well as during the course of employment irrespective of caste, creed, gender, race, religion, disability or sexual orientation.

c. Businesses should not use child labour, forced labour or any form of involuntary labour, paid or unpaid.

d. Businesses should take cognizance of the work life balance of its employees, especially that of women.

e. Businesses should provide facilities for the wellbeing of its employees including those with special needs. They should ensure timely payment of fair living wages to meet basic needs and economic security of the employees.

f. Businesses should provide a workplace environment that is safe, hygienic humane and which upholds the dignity of the employees. Business should communicate this provision to their employees and train them on a regular basis.

g. Businesses should ensure continuous skill and competence upgrading of all employees by providing access to necessary learning opportunities, on an equal and non-discriminatory basis. They should promote employee morale and career development through enlightened human resource interventions.

h. Businesses should create systems and practices to ensure a harassment free workplace where employees feel safe and secure in discharging their responsibilities.

8.1.2.4 Principle 4: Businesses should respect the interests of and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized

The principle recognizes that businesses have a responsibility to think and act beyond the interests of its shareholders to include all their stakeholders.

The Principle, while appreciating that all stakeholders are not equally influential or aware, encourages businesses to proactively engage with and respond to those that are disadvantaged, vulnerable and marginalized.

Core Elements

(a) Businesses should systematically identify their stakeholders, understand their concerns, define purpose and scope of engagement, and commit to engaging with them.

(b) Businesses should acknowledge, assume responsibility and be transparent about the impact of their policies, decisions, product & services and associated operations on the stakeholders.

(c) Businesses should give special attention to stakeholders in areas that are underdeveloped.

(d) Businesses should resolve differences with stakeholders in a just, fair and equitable manner.

8.1.2.5 Principle 5: Businesses should respect and promote human rights

The principle recognizes that human rights are the codification and agreement of what it means to treat others with dignity and respect. Over the decades, these have evolved under the headings of civil, political, economic, cultural and social rights. This holistic and widely agreed nature of human rights offers a practical and legitimate framework for business leaders seeking to manage risks, seize business opportunities and compete in a responsible fashion.

The principle imbibes its spirit from the Constitution of India, which through its provisions of Fundamental Rights and Directive Principles of State Policy, enshrines the achievement of human rights for all its citizens. In addition, the principle is in consonance with the Universal Declaration of Human Rights, in the formation of which, India played an active role.

Core Elements

(a) Businesses should understand the human rights content of the Constitution of India, national laws and policies and the content of International Bill of Human Rights. Businesses should appreciate that human rights are inherent, universal, indivisible and interdependent in nature.

(b) Businesses should integrate respect for human rights in management systems, in particular through assessing and managing human rights impacts of operations, and ensuring all individuals impacted by the business have access to grievance mechanisms.

(c) Businesses should recognize and respect the human rights of all relevant stakeholders and groups within and beyond the workplace, including that of communities, consumers and vulnerable and marginalized groups.

(d) Businesses should, within their sphere of influence, promote the awareness and realization of human rights across their value chain.

(e) Businesses should not be complicit with human rights abuses by a third party.

8.1.2.6 Principle 6: Business should respect, protect and make efforts to restore the environment

The principle recognizes that environmental responsibility is a prerequisite for sustainable economic growth and for the well being of society.

The principle emphasizes that environmental issues are interconnected at the local, regional and global levels which makes it imperative for businesses to address issues such as global warming, biodiversity conservation and climate change in a comprehensive and systematic manner.

Core Elements

(a) Businesses should utilize natural and manmade resources in an optimal and responsible manner and ensure the sustainability of resources by reducing, reusing, recycling and managing waste.

(b) Businesses should take measures to check and prevent pollution. They should assess the environmental damage and bear the cost of pollution abatement with due regard to public interest.

(c) Businesses should ensure that benefits arising out of access and commercialization of biological and other natural resources and associated traditional knowledge are shared equitably.

(d) Businesses should continuously seek to improve their environmental performance by adopting cleaner production methods, promoting use of energy efficient and environment friendly technologies and use of renewable energy.

(e) Businesses should develop Environment Management Systems (EMS) and contingency plans and processes that help them in preventing, mitigating and controlling environmental damages and disasters, which may be caused due to their operations or that of a member of its value chain.

(f) Businesses should report their environmental performance, including the assessment of potential environmental risks associated with their operations, to the stakeholders in a fair and transparent manner.

(g) Businesses should proactively persuade and support its value chain to adopt this principle.

8.1.2.7 Principle 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner

The principle recognizes that businesses operate within the specified legislative and policy frameworks prescribed by the Government, which guide their growth and also provide for certain desirable restrictions and boundaries.

The principle acknowledges that in a democratic set-up, such legal frameworks are developed in a collaborative manner with participation of all the stakeholders, including businesses.

The principle, in that context, recognizes the right of businesses to engage with the Government for redressal of a grievance or for influencing public policy and public opinion.

The principle emphasizes that policy advocacy must expand public good rather than diminish it or make it available to a select few.

Core Elements

(a) Businesses, while pursuing policy advocacy, must ensure that their advocacy positions are consistent with the Principles and Core Elements contained in these Guidelines.

(b) To the extent possible, businesses should utilize the trade and industry chambers and associations and other such collective platforms to undertake such policy advocacy.

8.1.2.8 Principle 8: Businesses should support inclusive growth and equitable development

The principle recognizes the challenges of social and economic development faced by India and builds upon the development agenda that has been articulated in the government policies and priorities.

The principle recognizes the value of the energy and enterprise of businesses and encourages them to innovate and contribute to the overall development of the country, especially to that of the disadvantaged, vulnerable and marginalised sections of society.

The principle also emphasizes the need for collaboration amongst businesses, government agencies and civil society in furthering this development agenda. The principle reiterates that business prosperity and inclusive growth and equitable development are interdependent.

Core Elements

(a) Businesses should understand their impact on social and economic development, and respond through appropriate action to minimise the negative impacts.

(b) Businesses should innovate and invest in products, technologies and processes that promote the wellbeing of society.

(c) Businesses should make efforts to complement and support the development priorities at local and national levels, and assure appropriate resettlement and rehabilitation of communities who have been displaced owing to their business operations.

(d) Businesses operating in regions that are underdeveloped should be especially sensitive to local concerns.

8.1.2.9 Principle 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner

This principle is based on the fact that the basic aim of a business entity is to provide goods and services to its customers in a manner that creates value for both.

The principle acknowledges that no business entity can exist or survive in the absence of its customers.

The principle recognizes that customers have the freedom of choice in the selection and usage of goods and services and that the enterprises will strive to make available goods that are safe, competitively priced, easy to use and safe to dispose off, for the benefit of their customers.

The principle also recognizes that businesses have an obligation to mitigating the long term adverse impacts that excessive consumption may have on the overall wellbeing of individuals, society and our planet.

Core Elements

(a) Businesses, while serving the needs of their customers, should take into account the overall wellbeing of the customers and that of society.

(b) Businesses should ensure that they do not restrict the freedom of choice and free competition in any manner while designing, promoting and selling their products.

(c) Businesses should disclose all information truthfully and factually, through labelling and other means, including the risks to the individual, to society and to the planet from the use of the products, so that the customers can exercise their freedom to consume in a responsible manner. Where required, businesses should also educate their customers on the safe and responsible usage of their products and services.

(d) Businesses should promote and advertise their products in ways that do not mislead or confuse the consumers or violate any of the principles in these Guidelines.

(e) Businesses should exercise due care and caution while providing goods and services that result in over exploitation of natural resources or lead to excessive conspicuous consumption.

(f) Businesses should provide adequate grievance handling mechanisms to address customer concerns and feedback.

8.1.3 Guidance on Implementation of Principles and Core Elements

Successful implementation of the Principles and Core elements require that all of them need to be integrated and embedded in the core business processes of an enterprise. This requires, specifically that the following actions are taken:

(a) Leadership: The Chairman/CEO/Owner/Manager should play a proactive role in convincing the board/Top Management and staff within the business that adopting these principles is crucial for success. The board and senior management need to ensure that the principles are fully understood across the organization and comprehensively executed.

(b) Integration: These principles and core elements must be embedded in the Business policies and strategies emanating from the core business purpose of the organization. For this to happen, these must align with each business's internal values and/or must provide clear business benefits.

(c) Engagement: Building strong relationships and engaging with stakeholders on a consistent, continuous basis is crucial.

(d) Reporting: Implementation process includes disclosure by companies of their impact on society an environment to their stakeholders.

8.1.4 Business Responsibility Report - Suggested Framework

This report may be presented in three parts as detailed below:

Part-A of the report includes basic information and data about the operations of the business entity so that the reading of the report becomes more contextual and comparable with other similarly placed businesses.

Part-B of the report incorporates the basic parameters on which the business may report their performance. Efforts have been made to keep the reporting simple keeping in view the fact that this framework is equally applicable to the small businesses as well. The report may be prepared in a free format with the basic performance indicators being included in the same. In case the business entity has chosen not to adopt or report on any of the Principles, the same may be stated along with, if possible, the reasons for not doing so.

Part-C of the report incorporates two important aspects on Business Responsibility reporting. Part C-1 is a disclosure on by the business entity on any negative consequences of its operations on the social, environmental and economic fronts. The objective is to encourage the business to report on this aspect in a transparent manner so that it can channelize its efforts to mitigate the same. Part C-2 is aimed at encouraging the business to continuously improve its performance in the area of Business Responsibility.

8.1.5 Road ahead

The first version of the National Voluntary Guidelines on Social, Environmental & Economic Responsibilities of Business (NVGs) were released during 2009 and thereafter refined and released during 2011 by the Ministry of Corporate Affairs.

Further, the International Standards organizations (ISO) issued the International Standard ISO-26000, covering 'Guidance on Social Responsibility' in July 2011.

Since that time, there have been significant international and national developments in the wider sustainable development and business responsibility landscapes that require to be integrated into the NVG framework in a manner that supports their uptake by business.

These voluntary guidelines mark a reversal of the earlier approach, signifying the preference to revert to a voluntary approach as opposed to the more mandatory approach prevalent in the form of Clause 49. However in a parallel process, the key corporate governance norms provided under the Companies Act, 2013 aimed at the corporate governance reforms in India has completed two full cycles - moving from the voluntary to the mandatory and then to the voluntary and now back to the mandatory approach.

However, recently the Government has appointed a two person committee to submit their recommendations in the form of a revised NVG document, by April 2016. The MCA is planning to invite public comments before finalising and releasing the new version of the NVGs.

8.2 CORPORATE SOCIAL RESPONSIBILITY – NATURE OF ACTIVITIES; EVALUATION OF CSR PROJECTS

8.2.1 Introduction

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 Corporate Social Responsibility (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 wellbeing 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 [Ministry of Corporate Affairs (MCA), Corporate Social Responsibility Voluntary Guidelines 2009].

The idea of CSR first came up in 1953 when it became an academic topic in HR Bowen's "Social Responsibilities of the Business". Since then, there has been continuous debate on the concept and its implementation. Although the idea has been around for more than half a century, there is still no clear consensus over its definition.

One of the most contemporary definitions is from the World Bank Group, stating, "Corporate social responsibility" is the commitment of businesses to contribute to sustainable economic development by working with employees, their families, the local community and society at large, to improve their lives in ways that are good for business and for development.

8.2.2 CSR in the global context

While there may be no single universally accepted definition of CSR, each definition that currently exists underpins the impact that businesses have on society at large and the societal expectations of them. Although the roots of CSR lie in philanthropic activities (such as donations, charity, relief work, etc.) of corporations, globally, the concept of CSR has evolved and now encompasses all related concepts such as triple bottom line [Triple bottom line (or otherwise noted as TBL or 3BL) is an accounting framework with three parts: social, environmental (or ecological) and financial.], corporate citizenship, philanthropy, strategic philanthropy, shared value, corporate sustainability and business responsibility. This is evident in some of the definitions presented below:

The European Commission (EC) defines CSR as "the responsibility of enterprises for their impacts on society". To completely meet their social responsibility, enterprises "should have in place a process to integrate social, environmental, ethical human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders"

The World Business Council for Sustainable Development (WBCSD) defines CSR as "the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large."

According to the United Nations Industrial Development Organization (UNIDO), "Corporate social responsibility is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood

as being the way through which a company achieves a balance of economic, environmental and social imperatives (Triple Bottom Line Approach), while at the same time addressing the expectations of shareholders and stakeholders. In this sense it is important to draw a distinction between CSR, which can be a strategic business management concept and charity, sponsorships or philanthropy. Even though the latter can also make a valuable contribution to poverty reduction, will directly enhance the reputation of a company and strengthen its brand, the concept of CSR clearly goes beyond that."

From the above definitions, it is clear that:

(a) The CSR approach is holistic and integrated with the core business strategy for addressing social and environmental impacts of businesses.

(b) CSR needs to address the wellbeing of all stakeholders and not just the company's shareholders.

(c) Philanthropic activities are only a part of CSR, which otherwise constitutes a much larger set of activities entailing strategic business benefits.

8.2.3 CSR in India

CSR in India has traditionally been seen as a philanthropic activity. And in keeping with the Indian tradition, it was an activity that was performed but not deliberated. As a result, there is limited documentation on specific activities related to this concept. However, what was clearly evident that much of this had a national character encapsulated within it, whether it was endowing institutions to actively participating in India's freedom movement, and embedded in the idea of trusteeship.

As some observers have pointed out, the practice of CSR in India still remains within the philanthropic space, but has moved from institutional building (educational, research and cultural) to community development through various projects. Also, with global influences and with communities becoming more active and demanding, there appears to be a discernible trend, that while CSR remains largely restricted to community development, it is getting more strategic in nature (that is, getting linked with business) than philanthropic and a large number of companies are reporting the activities they are undertaking in this space in their official websites, annual reports, sustainability reports and even publishing CSR reports.

The Companies Act, 2013 has introduced the idea of CSR to the forefront and through its 'disclose' or 'explain' mandate, is promoting greater transparency and disclosure. Schedule VII of the Act, which lists out the CSR activities, suggests communities to be the focal point. On the other hand, by discussing a company's relationship to its stakeholders and integrating CSR into its core operations, the rules to the Companies Act, 2013 suggest that CSR needs to go beyond communities and beyond the concept of philanthropy. It will be interesting to observe the ways in which this will translate into action at the ground level and how the understanding of CSR is set to undergo a change.

8.2.4 CSR and sustainability

Sustainability (Corporate Sustainability) is derived from the concept of sustainable development which is defined by the Brundtland Commission as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs". Corporate sustainability essentially refers to the role that companies can play in meeting the agenda of sustainable development and entails a balanced approach to economic progress, social progress and environmental stewardship.

CSR in India tends to focus on what is done with profits after they are made. On the other hand, sustainability is about factoring the social and environmental impacts of conducting business, that is, how profits are made. Hence, much of the Indian practice of CSR is an important component of sustainability or responsible business, which is a larger idea, a fact that is evident from various sustainability frameworks. An interesting case in point is the Naional Voluntary Guidelines (NVGs) for social, environmental and economic responsibilities of business issued by the Ministry of Corporate Affairs in June 2011. Principle eight relating to inclusive development encompasses most of the aspects covered by the CSR clause of the Companies Act, 2013. However, the remaining eight principles relate to other aspects of the business. The United Nations (UN) Global Compact, a widely used sustainability framework has 10 principles covering social, environmental, human rights and governance issues, and what is described as CSR is implicit rather than explicit in these principles.

Globally, the notion of CSR and sustainability seems to be converging, as is evident from the various definitions of CSR put forth by global organisations. The genesis of this convergence can be observed from the preamble to the recently released rules relating to the CSR clause within the Companies Act, 2013 which talks about stakeholders and integrating it with the social, environmental and economic objectives, all of which constitute the idea of a triple bottom line approach. It is also acknowledged in the Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises issued by the Department of Public Enterpirses (DPE) in April 2013. The new guidelines, which have replaced two existing separate guidelines on CSR and sustainable development, issued in 2010 and 2011 respectively, mentions the following:

"Since CSR and sustainability are so closely entwined, it can be said that CSR and sustainability is a company's commitment to its stakeholders to conduct business in an economically, socially and environmentally sustainable manner that is transparent and ethical."

8.2.5 Benefits of CSR programme

As the business environment gets increasingly complex and stakeholders become vocal about their expectations, good CSR practices can only bring in greater benefits, some of which are as follows:

(a) Communities provide the licence to operate: Apart from internal drivers such as values and ethos, some of the key stakeholders that influence corporate behaviour include governments (through laws and regulations), investors and customers. In India, a fourth and increasingly important stakeholder is the community and many companies have started realising that the 'licence to operate' is no longer given by governments alone, but communities that are impacted by a company's business operations. Thus, a robust CSR programme that meets the aspirations of these communities not only provides them with the licence to operate, but also to maintain the licence, thereby precluding the 'trust deficit'.

(b) Attracting and retaining employees: Several human resource studies have linked a company's ability to attract, retain and motivate employees with their CSR commitments. Interventions that encourage and enable employees to participate are shown to increase employee morale and a sense of belonging to the company.

(c) Communities as suppliers: There are certain innovative CSR initiatives emerging, wherein companies have invested in enhancing community livelihood by incorporating them into their supply chain. This has benefitted communities and increased their income levels, while providing these companies with an additional and secure supply chain.

(d) Enhancing corporate reputation: The traditional benefit of generating goodwill, creating a positive image and branding benefits continue to exist for companies that operate effective CSR programmes. This allows companies to position themselves as responsible corporate citizens.

8.2.6 Global principles and guidelines

A comprehensive guidance for companies pertaining to CSR is available in the form of several globally recognised guidelines, frameworks, principles and tools. It must be noted that most of these guidelines relate to the larger concept of sustainability or business responsibility, in keeping with the fact that these concepts are closely aligned globally with the notion of CSR.

8.2.7 The Companies Act, 2013

The concept of CSR is governed by clause 135 of the Companies Act, 2013. The CSR provisions within the Act is applicable to companies with an annual turnover of ₹1,000 crore and more, or a net worth of ₹500 crore and more, or a net profit of ₹ 5 crore and more. The new rules, which are applicable from the fiscal year 2014-15 onwards, also require companies to set up a CSR committee consisting of their board members, including at least one independent director.

The Act encourages companies to spend at least 2% of their average net profit in the previous three years on CSR activities. In the rules with respect to CSR net profit is defined as the profit before tax as per the books of accounts, excluding profits arising from branches outside India.

8.2.8 CSR Nature of Activities

The Act lists out a set of activities eligible under CSR. Companies may implement these activities taking into account the local conditions after seeking board approval. The indicative activities which can be undertaken by a company under CSR have been specified under Schedule VII of the Act are furnished below:

SCHEDULE VII TO THE COMPANIES ACT, 2013

(Section 135)

Sl. No.	**Activities which may be included by companies in their Corporate Social Responsibility Policies:**
	Activities relating to :
(i)	eradicating extreme hunger and poverty;
(ii)	promotion of education;
(iii)	promoting gender equality and empowering women;
(iv)	reducing child mortality and improving maternal health;
(v)	combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
(vi)	ensuring environmental sustainability;
(vii)	employment enhancing vocational skills;
(viii)	social business projects;
(ix)	contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
(x)	such other matters as may be prescribed.

The main provisions contained in the rules framed under the Companies Act, 2013 stipulated the following:

(a) Surplus arising out of the CSR projects or progammes or activities shall not form part of the business profit of a company.

(b) The company can implement its CSR activities through the following methods:

(1) Directly on its own : This would require adequate manpower and other infrastructure of the company.

(2) Through its own non-profit foundation set-up so as to facilitate this initiative.

(3) Through independently registered non-profit organisations that have a record of at least three years in similar such related activities. They may be implementing agency only or both implementing organisation and beneficiary.

(4) Collaborating or pooling their resources with other companies.

(c) Only CSR activities undertaken in India will be taken into consideration.

(d) Activities meant exclusively for employees and their families will not qualify.

(e) A format for the board report on CSR has been provided which includes amongst others, activity-wise, reasons for spends under 2% of the average net profits of the previous three years and a responsibility statement that the CSR policy, implementation and monitoring process is in compliance with the CSR objectives, in letter and in spirit. This has to be signed by either the CEO, or the MD or a Director of the company and Chairman of the CSR Committee. The report is required to be published in the Annual Report.

8.2.9 Governance

Clause 135 of the Act lays down the guidelines to be followed by companies while developing their CSR programme. The CSR committee will be responsible for preparing a detailed plan on CSR activities, including the expenditure, the type of activities, roles and responsibilities of various stakeholders and a monitoring mechanism for such activities. The CSR committee can also ensure that all the kinds of income accrued to the company by way of CSR activities should be credited back to the community or CSR corpus.

8.2.10 Reporting

The Companies Act, 2013 requires that the board of the company shall, after taking into account the recommendations made by the CSR committee, approve the CSR policy for the company and disclose its contents in their report and also publish the details on the company's official website, if any, in such manner as may be prescribed. If the company fails to spend the prescribed amount, the board, in its report, shall specify the reasons.

8.2.11 Evaluation of CSR Projects

The first step towards formalising CSR projects in a corporate structure is the constitution of a CSR committee as per the specifications provided under Section 135 of the Companies Act, 2013.

Section 135 of the Companies Act, 2013 requires a CSR committee to be constituted by the board of directors. They will be responsible for preparing a detailed plan of the CSR activities including, decisions regarding the expenditure, the type of activities to be undertaken, roles and responsibilities of the concerned individuals and a monitoring and reporting mechanism. The CSR committee will also be required to ensure that all the income accrued to the company by way of CSR activities is credited back to the CSR corpus.

This is an excellent starting point for any company new to CSR. In case a company already practices CSR, this committee should be set up at the earliest so that it can guide the alignment of the company's activities with the requirements of the Act. For effective implementation, the CSR committee must also oversee the systematic development of a set of processes and guidelines for CSR to deliver its proposed value to the company, including:

(a) one-time processes such as developing the CSR strategy and operationalising the institutional mechanism.

(b) repetitive processes such as the annual CSR policy, due diligence of the implementation partner, project development, project approval, contracting, budgeting and payments, monitoring, impact measurement and reporting and communication.

A set of such enabling processes, their inter-relationships and the sequence in which they need to be developed have been identified below:

Companies do not come under the audit of section 135 also should start CSR capital initiatives. Apart from doing good to the society, once the companies comes under the Audit, it would be easy for the company to adopt.

CSR Process Flow chart				
Step	**Activity**		**Step**	**Activity**
1	Developing a CSR strategy and policy	+	**2**	Operationalising the institutional mechanism
3	Due diligence of the implementation partner	+	**4**	Project development
5	Project approval	+	**6**	Finalising the arrangement with the implementing agency
Project implementation				
	Progress monitoring and reporting			
8	Impact Assessment	+	**9**	Report consolidation and communication
10	Review the policy and procedure based on experience, for future.			

While developing these processes, no standard set of recommendations exist for all companies. However, an overview of the required details, the activities required to be completed for each of these processes along with some additional guidance on critical issues has been provided below:

8.2.12 Table showing the Stepwise Evaluation of CSR Projects

Steps	Purpose	Objective	Process owners	Activities	Inputs	Outputs
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Developing a CSR strategy and policy	The Companies Act, 2013 requires that every company fulfilling the specified criteria, to put out its CSR policy in the public domain. The guidance provided in the Act and the rules on what constitutes a CSR policy are that it should: a) exclude normal business activities of the company. b) contain a list of the CSR projects or programmes which the company plans to undertake during the implementation year.	Developing the CSR strategy and policy.	The CSR committee.	1. Reviewing the past as well as the current CSR activities and examining their alignment with Schedule VII of the Companies Act, 2013. 2. Studying the publicly available information on national and local development priorities. 3. Meeting development experts in the government as well as the NGOs to understand priorities and identifying potential areas of intervention. 4. Conducting internal meetings with business leaders to establish the relevance of potential CSR activities to the company's core business. 5. Studying the good CSR practices of other companies and their achievements. 6. Developing a CSR strategy that defines. 7. For the next three to five years, what the company's CSR activities will cover in terms of: a) vision and mission. b) sectors and issues. c) geographies: states and districts. d) beneficiaries. e) KPIs. 8. Determining the implementation mechanism: a) grant-making or direct implementation. b) institutional mechanism: in-house department, corporate foundation, partnerships with other NGOs. 9. Annually developing a CSR policy in line with the Companies Act, 2013 rules that defines programmes, geographies and budgets for the following financial year, aligned with the strategy and ensuring that the 2% requirement of funds allocation is met. 10. Establish methods for monitoring and reporting.	a) Guidance from the board. b) Companies Act requirements. c) Corporate business strategy, plan and supply chain. d) Development priorities: both, national and wherever the company has business interests.	The CSR policy document and an indication of sectors and issues, geographies and a profile of the beneficiaries.

2. Operationalising the institutional mechanism	In order for a corporate to gain the greatest leverage and a strategic advantage through the investment of intellectual and financial resources, they are required to select their implementation mechanism.	Establishing a legal entity and aligning the accounting, tax, finance, administration, HR and IT systems to deliver the commitments made in the CSR policy.	The CSR committee	1. Selecting the organisation model for the CSR implementation: in-house versus outsourced and its legal entity (trust, society, Section 819 company, in-house department, etc). 2. Identifying the implementation model (grant making, direct project execution, etc). 3. Formalising the job description, the roles and responsibilities and the reporting relationships for the CSR team (whether in-house or in a foundation). 4. Integrating budgeting, procurement, payments and reporting for CSR with the existing finance, administration and IT systems. 5. Analysing accounting systems and chart of accounts and make required changes to record all expenses appropriately. Establish a method of allocation for the expenses (or assets created) that are partly for the CSR and partly for business or employee use.	The CSR strategy	a. creation of a separate legal entity or a CSR department for CSR activities b. other institutional mechanisms to align the accounting, finance, administration, HR and IT systems with CSR activities
3. Due diligence of the implementation partner	Due diligence refers to the process a company undertakes to determine the risks as well as the benefits of working with a potential implementation partner. This process has to be sufficiently robust to ensure that a company's implementation partners have the reputation, competence and integrity to deliver effective programmes on the ground.	Selecting the implementation partner.	The CSR department or Company Foundation.	1. Establishing a due diligence criteria to evaluate the implementation or concept development agency including its incorporation, permits and licenses, systems, processes, public image, management, team deployment, track record, financial soundness, competence level, presence in desired geography, compatibility with company CSR policy and any conflicts of interest. 2. Establishing a due diligence criteria for evaluation and empanelment of private funders for partnership and joint projects. 3. Evaluating the partnership opportunities for its risks and benefits.	a) the CSR strategy and policy. b) discussions with communities, board, staff, other funders, local government officials, local leaders or influencers, auditors. c) studying the books of accounts and the auditor's report.	a) a due diligence report

4. Project development	The CSR strategy of a company will be implemented through a series of projects which will have definite beginnings, ends, expected outputs and outcomes as well as budgets associated with it. These projects may be of a short duration (a few months) or multi-year.	Developing a feasible project proposal.	The implementation agency (the CSR department, company foundation or the NGO partner).	1. Developing a framework to identify key stakeholder groups including the local community, the local government or bodies, academia and research institutions, investors, etc. 2. Conducting a needs assessment (if required) to assess development priorities. The methodology for this can be participatory processes, surveys or a combination of the two. 3. Studying and adopting good practices to address similar challenges based on prior experiences or lessons available from other practitioners and developthe approach. 4. Detailing the project: the objectives, the beneficiaries and the impact on the beneficiaries, the assumptions, the expected outputs and outcomes, detailed activities, potential to influence public policy and practice. 5. Identifying the indicators of success with the means of verification and establish the baseline for each. This can be commissioned as a separate study or can even be included in the needs assessment stage. 6. Estimating the budget and how it will be funded specifying the community contributions, leveraging of the government schemes and contributions from the other donors. 7. Indicating the monitoring and evaluation methodologies for impact measurement.	a) the CSR policy. b) institutional mechanisms. c) information from the government sources, previous studies done in the area, etc. d) information on programs targeting similar geographies and beneficiary groups or strategies. e) monitoring impact measurement reports from any earlier projects.	a) a project context including the roles of other development actors. b) key needs of the target beneficiaries. c) project goals, KPIs, baselines and expected end lines. d) project milestones for progress monitoring purposes. e) activities and timelines to achieve the stated project goals. f) budgets along with the basis for estimation. g) risks and mitigation strategies. h) progress reporting: content, frequency.

5. Project approval	Every project, whether developed by the in-house team or an external agency, must be formally examined and approved. This is to ensure that each project is in line with the CSR strategy and policy, the monitoring indicators are clearly defined and relevant and there is an adequate budget available. Projects that go on for longer durations or demand a larger amount of resources must be scrutinised more carefully than the others.	Approve the project based on the CSR policy objectives, principles and guidelines.	CSR committee or the delegated project approval committee.	1. Determining the delegation of power for the project approval. 2. Establishing an evaluation framework for the appraisal of the project concepts and implementing agencies that ensure complete alignment with the CSR policy. 3. Establishing tests for the theory of change; whether the concept will be able to deliver the intended results. Establishing tests for the value for money, economy, effectiveness and efficiency. 4. Reviewing risks and mitigation measures. 5. Identifying resource availability and any specific organisational requirements and constraints. 6. Laying down organisational supervision and oversight requirements.	a) a project proposal b) due diligence report	An approved project proposal including a monitoring process and reporting and responsibility for this.
6. Finalising the arrangement with the implementing agency	While working with an external agency, it is very important to enter into a formal arrangement which is referred to here as a Memorandum of Understanding or MoU. It defines the roles, responsibilities, deliverables, commitments and consequences in case of any breach. This is essentially a formal acknowledgement that all the partners have voluntarily consented to work together to achieve an agreed outcome that requires each one to play their respective roles.	Agree upon and sign the MoU with the partner.	The CSR department or company foundation.	1. Developing template MoUs based on the context. Specify the outputs and outcomes, the approach and methodology, the KPIs, key parameters to be monitored and reported, the mode of communication, contract management team, scope of change in management procedures, dispute or conflict resolution mechanisms, inspection and audit requirements, contract closeout requirements, timelines, milestones and deliverables, budgets, process of invoicing and release of payments, etc 2. Establishing a process for negotiation of the MoU with the implementing agency. 3. Negotiating, agreeing upon and signing the MoU.	a) an approved project proposal b) due diligence report	MoU with the implementing agency including the disbursement schedule

7. Progress monitoring and reporting	Routine progress monitoring.	Monitoring progress, distilling lessons and forming the basis for reporting.	The CSR committee	1. Determining the monitoring schedule for each project based on the approved project proposal. 2. Obtaining all relevant progress reports from the project, studying them and making a note of the gaps. 3. Holding discussions with the implementation team on reasons for slippages (if any) and agreeing on a corrective action. This may be done through a field visit or remotely, based on what has been agreed in the MoU. 4. Holding discussions with the implementation team regarding what lessons are emerging and how they can be applied within the project as well as outside.	a) The approved project proposal. b) Previous monitoring reports.	a) Determining mid-course corrections. b) Recommendations for future project designs. c) Project monitoring reports to the CSR committee.
8. Impact Assessment	Impacts of the development projects typically take a while to manifest. For instance, a girl child education programme can show an increased enrolment and retention of girls and on a monthly basis, but further impacts such as improved learning levels will take at least a year. So, impact measurement studies have different objectives from project monitoring and typically have to be undertaken after providing sufficient time for them to manifest.	Measuring the outcome and impact of the projects.	The CSR committee.	1. Identifying methods for conducting the impact assessment and outcome measurement suited to the context and the size of the project and budgets available. 2. Identifying the skills set required for the impact measurement team and accordingly identifying, selecting and appointing the team. 3. Assisting the team to prepare the methodology for selecting a sample, conducting surveys, focus group discussions collecting information on the identified indicators. 4. Making the provisions for the site visits by the team, involvement of the agency involved during the baseline and needs assessment. 5. Undertaking the impact measurement exercise and preparing the report. 6. Identifying the lessons for future interventions.	a) resource planning. b) the project MoU.	a) impact measurement report. b) recommendations for the future project designs.

9. Report consolidation and communication	Reporting and communication closes the loop between intent and achievement and is hence a crucial element of the CSR process. In the context of the Companies Act, 2013 this is also a mandatory requirement as it provides crucial inputs to preparing the directors' report.	Reporting the CSR at an individual project level, consolidated at a programme level and aligned with the requirements under the Companies Act, 2013 and the CSR committee.	The CSR department.	1. Identifying the recipient of the report: the board of directors, investors, government agencies, beneficiaries, etc. 2. Selecting the appropriate reporting framework that is aligned with the requirements of the Companies Act, 2013 and the global best practices. 3. Consolidating project reports into programme reports and an overall CSR report.	a) CSR strategy and policy. b) the project MoU. c) monitoring reports from individual projects.	a) consolidated CSR reports. b) external stakeholder communication.

8.3 E-GOVERNANCE

8.3.1 Introduction

Electronic governance (e-Governance) is generally understood as the use of Information and Communication Technology (ICT) at all the level of the Government in order to provide services to the citizens, interaction with business enterprises and communication and exchange of information between different agencies of the Government in a speedy, convenient efficient and transparent manner.

e-governance is the application of ICT for delivering government services, exchange of information communication transactions, integration of various standalone systems and services between Government to Customer (G2C), Government to Employees (G2E), Government to Government (G2G) and Government to Business (G2B), as well as back office processes and interactions within the entire government framework. Through e-governance, government services will be made available to citizens in a convenient, efficient and transparent manner. The three main target groups that can be distinguished in governance concepts are government, citizens and businesses/interest groups. In e-governance there are no distinct boundaries.

8.3.2 Different Models of E-Governance

8.3.2.1 Government to Citizen (G2C)

The goal of government to customer/citizen (G2C) e-governance is to offer a variety of ICT services to citizens in an efficient and economical manner and to strengthen the relationship between government and citizens using technology.

There are several methods of government-to-customer e-governance. Two-way communication allows citizens to instant message directly with public administrators and cast remote electronic votes (electronic voting) and instant opinion poll. Transactions such as payment of services, such as city utilities, can be completed online or over the phone. Mundane services such as name or address changes, applying

for services or grants, or transferring existing services are more convenient and no longer have to be completed face to face.

8.3.2.2 Government to Employees (G2E)

E-Governance to Employee partnership (G2E) is one of four main primary interactions in the delivery model of E-Governance. It is the relationship between online tools, sources, and articles that help employees maintain communication with the government and their own companies. E-Governance relationship with Employees allows new learning technology in one simple place as the computer. Documents can now be stored and shared with other colleagues online. E-governance makes it possible for employees to become paperless and makes it easy for employees to send important documents back and forth to colleagues all over the world instead of having to print out these records or fax G2E services also include software for maintaining personal information and records of employees.

8.3.2.3 Government to Government (G2G)

It is an electronic sharing of data and/or information system between government agencies, departments or organizations. The goal of G2G is to support e-government initiatives by improving communication, data access and data sharing.

8.3.2.4 Government to business (G2B)

It is an online non-commercial interaction between local and central government and the commercial business sector with the purpose of providing businesses information and advice on e-business 'best practices'. G2B is also refers to the conduction through the Internet between government agencies and trading companies. Public issue and share transfer records is mandatory to be kept in electronic form.

8.3.3 e-Governance - Initiatives in India

Recognising the increasing importance of electronics, the Government of India established the Department of Electronics in 1970. The subsequent establishment of the National Informatics Centre (NIC) in 1977 was the first major step towards e-Governance in India as it brought 'information' and its communication in focus. In the early 1980s, use of computers was confined to very few organizations. The advent of personal computers brought the storage, retrieval and processing capacities of computers to Government offices. By the late 1980s, a large number of government officers had computers but they were mostly used for 'word processing'. Gradually, with the introduction of better softwares, computers were put to other uses like managing databases and processing information. Advances in communications technology further improved the versatility and reach of computers and many Government departments started using ICT for a number of applications like tracking movement of papers and files, monitoring of development programmes, processing of employees' pay rolls, generation of reports etc.

However, the main thrust for e-Governance was provided by the launching of National Informatics Centre Network (NICNET) in 1987, the national satellite based computer network. This was followed by the launch of the District Information System of the National Informatics Centre (DISNIC) programme to computerize all district offices in the country for which free hardware and software was offered to the State Governments. NICNET was extended via the State capitals to all district headquarters by 1990.

In the ensuing years, with ongoing computerization, teleconnectivity and internet connectivity, came a large number of e-Governance initiatives, both at the Union and State levels. A National Task Force on Information Technology and Software Development was constituted in May 1998. While recognising Information Technology as a frontier area of knowledge per se, it focused on utilizing it as an enabling tool for assimilating and processing all other spheres of knowledge. It recommended the launching of an 'Operation Knowledge' aimed at universalizing computer literacy and spreading the use of computers and IT in education. In 1999, the Union Ministry of Information Technology was created. By 2000, a 12-point minimum agenda for e-Governance was identified by Government of India for implementation in all the Union Government Ministries/Departments. The agenda undertaken which is adapted from Minimum Agenda for e-Governance in the Central Government has included the following action points:

(a) Each Ministry/Department must provide PCs with necessary software up to the Section Officer level. In addition, Local Area Network (LAN) must also be set up.

(b) It should be ensured that all staff, who have access to and need to use computer for their office work are provided with adequate training. To facilitate this, inter alia, Ministries/Departments should set-up their own or share other's Learning Centres for decentralized training in computers as per the guidelines issued by the Ministry.

(c) Each Ministry/Department should start using the Office Procedure Automation software developed by NIC with a view to keeping a record of receipt of dak, issue of letters, as well as movement of files in the department.

(d) Pay roll accounting and other house-keeping software should be put to use in day-to-day operations.

(e) Notices for internal meetings should be sent by e-mail. Similarly, submission of applications for leave and for going on tour should also be done electronically. Ministries/Departments should also set up online notice board to display orders, circulars etc., as and when issued.

(f) Ministries/Departments should use the web-enabled Grievance Redressal Software developed by the Department of Administrative Reforms and Public Grievances.

(g) Each Ministry/Department should have its own website.

(h) All Acts, Rules, Circulars must be converted into electronic form and along with other published material of interest or relevance to the public, should be made available on the internet and be accessible from the Information and Facilitation Counter.

(i) The websites of Ministries/Departments/Organisations should specifically contain a section in which various forms to be used by citizens/customers are available. The forms should be available for being printed or for being completed on the computer itself and then printed out for submission. Attempts should also be made to enable completion and submission of forms online.

(j) The Hindi version of the content of the websites should as far as possible be developed simultaneously.

(k) Each Ministry/Department would also make efforts to develop packages so as to begin electronic delivery of services to the public.

(l) Each Ministry/Department should have an overall IT vision or strategy for a five year period, within which it could dovetail specific action plans and targets (including the minimum agenda) to be implemented within one year.

8.3.4 Steps to adopt e-Governance initiatives

Prior to 2006 when the Government of India formally launched its National e-Governance Plan (NeGP), some Departments of Government of India as well as State Governments had initiated steps to adopt e-Governance. These initiatives are discussed under the following categories:

8.3.4.1 Government to Citizen (G2C) initiatives

The e-Governance scenario in India has come a long way since computers were first introduced. The focus now is on extending the reach of governance to have a major impact on the people at large. e-Governance is an important tool to enhance the quality of government services to citizens, to bring in more transparency, to reduce corruption and subjectivity, to reduce costs for citizens and to make government more accessible. A large number of initiatives have been taken in this category by the Union and the State Governments. Some of the important initiatives are furnished below:

(a) Computerisation of Land Records (Department of Land Resources, Government of India).

(b) Bhoomi Project in Karnataka : Online Delivery of Land Records.

(c) Gyandoot in Madhya Pradesh - It is an Intranet-based Government to Citizen (G2C) service delivery initiative.

(d) Lokvani Project in Uttar Pradesh - It is a public-private partnership project to provide a single window, self sustainable e-Governance solution with regard to handling of grievances, land record maintenance and providing a mixture of essential services.

(e) Project FRIENDS (Fast, Reliable, Instant, Efficient Network for the Disbursement of Services) in Kerala - It is a Single Window Facility providing citizens the means to pay taxes and other financial dues to the State Government.

(f) e-Mitra Project in Rajasthan - It is an initiative to provide information and services under one roof to urban and rural populations.

(g) e-Seva in Andhra Pradesh - It is an initiative to provide 'Government to Citizen' and 'e-Business to Citizen' services.

(h) Revenue Administration through Computerized Energy (RACE) Billing Project, Bihar.

(i) Admission to Professional Colleges in Karnataka – Common Entrance Test (CET).

(j) No transfer in securities unless in dematerilised form even for shareholders of unlisted company.

8.3.4.2 Government to Business (G2B) initiatives

G2B initiatives encompass all activities of government which impinge upon business organizations. These include registrations under different statutes, licenses under different laws and exchange of information between government and business. The objective of bringing these activities under e-Governance is to provide a congenial legal environment to business, expedite various processes and provide relevant information to business. Some of the important initiatives are furnished below:

(a) e-Procurement Project in Andhra Pradesh - It is an initiative for procurement of material through e-tender process by avoiding human interface i.e., supplier and buyer interaction during the pre-bidding and post-bidding stages.

(b) e-Procurement in Gujarat - It is an initiative to establish transparency in procurement process, shortening of procurement cycle, availing of competitive price, enhancing confidence of suppliers and establishing flexible and economical bidding process for suppliers.

(c) MCA 21 - This project aims at providing easy and secure online access to all registry related services provided by the Union Ministry of Corporate Affairs (MCA) to corporates and other stakeholders at any time and in a manner that best suits them.

MCA made it mandatory for some companies having fulfilled the stipulated criteria to file their Balance Sheet and Profit and Loss account statements in XBRL (Extensible Business Reporting Language). With the development of taxonomies for Banks, Insurance, Non-Banking Finance Companies and Power sector, the companies operating in these sectors would also be filing their financial reports in XBRL. The details as to XBRL are discussed elsewhere in this Chapter.

8.3.4.3 Government to Government (G2G) initiatives

Within the government system there is large scale processing of information and decision making. G2G initiatives help in making the internal government processes more efficient. Many a time G2C and G2B processes necessitate the improvements in G2G processes. Some of the important initiatives are furnished below:

(a) Khajane Project in Karnataka - This project aims at the computerization of the entire treasury related activities of the State Government and the system has the ability to track every activity right from the approval of the State Budget to the point of rendering accounts to the government.

(b) SmartGov in Andhra Pradesh - This project has been developed to streamline operations, enhance efficiency through workflow automation and knowledge management for implementation in the Andhra Pradesh Secretariat

8.3.5 XBRL (Extensible Business Reporting Language)

XBRL is a language for the electronic communication of business and financial data which is revolutionizing business reporting around the world. It provides major benefits in the preparation, analysis and communication of business information. It offers cost savings, greater efficiency and improved accuracy and reliability to all those involved in supplying or using financial data. XBRL stands for extensible Business Reporting Language. It is already being put to practical use in a number of countries and implementations of XBRL are growing rapidly around the world.

XBRL is an open, royalty-free software specification developed through a process of collaboration between accountants and technologists from all over the world. Together, they formed XBRL International which is now made up of over 650 members, which includes global companies, accounting, technology, government and financial services bodies. XBRL is and will remain an open specification based on XML that is being incorporated into many accounting and analytical software tools and applications.

8.3.4.4 Advantages of XBRL

XBRL offers major benefits at all stages of business reporting and analysis. The benefits are seen in automation, cost saving, faster, more reliable and more accurate handling of data, improved analysis and in better quality of information and decision making. XBRL enables producers and consumers of financial data to switch resources away from costly manual processes, typically involving time consuming comparison, assembly and re-entry of data. They are able to concentrate effort on analysis, aided by software which can validate and process XBRL information. XBRL is a flexible language, which is intended to support all current aspects of reporting in different countries and industries. Its extensible nature means that it can be adjusted to meet particular business requirements, even at the individual organization level.

All types of organizations can use XBRL to save costs and improve efficiency in handling business and financial information. Because XBRL is extensible and flexible, it can be adapted to a wide variety of different requirements. All participants in the financial information supply chain can benefit, whether they are preparers, transmitters or users of business data.

XBRL is set to become the standard way of recording, storing and transmitting business financial information. It is capable of use throughout the world, whatever the language of the country concerned, for a wide variety of business purposes. It will deliver major cost savings and gains in efficiency, improving processes in companies, governments and other organisations.

8.3.4.5 Status of implementation of XBRL in India

(a) India is now an established jurisdiction of XBRL International. A separate company, under Section 25 has been created, to manage the operations of XBRL India. The main objectives of XBRL in India are:

(1) To create awareness about XBRL in India.

(2) To develop and maintain Indian Taxonomies.

(3) To help companies, adopt and implement XBRL.

XBRL in India has come a long way since it initiated. Stock Exchanges and the Reserve Bank of India (RBI) have been using XBRL since 2009. Both BSE and NSE use an XBRL enabled integrated filing platform for corporate disclosures. RBI makes use of XBRL for internal reporting i.e. for collecting the capital adequacy related data from all banks so as to check their compliance of Basel - II requirements. More recently, Ministry of Corporate Affairs has mandated XBRL in India in a phased manner for all companies.

(b) The mandate applies to the following companies:

(1) All public listed companies in India and their Indian Subsidiaries.

(2) All companies having a paid up capital of INR 5 crores and above.

(3) All companies having a turnover of INR 100 crores and above.

(c) All the companies that fall under the mandate are required to file with MCA following information in XBRL:

(1) Balance Sheet.

(2) Profit and Loss Account.

(3) Cash Flow Statement.

(4) Schedules related to Balance Sheet and Profit and Loss Statement.

(5) Notes to Accounts.

(6) Statement relating to subsidiary companies.

(7) Auditors Report.

(8) Directors Report.

(9) Cost Audit Report.

(d) In view of the advantages of XBRL reporting, now the Companies need to quickly gear-up to this new reporting challenge and also to gain benefits from the broader business uses of XBRL. Some of the key challenges that companies might encounter as they adopt XBRL reporting are:

(1) Requirement of training staff to understand XBRL and how it needs to be implemented including matters like timely tagging and validation processes.

(2) The software tool to be used for the purpose of tagging.

(3) The first-time efforts involved in tagging and resolving errors identified by validation checks.

(4) Smooth and timely closure of reporting within the prescribed timelines.

Self-Assessment Questions

1. What are the main principles based on which the NVGs have been formulated?
2. Businesses should support inclusive growth and equitable development – Explain.
3. What is the suggested frame work for Business Responsibility Statement?
4. Explain various benefits of CSR projects.
5. What are initiatives of CSR as per the Companies Act, 2013?
6. What is the procedure for formulation and evaluation of CSR projects?
7. What do you understand the term of e-Governance?
8. Explain the different models of e-Governance.
9. Explain the initiatives of e-Governance in India.
10. Write short notes on the following:
    a. XBRL
    b. CSR and sustainability.

ANNEXURE 1 : (Addendum to Section A)

INSOLVENCY AND BANKRUPTCY CODE, 2016

INSOLVENCY AND BANKRUPTCY CODE, 2016

Introduction

Corporate Insolvency Resolution Process

Liquidation of a Corporate Person

INTRODUCTION

The Insolvency and Bankruptcy Code passed by the Parliament is a welcome overhaul of the existing framework dealing with insolvency of corporate, individuals, partnerships and other entities. It paves the way for much needed reforms while focussing on creditor driven insolvency resolution.

There were multiple overlapping laws and adjudicating forums dealing with financial failure and insolvency of companies and individuals in India. The erstwhile legislative frame work comprised of:

(a) Chapter XIX and Chapter XX of Companies Act, 2013

(b) Part VIA, Part VII and Section 391 of Companies Act, 1956

(c) RDDBFI Act, 1993

(d) SARFAESI Act, 2002

(e) SICA Act, 1985

(f) The Presidency Towns Insolvency Act, 1909

(g) The Provincial Insolvency Act, 1920

(h) Chapter XIII of LLP Act, 2008

This legal and institutional framework did not aid lenders in effective and timely recovery or restructuring of defaulted assets and causes undue strain on the Indian credit system. Recognising that reforms in the bankruptcy and insolvency regime are critical for improving the business environment and alleviating distressed credit markets, the Government introduced the Insolvency and Bankruptcy Code Bill in November 2015, drafted by a specially constituted 'Bankruptcy Law Reforms Committee' (BLRC) under the Ministry of Finance. After a public consultation process and recommendations from a joint committee of Parliament, both houses of Parliament have passed the Insolvency and Bankruptcy Code, 2016.

Insolvency and Bankruptcy Code, 2016

The old and archaic provisions to deal with sickness arising out of financial difficulties are being replaced by Insolvency and Bankruptcy Code, 2016.

As per preamble to the Code, the purpose of this Act is as follows —

- Consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals
- In a time bound manner
- For maximisation of value of assets of such persons
- To promote entrepreneurship
- Availability of credit
- Balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues

- Establish an Insolvency and Bankruptcy Board of India

The Insolvency and Bankruptcy Code, 2016 applies to whole of India. However, Part III of the code, which deals with Insolvency Resolution and Bankruptcy for Individuals and Partnership, shall not extend to the State of Jammu and Kashmir.

Applicability of Insolvency and Bankruptcy Code, 2016

The provisions of Insolvency and Bankruptcy Code, 2016 applies to the following, in relation to their insolvency, liquidation, voluntary liquidation or bankruptcy, as the case may be (Section 2 of Insolvency and Bankruptcy Code, 2016).

(a) Companies incorporated under Companies Act

(b) Companies governed under special Act (so far as of Insolvency and Bankruptcy Code, 2016 is consistent with those special Acts i.e. provisions of Special Act will prevail over of Insolvency and Bankruptcy Code, 2016)

(c) Limited Liability Partnership (LLP)

(d) Other body corporates as may be notified by Central Government

(e) Partnership firms and individuals.

(f) Personal guarantors to corporate debtros:

(g) Partnership firms and proprietorship firms; and

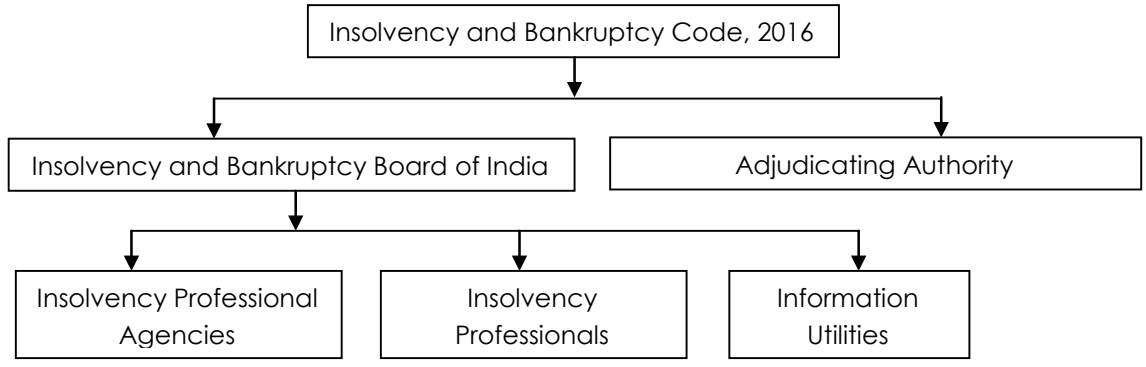
(h) Individuals, other than persons referred to in clause (e).

Code not applicable to financial service providers - The Insolvency and Bankruptcy Code is not applicable to corporates in finance sector. Section 3(7) of Insolvency and Bankruptcy Code, 2016 states that "Corporate person" shall not include any financial service provider. Thus, the Code does not cover Bank, Financial Institutions, Insur¬ance Company, Asset Reconstruction Company, Mutual Funds, Collective Investment Schemes or Pension Funds.

The Regulatory Mechanism and Regulatory Bodies

The regulatory mechanism as per The Insolvency and Bankruptcy Code, 2016 would be based on the following five pillars:

- Insolvency and Bankruptcy Board of India
- Adjudicating Authority
- Insolvency Professional Agencies
- Insolvency Professionals
- Information Utilities



Insolvency and Bankruptcy Board of India

An Insolvency and Bankruptcy Board of India (IABBI) will be established by Central Government under Section 188(1) of Insolvency and Bankruptcy Code, 2016.

"Board" means the Insolvency and Bankruptcy Board of India established under sub-Section (1) of Section 188 - Section 3(1) of Insolvency and Bankruptcy Code, 2016.

The Board will have powers of civil court in respect of issuing summons, discovery and production of books, inspection of books/ registers and issue of commissions for examination of witnesses -Section 196(2) of Insolvency and Bankruptcy Code, 2016.

Constitution of Board has been specified in Section 189 of Insolvency and Bankruptcy Code, 2016. The Board will be headed by Chairperson. It will consist of ten members out of which at least three will be whole-time members.

Function of the Board is to exercise regulatory oversight over insolvency professionals, insolvency professional agencies and information utilities. Some of the main functions of the Board are enumerated as follows:

(a) register insolvency professional agencies, insolvency professionals and information utilities and renew, withdraw, suspend or cancel such registrations;

(b) specify the minimum eligibility requirements for registration of insolvency professional agencies, insolvency professionals and information utilities;

(c) levy fee or other charges for the registration of insolvency professional agencies, insolvency professionals and information utilities;

(d) specify by regulations standards for the functioning of insolvency professional agencies, insolvency professionals and information utilities;

(e) lay down by regulations the minimum curriculum for the examination of the insolvency professionals for their enrolment as members of the insolvency professional agencies;

(f) carry out inspections and investigations on insolvency professional agencies, insolvency professionals and information utilities and pass such orders as may be required for compliance of the provisions of this Code and the regulations issued hereunder;

(g) monitor the performance of insolvency professional agencies, insolvency professionals and information utilities and pass any directions as may be required for compliance of the provisions of this Code and the regulations issued hereunder;

(h) call for any information and records from the insolvency professional agencies, insolvency professionals and information utilities;

(i) publish such information, data, research studies and other information as may be specified by regulations;

(j) specify by regulations the manner of collecting and storing data by the information utilities and for providing access to such data;

(k) collect and maintain records relating to insolvency and bankruptcy cases and disseminate information relating to such cases;

(l) constitute such committees as may be required including in particular the committees laid down in Section 197;

(m) promote transparency and best practices in its governance;

(n) maintain websites and such other universally accessible repositories of electronic information as may be necessary;

(o) enter into memorandum of understanding with any other statutory authorities;

(p) issue necessary guidelines to the insolvency professional agencies, insolvency professionals and information utilities;

(q) specify mechanism for redressal of grievances against insolvency professionals, insolvency professional agencies and information utilities and pass orders relating to complaints filed against the aforesaid for compliance of the provisions of this Code and the regulations issued hereunder;

(r) conduct periodic study, research and audit the functioning and performance of to the insolvency professional agencies, insolvency professionals and information utilities at such intervals as may be specified by the Board;

(s) specify mechanisms for issuing regulations, including the conduct of public consultation processes before notification of any regulations;

(t) make regulations and guidelines on matters relating to insolvency and bankruptcy as may be required under this Code, including mechanism for time bound disposal of the assets of the corporate debtor or debtor; and

(u) perform such other functions as may be prescribed.

Adjudicating Authority

National Company Law Tribunal (NCLT) constituted under Section 408 of Companies Act, 2013 is the Adjudicating Authority for purpose of insolvency resolution and liquidation for corporate persons - Section 5(1) read with Section 69(1) of Insolvency and Bankruptcy Code, 2016. National Company Law Appellate Tribunal (NCLAT) is the appellate authority over decisions of NCLT - Section 61 of Insolvency and Bankruptcy Code, 2016.

Debt Recovery Tribunal (DRT) will be adjudicating authority for individuals and firms - Section 179(1) of Insolvency and Bankruptcy Code, 2016. Powers of Adjudicating Authority are specified in Section 179(2) of Insolvency and Bankruptcy Code, 2016. DRAT (Debt Recovery Appellate Tribunal) will be appellate authority - Section 181 of Insolvency and Bankruptcy Code, 2016.

Appeal against order of NCLAT and DRAT can be filed to Supreme Court on question of law arising out of such order, within 45 days.

Insolvency Professional Agencies

Work relating to insolvency resolution is expected to be handled by 'Insolvency Professionals'. These professionals are required to be registered with 'Insolvency Professional Agency'.

"Insolvency Professional Agency" means any person registered with the Board under Section 201 of Insolvency and Bankruptcy Code, 2016 as an insolvency professional agency - Section 3(20) of Insolvency and Bankruptcy Code, 2016.

The Insolvency Professional Agencies will develop professional standards, code of ethics and be first level regulator for insolvency professional members. This will lead to development of a competi¬tive industry for such professionals.

Insolvency Professionals

The Insolvency and Bankruptcy Code, 2016 envisages a very big role for insolvency professionals. It is envisaged that most of work relating to insolvency and bankruptcy will be handled by insolvency professionals.

"Insolvency Professional" means a person enrolled under Section 206 of Insolvency and Bankruptcy

Code, 2016 with an insolvency professional agency as its member and registered with the Board as an insolvency professional under Section 207 of Insolvency and Bankruptcy Code, 2016 - Section 3(19) of Insolvency and Bankruptcy Code, 2016. Thus, insolvency professional can be only an individual.

Disciplinary action against insolvency professional agency and insolvency professional can be initiated by Board as per provisions of Sections 217 to 220 of Insolvency and Bankruptcy Code, 2016.

Information Utilities

The Insolvency and Bankruptcy professionals are expected to function on basis of financial information available electronically. Information Utility will collect, collate, authenticate and disseminate financial information to be used in insolvency, liquidation and bankruptcy proceedings.

"Information utility" means a person who is registered with the 'Insolvency and Bankruptcy Board of India' (Board) as an information utility under Section 210 of Insolvency and Bankruptcy Code, 2016 - Section 3(21) of Insolvency and Bankruptcy Code, 2016. They will have to be registered with Board - Section 209 of Insolvency and Bankruptcy Code, 2016.

The information utility shall provide services as may be specified by Board. It will also provide core services to any person if such person complies with terms and conditions as may be specified in regulations - Section 213 of Insolvency and Bankruptcy Code, 2016.

"Core services" means services rendered by an information utility for –

(a) accepting electronic submission of financial information in such form and manner as may be specified

(b) safe and accurate recording of financial information

(c) authenticating and verifying the financial information submitted by a person; and

(d) providing access to information stored with the information utility to persons as may be specified - Section 3(9) of Insolvency and Bankruptcy Code, 2016.

CORPORATE INSOLVENCY RESOLUTION PROCESS

Part II of Insolvency and Bankruptcy Code, 2016 [Sections 4 to 77] deal with Insolvency Resolution and liquidation of corporate persons. This part is divided into seven chapters pertaining to:

(i) Corporate Insolvency Resolution Process [Section 4 – 32]

(ii) Liquidation Process [Section 33 – 54]

(iii) Fast Track Corporate Insolvency Resolution Process [Section 55 – 58]

(iv) Voluntary Liquidation of Corporate Persons [Section 59]

(v) Adjudicating Authority for Corporate Persons [Section 60 – 67]

(vi) Offences and Penalties [Section 68 – 77]

We would be learning about Corporate Insolvency Resolution Process and Liquidation process [Section 4 – 54] of this Code. To start with, let us understand a few definitions:

Definitions [Section 3 and 5]

(1) **Corporate Person** means

(a) a company as defined under Section 2(20) of the Companies Act, 2013;

(b) a Limited Liability Partnership as defined in 2(1)(n) of Limited Liability Act, 2008; or,

(c) any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider. [Section 3(7)]

(2) **Corporate Debtor** means a corporate person who owes a debt to any person. [Section 3(8)]

(3) **Creditor** means any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor and a decree holder. [Section 3(10)]

(4) **Debt** means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt. [Section 3(11)]

(5) **Claim** means a right to payment or right to remedy for breach of contract if such breach gives rise to a right to payment whether or not such right is reduced to judgment, fixed, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured. [Section 3(6)]

(6) **Default** means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not paid by the debtor or the corporate debtor, as the case may be. [Section 3(12)]

(7) **Financial information,** in relation to a person, means one or more of the following categories of information, namely:—

(a) records of the debt of the person;

(b) records of liabilities when the person is solvent;

(c) records of assets of person over which security interest has been created;

(d) records, if any, of instances of default by the person against any debt;

(e) records of the balance sheet and cash-flow statements of the person; and

(f) such other information as may be specified. [Section 3(13)]

(8) **Financial creditor** means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to. [Section 5(7)]

(9) **Financial debt** [Section 5(8)] means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes—

(a) money borrowed against the payment of interest;

(b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;

(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;

(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;

(e) receivables sold or discounted other than any receivables sold on non-recourse basis;

(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing;

Explanation: Any amount raised from an allottee under real estate project shall be deemed to be an amount having commercial effect on borrowing.

(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;

(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;

(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause;

(10) **Operational debt** means a claim in respect of the provision of goods or services including employment or a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority;

(11) A **person** includes:-

- an individual
- a Hindu Undivided Family
- a company
- a trust
- a partnership
- A limited liability partnership, and
- any other entity established under a Statute.

And includes a person resident outside India [Section 3(23)]

(12) **Secured creditor** means a creditor in favour of whom security interest is created; [Section 3(30)]

(13) **Security Interest** means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person. [Section 3(31)]

(14) A **transaction** includes an agreement or arrangement in writing for transfer of assets, or funds, goods or services, from or to the corporate debtor. [Section 3(33)]

(15) **Transfer** includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien. In case of property- transfer of property means transfer of any property. [Section 3(34)]

(16) **Transfer of property** means transfer of any property and includes a transfer of any interest in the property and creation of any charge upon such property; [Section 3(35)]

(17) **Adjudicating Authority**, for the purposes of this Part II (Insolvency Resolution and Liquidation for corporate persons), means National Company Law Tribunal constituted under Section 408 of the Companies Act, 2013. [Section 5(1)]

(18) **Corporate applicant** means—

(a) corporate debtor; or

(b) a member or partner of the corporate debtor who is authorised to make an application for the corporate insolvency resolution process under the constitutional document of the corporate debtor; or

(c) an individual who is in charge of managing the operations and resources of the corporate debtor; or

(d) a person who has the control and supervision over the financial affairs of the corporate debtor; [Section 5(5)]

(19) **Dispute** includes a suit or arbitration proceedings relating to—

(a) the existence of the amount of debt;

(b) the quality of goods or service; or

(c) the breach of a representation or warranty; [Section 5(6)]

(19) **Financial position**, in relation to any person, means the financial information of a person as on a certain date; [Section 5(9)]

(20) **Initiation date** means the date on which a financial creditor, corporate applicant or operational creditor, as the case may be, makes an application to the Adjudicating Authority for initiating corporate insolvency resolution process; [Section 5(11)]

(21) **Insolvency commencement date** means the date of admission of an application for initiating corporate insolvency resolution process by the Adjudicating Authority under Sections 7, 9 or Section 10, as the case may be; [Section 5(12)]

(22) I**nsolvency resolution process period** means the period of one hundred and eighty days beginning from the insolvency commencement date and ending on one hundred and eightieth day; [Section 5(14)]

(23) **Liquidation commencement date** means the date on which proceedings for liquidation commence in accordance with Section 33 or Section 59, as the case may be; [Section 5(17)]

(24) **Operational creditor** means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred; [Section 5(20)]

(25) **Related party**, in relation to a corporate debtor, means—

(a) a director or partner or a relative of a director or partner of the corporate debtor

(b) a key managerial personnel or a relative of a key managerial personnel of the corporate debtor;

(c) a limited liability partnership or a partnership firm in which a director, partner, or manager of the corporate debtor or his relative is a partner;

(d) a private company in which a director, partner or manager of the corporate debtor is a director and holds along with his relatives, more than two per cent, of its share capital;

(e) a public company in which a director, partner or manager of the corporate debtor is a director and holds along with relatives, more than two per cent, of its paid-up share capital;

(f) anybody corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;

(g) any limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;

(h) any person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;

(i) a body corporate which is a holding, subsidiary or an associate company of the corporate debtor, or a subsidiary of a holding company to which the corporate debtor is a subsidiary;

Provided, where the interim resolution professional is not appointed in the order admiting application u/s 7, 9 & 10, the insolvency commencement date shall be the date on which such IRP is appointed by the adjucating authority.

(j) any person who controls more than twenty per cent, of voting rights in the corporate debtor on account of ownership or a voting agreement;

(k) any person in whom the corporate debtor controls more than twenty per cent, of voting rights on account of ownership or a voting agreement;

(l) any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor;

(m) any person who is associated with the corporate debtor on account of—

(i) participation in policy making processes of the corporate debtor; or

(ii) having more than two directors in common between the corporate debtor and such person; or

(iii) interchange of managerial personnel between the corporate debtor and such person; [Section 5(24)]

(26) **Resolution plan** means a plan proposed by resolution applicant for insolvency resolution of the corporate debtor as a going concern in accordance with Part II;[Section 5(26)]

(27) **Resolution professional**, for the purposes of this Part, means an insolvency professional appointed to conduct the corporate insolvency resolution process and includes an interim resolution professional; [Section 5(27)]

(28) **Voting Share** means the share of the voting rights of a single financial creditor in the committee of creditors which is based on the proportion of the financial debt owed to such financial creditor in relation to the financial debt owed by the corporate debtor.

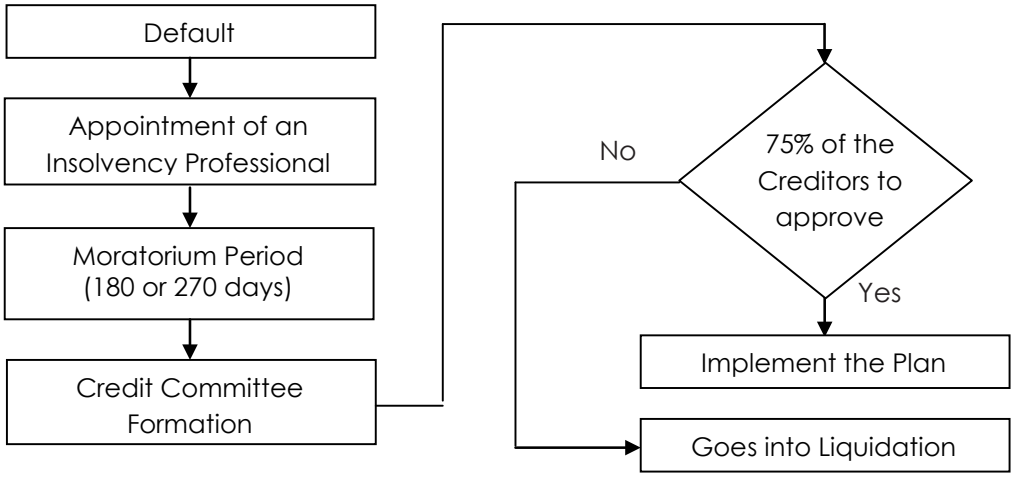
(29) "Resolution Applicant" means a person, who individually or jointly with any other person, submit a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25.

Initiation of corporate insolvency resolution process

Corporate insolvency resolution process can be commenced when a corporate debtor commits a default - Section 4(1) of Insolvency and Bankruptcy Code, 2016.

The default should be minimum Rupees one lakh. The amount can be increased by Central Government but shall not exceed Rupees one crore - proviso to Section 4(1) of Insolvency and Bankruptcy Code, 2016.

The resolution process and timeline can be diagrammatically represented as:



Meaning of Corporate Person

Corporate person means company or LLP or other body corporate with limited liability. However, the Code completely excludes financial service providers. The reason is that they are regulated by specialized agencies. Thus, the Code does not cover Bank, Financial Institutions, Insurance Company, Asset Reconstruction Company, Mutual Funds, Collective Investment Schemes or Pension Funds.

Who can initiate insolvency resolution process

Where any corporate debtor commits a default, a financial creditor, an operational creditor or the corporate debtor itself may initiate corporate insolvency resolution process in respect of such corporate debtor in the manner as provided - Section 6 of Insolvency and Bankruptcy Code, 2016.

Persons who are not entitled to initiate insolvency resolution process

The Code states that a corporate debtor (which includes a corporate applicant in respect of such corporate debtor) shall not be entitled to make an application to initiate corporate insolvency resolution process [Section 11 of Insolvency and Bankruptcy Code, 2016] in the following cases:

(a) when undergoing a corporate insolvency resolution process; or

(b) having completed corporate insolvency resolution process twelve months preceding the date of making of the application; or

(c) or a financial creditor who has violated any of the terms of resolution plan which was approved twelve months before the date of making of an application under this Chapter; or

(d) in respect of him a liquidation order has been made.

Thus, application to initiate insolvency resolution process cannot be filed within 12 months or if there were violation of conditions or where order of liquidation has been made.

New Section 29A has been inserted in November, 2017 amended .

Persons not eligible to resolution applicant:

A person shall not be eligible to submit a resolution plan, if such person, or any other person acting jointly or in concert with such person -

(a) is an undischarged insolvent;

(b) is a willful defaulter of the time of submission of resolution plan,

(c) At the time of summission of plan, has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter, classified as non-performing asset.

(d) has been convicted for any offence punishable with imprisonment for two years for offences under 12th Schedule of the Code or 7 years under any law.

(e) is disqualified to act as a director under the Companies Act, 2013;

(f) is prohibited by the Securities and Exchange Board of India from trading in securities or accessing the securities markets;

(g) has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the Adjudicating Authority under this Code;

(h) has executed a guarantee in favour of a creditor in respect of a corporate debtor;

(i) has been subject to any disability, corresponding to clauses (a) to (h), under any law in a jurisdiction outside India; or

(j) has a connected person not eligible under clauses (a) to (i).

Process of initiation by Financial Creditor

A financial creditor can initiate action himself or jointly with other financial creditors or any other person on behalf of financial creditors, against a corporate debtor when a default occurs. The default can be in respect of any other financial creditor also - Section 7(1) of Insolvency and Bankruptcy Code, 2016.

Application shall be made in prescribed form with fees. Application should give details of record of default and name of resolution professional proposed to be appointed as interim resolution professional - Section 7(3) of Insolvency and Bankruptcy Code, 2016.

Adjudicating Authority (NCLT) shall ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the financial creditor.

Rejection of application - Adjudicating Authority may reject the application by issuing order, if it is satisfied that - (a) default has not occurred or (b) the application under sub-Section (2) is incomplete or (c) any disciplinary proceeding is pending against the proposed resolution professional- Section 7(5)(b) of Insolvency and Bankruptcy Code, 2016.

Before rejecting application, opportunity will be given to applicant to rectify the defects within seven days. If defects are not rectified, application will be rejected by Adjudi¬cating Authority and intimation sent to the financial creditor.

Admission of application - If Adjudicating Authority is satisfied that default has occurred, it will admit application - Section 7(5)(a) of Insolvency and Bankruptcy Code, 2016. Order of admission will be sent to financial creditor and corporate debtor - Section 7(7)(a) of Insolvency and Bankruptcy Code, 2016.

Commencement of corporate insolvency resolution process initiated by a financial creditor – The corporate insolvency resolution process shall commence from the date of admission of the application under Section 7(5) - Section 7(6) of Insolvency and Bankruptcy Code, 2016.

Initiation of Insolvency resolution by operational creditor

Operational creditor means creditor in respect of goods and services. Process of insolvency resolution can be initiated by operational creditor on the occurance of default, by delivering demand notice or copy of an invoice demanding payment of the amount involved in the default to the corporate debtor.

The operational creditor is required to deliver demand notice of unpaid operational debtor copy of invoice to corporate debtor in prescribed manner - Section 8(1) of Insolvency and Bankruptcy Code, 2016.

"Demand notice" means a notice served by an operational creditor to the corporate debtor demanding repayment of the operational debt in respect of which the default has occurred - Explanation to Section 8(2) of Insolvency and Bankruptcy Code, 2016.

Action to be taken by corporate debtor on receipt of demand notice

The corporate debtor is required to reply within ten days of receipt of copy of invoice. If he had paid the unpaid operational debt, he will inform details of electronic transfer or encashment of cheque issued by corpo¬rate debtor to operational creditor - Section 8(2)(b) of Insolvency and Bankruptcy Code, 2016.

Inform existence of dispute - If there is existence of dispute, the same shall be informed or record of pendency of suit or arbitration proceedings, if any.

Since the word used in definition of 'dispute' as per Section 5(6) is 'includes', the dispute can be on any ground. It is not necessary that suit or arbitration proceeding should be pending.

Further action by operational creditor

If no reply is received from within ten days from date of delivery of demand notice or copy of invoice, operational creditor can file application before Adjudicating Authority (NCLT) for initiating a corporate insolvency resolution process - Section 9(1) of Insolvency and Bankruptcy Code, 2016.

The application should be in prescribed form, with documents as specified in Section 9(3) of Insolvency and Bankruptcy Code, 2016.

The operational creditor may propose a resolution professional to act as an interim resolution professional - Section 9(4) of Insolvency and Bankruptcy Code, 2016.

The application will be admitted if notice of dispute is not received from operational debtor and evidence is produced that amount is not received.

If notice of dispute has been received, the application will not be admitted. The application will be admitted if (a) it is complete, (b) unpaid operational debt has not been paid (c) demand notice was delivered (d) notice of dispute is not received from operational creditor and (e) no disciplinary proceeding is pending against the proposed resolution professional - Section 9(5)(i) of Insolvency and Bankruptcy Code, 2016.

If any of these requirements is not fulfilled, application will be rejected - Section 9(5)(ii) of Insolvency and Bankruptcy Code, 2016. Before rejecting application, notice will be given to operational creditor.

Commencement of corporate insolvency resolution process initiated by an operational creditor – The corporate insolvency resolution process shall commence from the date of admission of the application under Section 9(5) - Section 9(6) of Insolvency and Bankruptcy Code, 2016.

No admission of application if demand disputed - If demand is disputed, application will not be admitted at all. Adjudicating Authority (NCLT) is not empowered to go into dispute i.e. whether dispute is genuine or bogus.

Initiation of corporate insolvency resolution process by corporate debtor

As per Section 10, where a corporate debtor has committed a default, a corporate applicant thereof may file an application for initiating corporate insolvency resolution process with the Adjudicating Authority.

The application under sub-Section (1) shall be filed in such form, containing such particulars and in such manner and accompanied with such fee as may be prescribed.

The corporate applicant shall, along with the application furnish the information relating to—

(a) its books of account and such other documents relating to such period as may be specified; and

(b) the resolution professional proposed to be appointed as an interim resolution professional.

(c) approval of taking of application by special resolution of corporte debtors or 3/4th of number of partners of corporate debtors.

The Adjudicating Authority shall, within a period of fourteen days of the receipt of the application, by an order—

(a) admit the application, if it is complete; or

(b) reject the application, if it is incomplete:

Provided that Adjudicating Authority shall, before rejecting an application, give a notice to the applicant to rectify the defects in his application within seven days from the date of receipt of such

notice from the Adjudicating Authority.

The corporate insolvency resolution process shall commence from the date of admission of the application under sub-Section (4) of this Section.

Time-limit for completion of insolvency resolution process

Subject to sub-Section 12(2), where extension of time is requested, the corporate insolvency resolution process shall be completed within a period of one hundred and eighty days from the date of admission of the application to initiate such process.

The resolution professional shall file an application to the Adjudicating Authority to extend the period of the corporate insolvency resolution process beyond one hundred and eighty days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of sixty six per cent of the voting shares.

On receipt of an application under sub-Section 12(2), if the Adjudicating Authority is satisfied that the subject matter of the case is such that corporate insolvency resolution process cannot be completed within one hundred and eighty days, it may by order extend the duration of such process beyond one hundred and eighty days by such further period as it thinks fit, but not exceeding ninety days:

Provided that any extension of the period of corporate insolvency resolution process under this Section shall not be granted more than once.

Moratorium and public announcement

Meaning of Moratorium - A "moratorium" is a delay or suspension of an activity or a law. In a legal context, it may refer to the temporary suspension of a law to allow a legal challenge to be carried out. It is legal authorisation to debtors to delay payments due.

After admission of application, Adjudicating Authority shall pass following orders [Section 15(1)]

(a) declare a moratorium for the purposes referred to in Section 14 of Insolvency and Bankruptcy Code, 2016

(b) cause a public announcement of the initiation of corporate insolvency resolution process and call for the submission of claims under Section 15 of Insolvency and Bankruptcy Code, 2016; and

(c) appoint an interim resolution professional in the manner as laid down in Section 16 of Insolvency and Bankruptcy Code, 2016

The public announcement referred to above shall be made immediately after the appointment of the interim resolution professional - Section 15(2) of Insolvency and Bankruptcy Code, 2016.

Order declaring Moratorium

On the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following [Section 14(1)]

(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority

(b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein

(c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(d) the recovery of any property by an owner or less or where such property is occupied by or in the possession of the corporate debtor.

No moratorium on essential supplies or notified transactions

The supply of essential goods or services to the corporate debtor as may be specified under Regulations shall not be terminated or suspended or interrupted during moratorium period - Section 14(2) of Insolvency and Bankruptcy Code, 2016.

Moratorium shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator - Section 14(3) of Insolvency and Bankruptcy Code, 2016.

"Property" includes money, goods, actionable claims, land and every description of property situated in India or outside India and every description of interest including present or future or vested or contingent interest arising out of, or incidental to, property - Section 3(17) of Insolvency and Bankruptcy Code, 2016.

Duration of order of moratorium - The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process. However, if resolution plan is approved under Section 31(1) or order of liquidation or corporate debtor is passed, the moratorium shall cease to have effect from the date of such approval or liquidation order - Section 14(4) of Insolvency and Bankruptcy Code, 2016.

Period of moratorium excluded for purpose of limitation – In computing the period of limitation specified for any suit or application by or against a corporate debtor for which an order of moratorium has been made under this Part, the period during which such moratorium is in place shall be excluded. This provision overrides provision of Limitation Act or any other law - Section 60(6) of Insolvency and Bankruptcy Code, 2016.

Public announcement of corporate insolvency resolution process

The public announcement of the corporate insolvency resolution process shall contain information as specified in Section 15(1) of Insolvency and Bankruptcy Code, 2016 and will be made in manner prescribed.

Appointment and tenure of interim resolution professional

The Adjudicating Authority (NCLT) shall appoint an interim resolution professional within fourteen days from the insolvency commencement date, as per procedure specified in Section 15 of Insolvency and Bankruptcy Code, 2016. His appointment cannot be for more than 30 days - Section 16(5) of Insolvency and Bankruptcy Code, 2016.

Management of affairs of corporate debtor by interim resolution professional

From the date of appointment of the interim resolution professional, the management of the affairs of the corporate debtor shall vest in the interim resolution professional.

The powers of the board of directors or the partners of the corporate debtor, as the case may be, shall stand suspended and be exercised by the interim resolution professional.

The officers and managers of the corporate debtor shall report to the interim resolution professional and provide access to such documents and records of the corporate debtor as may be required by the interim resolution professional.

The financial institutions maintaining accounts of the corporate debtor shall act on the instructions of the interim resolution professional in relation to such accounts and furnish all information relating to the corporate debtor available with them to the interim resolution professional [Section 17(1) of Insolvency and Bankruptcy Code, 2016].

Authority of interim resolution professional

The interim resolution professional vested with the management of the corporate debtor shall have all the powers of management as specified in Section 17(2) of Insolvency and Bankruptcy Code, 2016.

He can act and execute in the name and on behalf of the corporate debtor all deeds, receipts, and other documents, if any. He can take such actions, in the manner and subject to such restrictions, as may be specified by the Board. He has the authority to access the electronic records of corporate debtor from information utility having financial information of the corporate debtor. He has the authority to access the books of account, records and other relevant documents of corporate debtor available with government authorities, statutory auditors, accountants and such other persons as may be specified. He shall also be responsible for compliance of the law inforce.

Duties of interim resolution professional

The interim resolution professional shall perform the following duties - Section 18(1) of Insolvency and Bankruptcy Code, 2016.

(a) collect all information relating to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor, including information relating to— (i) business operations for the previous two years (ii) financial and operational payments for the previous two years (iii) list of assets and liabilities as on the initiation date; and (iv) such other matters as may be specified.

(b) receive and collate all the claims submitted by creditors to him, pursuant to the public announcement made under Sections 13 and 15.

(c) constitute a committee of creditors.

(d) monitor the assets of the corporate debtor and manage its operations until a resolution professional is appointed by the committee of creditors.

(e) file information collected with the information utility, if necessary; and

(f) take control and custody of any asset over which the corporate debtor has ownership rights as recorded in the balance sheet of the corporate debtor, or with information utility or the depository of securities or any other registry that records the ownership of assets.

(g) perform such other duties as may be specified by the Board.

Personnel to extend cooperation to interim resolution professional

The personnel of the corporate debtor, its promoters or any other person associated with the management of the corporate debtor shall extend all assistance and cooperation to the interim resolution professional as may be required by him in managing the affairs of the corporate debtor - Section 19(1) of Insolvency and Bankruptcy Code, 2016.

If they do not cooperate, application can be made by interim resolution professional to the Adjudicating Authority (NCLT) for necessary directions. NCLT will issue suitable orders - Section 19(3) of Insolvency and Bankruptcy Code, 2016.

Management of operations of corporate debtor as going concern

The interim resolution professional shall make every endeavour to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern [Section 20(1) of Insolvency and Bankruptcy Code, 2016].

For this purpose, he can take any of the actions specified in Section 20(2) of Insolvency and Bankruptcy Code, 2016. This includes appointments of professionals, entering into contracts, raise interim finance etc.

"Interim finance" means any financial debt raised by the resolution professional during the insolvency resolution process period -Section 5(15) of Insolvency and Bankruptcy Code, 2016.

Committee of creditors

The interim resolution professional shall after collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a commit¬tee of creditors - Section 21(1) of Insolvency and Bankruptcy Code, 2016.

The committee of creditors shall comprise all financial creditors of the corporate debtor.

Where the corporate debtor owes financial debts to two or more financial creditors as part of a consortium or agreement, each such financial creditor shall be part of the committee of creditors and their voting share shall be determined on the basis of the financial debts owed to them.

However, related party to whom a corporate debtor owes a financial debt shall not have any right of representation, participation or voting in a meeting of the committee of creditors.

Section 21 of Insolvency and Bankruptcy Code, 2016 makes delated provisions relating to composition and voting rights of Committee of Creditors.

All decisions of the committee of creditors shall be taken by a vote of not less than fifty one per cent of voting share of the financial creditors - Section 21(8) of Insolvency and Bankruptcy Code, 2016.

The committee of creditors shall have the right to require the resolution professional to furnish any financial information in relation to the corporate debtor at any time during the corporate insolvency resolution process - Section 21(9) of Insolvency and Bankruptcy Code, 2016.

The resolution professional shall make available any financial information so required by the committee of creditors within a period of seven days of such requisition - Section 21(10) of Insolvency and Bankruptcy Code, 2016.

Voting share of creditors - Committee of creditors which is based on the proportion of the financial debt owed to such financial creditor in relation to the financial debt owed by the corporate debtor - Section 5(28) of Insolvency and Bankruptcy Code, 2016.

Related Party in case of corporate debtor - The definition in Section 5(24) of Insolvency and Bankruptcy Code, 2016 is very wide. It covers director, partners, LLP or firm having common even one common partner or director, relative of director or partner, KMP, private company where a director holds more than 2% of share capital, holding and subsidiary, person controlling more than 20% of voting rights, company having more than two directors common and even person on whose advise or directions a director or partner is accustomed to act.

Appointment of resolution professional

The first meeting of the committee of creditors shall be held within seven days of the constitution of the committee of creditors - Section 22(1) of Insolvency and Bankruptcy Code, 2016.

The committee of creditors, may, in the first meeting, by a majority vote of not less than sixty six per cent of the voting share of the financial creditors, either resolve to appoint the interim resolution professional as a resolution professional with written consent in specified form or to replace the interim resolution professional by another resolution professional - Section 22(2) of Insolvency and Bankruptcy Code, 2016.

If they decide to continue interim resolution professional, they will inform its decision to the interim resolution professional, the corporate debtor and the Adjudicating Authority [Section 24(2)(a) of Insolvency and Bankruptcy Code, 2016].

However, if they decide to replace the interim resolution professional, the resolution professional can be appointed only with approval of Board. Till then, the interim resolution professional will continue - Section 22(5) of Insolvency and Bankruptcy Code, 2016.

Resolution professional to conduct corporate insolvency resolution process

The resolution professional shall conduct the entire corporate insolvency resolution process and manage the operations of the corporate debtor during the corporate insolvency resolution process period provided that the RP, if resolution plan is submitted, continue to manage the operation of the CD after the expiry of CIRP, untill an order is passed by adjucating authority. Section 23(1) of Insolvency and Bankruptcy Code, 2016.

The resolution professional shall exercise powers and perform duties as are vested or conferred on the interim resolution professional - Section 23(2) of Insolvency and Bankruptcy Code, 2016.

If another resolution professional is appointed as per Section 22(4) of Insolvency and Bankruptcy Code, 2016, the interim resolution professional shall provide all the information, documents and records pertaining to the corporate debtor in his possession and knowledge to the resolution professional - Section 23(3) of Insolvency and Bankruptcy Code, 2016.

Meeting of committee of creditors

The members of the committee of creditors may meet in person or by such electronic means as may be specified - Section 24(2) of Insolvency and Bankruptcy Code, 2016.

All meetings of the committee of creditors shall be conducted by the resolution professional - Section 24(3) of Insolvency and Bankruptcy Code, 2016.

Notice of such meeting will be given to (a) members of Committee of creditors (b) members of the suspended Board of Directors or the partners of the corporate persons, as the case may be (c) operational creditors or their representatives if the amount of their aggregate dues is not less than ten per cent of the debt.

The directors, partners and one representative of operational creditors, as referred above, may attend the meetings of committee of creditors, but shall not have any right to vote in such meetings - Section 24(4) of Insolvency and Bankruptcy Code, 2016.

Any creditor who is a member of the committee of creditors may appoint an insolvency professional other than the resolution professional to represent such creditor in a meeting of the committee of creditors. The fees payable to such insolvency professional representing any individual creditor will be borne by such creditor - Section 24(5) of Insolvency and Bankruptcy Code, 2016.

Each creditor shall vote in accordance with the voting share assigned to him based on the financial debts owed to such creditor - Section 24(6) of Insolvency and Bankruptcy Code, 2016.

The resolution professional shall determine the voting share to be assigned to each creditor in the manner specified by the Board - Section 24(7) of Insolvency and Bankruptcy Code, 2016.

Any resolution at meeting of secured creditors should be passed with 75% majority.

The meetings of the committee of creditors shall be conducted in such manner as may be specified.

Duties of resolution professional

It shall be the duty of the resolution professional to preserve and protect the assets of the corporate debtor, including the continued business operations of the corporate debtor - Section 25(1) of Insolvency and Bankruptcy Code, 2016.

He can take any or all the actions specified in Section 25(2) of Insolvency and Bankruptcy Code, 2016 for this purpose. However, action as specified in Section 28 of Insolvency and Bankruptcy Code, 2016 cannot be taken without prior approval of committee of creditors with 66% voting in favour.

File Application for avoidance of transactions not to affect proceedings

The resolution professional can file application for avoidance of transactions as specified in Sections 43 to 51 of Insolvency and Bankruptcy Code, 2016 - Section 25(2)(j) of Insolvency and Bankruptcy Code, 2016.

Filing of such avoidance application under by the resolution professional shall not affect the proceedings of the corporate insolvency resolution process - Section 26 of Insolvency and Bankruptcy Code, 2016.

Replacement of resolution professional by committee of creditors

Committee of Creditors can change the resolution professional. They have to forward new name to Adjudicating Authority who will appoint another resolution professional after getting approval from Board - Section 27 of Insolvency and Bankruptcy Code, 2016.

Prior approval of committee of creditors for certain actions by resolution professional

In following cases, resolution professional can take action only with prior approval of committee of creditors, with 66% voting in favour [Section 28(1) of Insolvency and Bankruptcy Code, 2016].

(a) raise any interim finance in excess of the amount as may be decided by the committee of creditors in their meeting.

(b) create any security interest over the assets of the corporate debtor.

(c) change the capital structure of the corporate debtor, including by way of issuance of additional securities, creating a new class of securities or buying back or redemption of issued securities in case the corporate debtor is a company.

(d) record any change in the ownership interest of the corporate debtor.

(e) give instructions to financial institutions maintaining accounts of the corporate debtor for a debit transaction from any such accounts in excess of the amount as may be decided by the committee of creditors in their meeting.

(f) undertake any related party transaction

(g) amend any constitutional documents of the corporate debtor.

(h) delegate its authority to any other person.

(i) dispose of or permit the disposal of shares of any shareholder of the corporate debtor or their nominees to third parties.

(j) make any change in the management of the corporate debtor or its subsidiary.

(k) transfer rights or financial debts or operational debts under material contracts otherwise than in the ordinary course of business.

(l) make changes in the appointment or terms of contract of such personnel as specified by the committee of creditors; or

(m) make changes in the appointment or terms of contract of statutory auditors or internal auditors of the corporate debtor.

(n) Invite prospective resolution applicant, who fulfill certain criteria as laid down by COC.

"Constitutional document", in relation to a corporate person, includes articles of association, memorandum of association of a company and incorporation document of a Limited Liability Partnership - Section 5(4) of Insolvency and Bankruptcy Code, 2016.

"Security interest" means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person. However, that security interest shall not include a performance guarantee - Section 3(31) of Insolvency and Bankruptcy Code, 2016.

"Transaction" includes an agreement or arrangement in writing for the transfer of assets, or funds, goods or services, from or to the corporate debtor - Section 3(33) of Insolvency and Bankruptcy Code, 2016.

Action void if taken without approval - Where any action under Section 28(1) is taken by the resolution professional without seeking the approval of the committee of creditors in the manner as required in this Section, such action shall be void - Section 28(4) of Insolvency and Bankruptcy Code, 2016.

The committee of creditors may report the actions of the resolution professional under Section 28(4) to the Board for taking necessary actions against him under the Insolvency and Bankruptcy Code - Section 28(5) of Insolvency and Bankruptcy Code, 2016.

Preparation of information memorandum

The resolution professional shall prepare an information memorandum in such form and manner containing such relevant information as may be specified by the Board for formulating a resolution plan - Section 29(1) of Insolvency and Bankruptcy Code, 2016.

The resolution professional can appoint resolution applicant for this purpose.

"Resolution applicant" means any person who submits a resolution plan to the resolution professional - Section 5(25) of Insolvency and Bankruptcy Code, 2016.

The resolution professional shall provide to the resolution applicant access to all relevant information in physical and electronic form. The resolution applicant should undertake - (a) to comply with provisions of law for the time being in force relating to confidentiality and insider trading (b) to protect any intellectual property of the corporate debtor it may have access to and (c) not to share relevant information with third parties unless clauses (a) and (b) of this sub-Section are complied with - Section 30(1) of Insolvency and Bankruptcy Code, 2016.

"Relevant information" means the information required by the resolution applicant to make the resolution plan for the corporate debtor, which shall include the financial position of the corporate debtor, all information related to disputes by or against the corporate debtor and any other matter pertaining to the corporate debtor as may be specified.

Submission and approval of resolution plan by resolution applicant

A resolution applicant may submit a resolution plan alongwith affidavit stating that he is eligible under 29A to the resolution professional prepared on the basis of the information memorandum - Section 30(1) of Insolvency and Bankruptcy Code, 2016.

Requirements of resolution plan - The resolution plan shall contain following [Section 30(2) of Insolvency and Bankruptcy Code, 2016] —

(a) provision for the payment of insolvency resolution process costs in a manner specified by the Board in priority to the repayment of other debts of the corporate debtor.

(b) provision for the payment of the debts of operational creditors in such manner as may be specified by the Board which shall not be less than the amount to be paid to the operational creditors in the event of a liquidation of the corporate debtor under Section 53 of Insolvency and Bankruptcy Code, 2016.

(c) provision for the management of the affairs of the Corporate debtor after approval of the resolution plan.

(d) the implementation and supervision of the resolution plan

(e) the plan should not contravene any of the provisions of the law for the time being in force.

(f) plan should conform to such other requirements as may be specified by the Board of Insolvency and Bankruptcy of India.

Insolvency resolution process costs

Insolvency resolution process costs means –

(a) the amount of any interim finance and the costs incurred in raising such finance

(b) the fees payable to any person acting as a resolution professional

(c) any costs incurred by the resolution professional in running the business of the corporate debtor as a going concern

(d) any costs incurred at the expense of the Government to facilitate the insolvency resolution process; and

(e) any other costs as may be specified by the Board - Section 5(13) of Insolvency and Bankruptcy Code, 2016.

Interim finance means any financial debt raised by the resolution professional during the insolvency resolution process period - Section 5(15) of Insolvency and Bankruptcy Code, 2016.

Approval of resolution plan by Committee of Creditors

The resolution professional shall present to the committee of creditors for its approval such resolution plans which confirm the conditions in Section 30(2) of Insolvency and Bankruptcy Code, 2016.

The resolution plan should be approved by 66% of voting shares of financial creditors after considering its feesibility and viability and such requirement as may be specified by the Board - Section 30(4) of Insolvency and Bankruptcy Code, 2016.

The resolution applicant may attend the meeting of the committee of creditors in which the resolution plan of the applicant is considered, but he will not have voting rights, unless such resolution applicant is also a financial creditor - Section 30(5) of Insolvency and Bankruptcy Code, 2016.

After approval of Committee of Creditors, the resolution professional shall submit the resolution plan to the Adjudicating Authority - Section 30(6) of Insolvency and Bankruptcy Code, 2016.

Approval of resolution plan by Adjudicating Authority

If the Adjudicating Authority (NCLT) is satisfied that the resolution plan as approved by the committee of creditors meets the requirements as referred to Section 30(2) of Insolvency and Bankruptcy Code, 2016, it shall by order approve the resolution plan. Adjucating Authority to satisfy itself that the plan has provision for effective implementation.

The resolution plan so approved shall be binding on the corporate debtor and its employees, members,

creditors, guarantors and other stakeholders involved in the resolution plan - Section 31 (2) of Insolvency and Bankruptcy Code, 2016.

After the order of approval of resolution plan by Adjudicating Authority (a) the moratorium order passed by the Adjudicating Authority under Section 14 shall cease to have effect; and (b) the resolution professional shall forward all records relating to the conduct of the corporate insolvency resolution process and the resolution plan to the Board to be recorded on its database.

Effect if resolution plan rejected by NCLT

If resolution plan is rejected by Adjudicating Authority, liquidation process will commence - Section 33(1) of Insolvency and Bankruptcy Code, 2016.

Appeal against order of adjudicating authority

Any appeal from an order approving the resolution plan shall be in the manner and on the grounds specified in Section 61(3) of Insolvency and Bankruptcy Code, 2016. Appeal can be only on the grounds specified in that Section.

LIQUIDATION OF A CORPORATE PERSON

Initiation of Liquidation [Section 33]

Where the Adjudicating Authority,—

(a) before the expiry of the insolvency resolution process period or the maximum period permitted for completion of the corporate insolvency resolution process under Section 12 or the fast track corporate insolvency resolution process under Section 56, as the case may be, does not receive a resolution plan under sub-Section (6) of Section 30; or

(b) rejects the resolution plan under Section 31 for the non-compliance of the requirements specified therein, it shall—

  (i) pass an order requiring the corporate debtor to be liquidated in the manner as laid down in this Chapter;

  (ii) issue a public announcement stating that the corporate debtor is in liquidation; and

  (iii) require such order to be sent to the authority with which the corporate debtor is registered.

Where the resolution professional, at any time during the corporate insolvency resolution process but before confirmation of resolution plan, intimates the Adjudicating Authority of the approval by not less than 66% of voting share to liquidate the corporate debtor, the Adjudicating Authority shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of the above sub-Section.

Where the resolution plan approved by the Adjudicating Authority is contravened by the concerned corporate debtor, any person other than the corporate debtor, whose interests are prejudicially affected by such contravention, may make an application to the Adjudicating Authority for a liquidation order as referred to in sub-clauses (i), (ii) and (in) of clause (b) of the above sub-Section.

On receipt of an application under sub-Section (3), if the Adjudicating Authority determines that the corporate debtor has contravened the provisions of the resolution plan, it shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub-Section (1).

Subject to Section 52, when a liquidation order has been passed, no suit or other legal proceeding shall be instituted by or against the corporate debtor:

Provided that a suit or other legal proceeding may be instituted by the liquidator, on behalf of the corporate debtor, with the prior approval of the Adjudicating Authority.

The provisions of sub-Section (5) shall not apply to legal proceedings in relation to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.

The order for liquidation under this Section shall be deemed to be a notice of discharge to the officers, employees and workmen of the corporate debtor, except when the business of the corporate debtor is continued during the liquidation process by the liquidator.

Appointment of Liquidator and fee to be paid [Section 34]

Where the Adjudicating Authority passes an order for liquidation of the corporate debtor under Section 33, the resolution professional appointed for the corporate insolvency resolution process under Chapter II subject to written consent in specified form act as the liquidator for the purposes of liquidation unless replaced by the Adjudicating Authority under sub-Section (4).

On the appointment of a liquidator under this Section, all powers of the board of directors, key managerial personnel and the partners of the corporate debtor, as the case may be, shall cease to have effect and shall be vested in the liquidator.

The personnel of the corporate debtor shall extend all assistance and co-operation to the liquidator as may be required by him in managing the affairs of the corporate debtor and provisions of Section 19 shall apply in relation to voluntary liquidation process as they apply in relation to liquidation process with the substitution of references to the liquidator for references to the interim resolution professional.

The Adjudicating Authority shall by order replace the resolution professional, if-

(a) the resolution plan submitted by the resolution professional under Section 30 was rejected for failure to meet the requirements men¬tioned in sub-Section (2) of Section 30; or

(b) the Board recommends the replacement of a resolution professional to the Adjudicating Authority for reasons to be recorded in writing.

For the purposes of clause (a) of sub-Section (4), the Adjudicating Authority may direct the Board to propose the name of another insolvency professional to be appointed as a liquidator.

The Board shall propose the name of another insolvency professional within ten days of the direction issued by the Adjudicating Authority under sub-Section (5).

The Adjudicating Authority shall, on receipt of the proposal of the Board for the appointment of an insolvency professional as liquidator, subject to written consent by an order appoint such insolvency professional as the liquidator.

An insolvency professional proposed to be appointed as a liquidator shall charge such fee for the conduct of the liquidation proceedings and in such proportion to the value of the liquidation estate assets, as may be specified by the Board.

The fees for the conduct of the liquidation proceedings under sub-Section (8) shall be paid to the liquidator from the proceeds of the liquidation estate under Section 53.

Powers and duties of Liquidator

The liquidator will work under overall directions of the Adjudicating Authority. He will have the following powers and duties [Section 35(1) of Insolvency and Bankruptcy Code, 2016].

(a) to verify claims of all the creditors.

(b) to take into his custody or control all the assets, property, effects and actionable claims of the corporate debtor.

(c) to evaluate the assets and property of the corporate debtor in the manner as may be specified by the Board and prepare a report.

(d) to take such measures to protect and preserve the assets and properties of the corporate debtor as he considers necessary.

(e) to carry on the business of the corporate debtor for its beneficial liquidation as he considers necessary.

(f) subject to Section 52, to sell the immovable and movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels in such manner as may be specified.

Provided that the liquidator shall not sell the innovable and movable property or actionable claims of the corporate debtor in liquidation to any person who is not eligible to be a resolution applicant.

(g) to draw, accept, make and endorse any negotiable instruments including bill of exchange, hundi or promissory note in the name and on behalf of the corporate debtor, with the same effect with respect to the liability as if such instruments were drawn, accepted, made or endorsed by or on behalf of the corporate debtor in the ordinary course of its business.

(h) to take out, in his official name, letter of administration to any deceased contributory and to do in his official name any other act necessary for obtaining payment of any money due and payable from a contributory or his estate which cannot be ordinarily done in the name of the corporate debtor, and in all such cases, the money due and payable shall, for the purpose of enabling the liquidator to take out the letter of administration or recover the money, be deemed to be due to the liquidator himself.

(i) to obtain any professional assistance from any person or appoint any professional, in discharge of his duties, obligations and responsibilities

(j) to invite and settle claims of creditors and claimants and distribute proceeds in accordance with the provisions of this Code.

(k) to institute or defend any suit, prosecution or other legal proceedings, civil or criminal, in the name of on behalf of the corporate debtor.

(l) to investigate the financial affairs of the corporate debtor to determine undervalued or preferential transactions

(m) to take all such actions, steps, or to sign, execute and verify any paper, deed, receipt document, application, petition, affidavit, bond or instrument and for such purpose to use the common seal, if any, as may be necessary for liquidation, distribution of assets and in discharge of his duties and obligations and functions as liquidator.

(n) to apply to the Adjudicating Authority for such orders or directions as may be necessary for the liquidation of the corporate debtor and to report the progress of the liquidation process in a manner as may be specified by the Board, and

(o) to perform such other functions as may be specified by the Board.

Consultation with stakeholders - The liquidator shall have the power to consult any of the stakeholders entitled to a distribution of proceeds under Section 53 of Insolvency and Bankruptcy Code, 2016. However, such consultation shall not be binding on the liquidator. The records of any such consultation shall be made available to all other stakeholders not so consulted, in a manner specified by the Board

- Section 35(2) of Insolvency and Bankruptcy Code, 2016.

Liquidation Estate

The liquidation estate shall comprise all liquidation estate assets as follow, except those specified in Section 36(4) of Insolvency and Bankruptcy Code, 2016 [Section 36(3) of Insolvency and Bankruptcy Code, 2016]

(a) any assets over which the corporate debtor has ownership rights, including all rights and interests therein as evidenced in the balance sheet of the corporate debtor or an information utility or records in the registry or any depository recording securities of the corporate debtor or by any other means as may be specified by the Board, including shares held in any subsidiary of the corporate debtor.

(b) assets that may or may not be in possession of the corporate debtor including but not limited to encumbered assets.

(c) tangible assets, whether movable or immovable.

(d) intangible assets including but not limited to intellectual property, securities (including shares held in a subsidiary of the corporate debtor) and financial instruments, insurance policies, contractual rights.

(e) assets subject to the determination of ownership by the court or authority.

(f) any assets or their value recovered through proceedings for avoidance of transactions in accordance with this Chapter.

(g) any asset of the corporate debtor in respect of which a secured creditor has relinquished security interest.

(h) any other property belonging to or vested in the corporate debtor at the insolvency commencement date, and

(i) all proceeds of liquidation as and when they are realised.

Assets which will not form part of liquidation assets - As per Section 36(4) of Insolvency and Bankruptcy Code, 2016, the following shall not be included in the liquidation estate assets. These shall not be used for recovery in the liquidation.

(a) assets owned by a third party which are in possession of the corporate debtor, including - (i) assets held in trust for any third party (ii) bailment contracts (iii) all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund (iv) other contractual arrangements which do not stipulate transfer of title but only use of the assets and (v) such other assets as may be notified by the Central Government in consultation with any financial sector regulator.

(b) assets in security collateral held by financial services providers and are subject to netting and set-off in multi-lateral trading or clearing transactions.

(c) personal assets of any shareholder or partner of a corporate debtor as the case may be provided such assets are not held on account of avoidance transactions that may be avoided under this Chapter.

(d) assets of any Indian or foreign subsidiary of the corporate debtor, or

(e) any other assets as may be specified by the Board, including assets which could be subject to set-off on account of mutual dealings between the corporate debtor and any creditor.

Workman - "Workman" shall have the same meaning as assigned to it in Section 2(s) of the Industrial

Disputes Act, 1947 - Section 3(36) of Insolvency and Bankruptcy Code, 2016.

Liquidator to form a liquidation estate - The liquidator shall form an estate of the assets mentioned in Section 36(3) of Insolvency and Bankruptcy Code, 2016. These will be for the purposes of liquidation. These which will be called the 'liquidation estate' in relation to the corporate debtor - Section 36(1) of Insolvency and Bankruptcy Code, 2016.

The liquidator shall hold the liquidation estate as a fiduciary for the benefit of all the creditors - Section 36(2) of Insolvency and Bankruptcy Code, 2016.

Insolvency commencement date - "Insolvency commencement date" means the date of admission of an application for initiating corporate insolvency resolution process by the Adjudicating Authority under Sections 7, 9 or Section 10 of Insolvency and Bankruptcy Code, 2016, as the case may be - Section 5(12) of Insolvency and Bankruptcy Code, 2016.

Liquidator has powers to access information

The liquidator shall have the power to access any information systems for the purpose of admission and proof of claims and identification of the liquidation estate assets relating to the corporate debtor from the following specified sources. These powers are overriding powers, irrespective of provisions in any other law [Section 37(1) of Insolvency and Bankruptcy Code, 2016]

(a) an information utility.

(b) credit information systems regulated under any law for the time being in force.

(c) any agency of the Central, State or Local Government including any registration authorities.

(d) information systems for financial and non-financial liabilities regulated under any law for the time being in force.

(e) information systems for securities and assets posted as security interest regulated under any law for the time being in force

(f) any database maintained by the Board, and

(g) any other source as may be specified by the Board.

Creditors can ask for information from liquidator

The creditors may require the liquidator to provide them any financial information relating to the corporate debtor in specified manner - Section 37(2) of Insolvency and Bankruptcy Code, 2016.

The liquidator shall provide information to such creditors within a period of seven days or provide reasons for not providing such information.

Ascertaining claims against corporate debtor

The liquidator shall receive or collect the claims of creditors within a period of thirty days from the date of the commencement of the liquidation process - Section 38(1) of Insolvency and Bankruptcy Code, 2016.

A financial creditor may submit a claim to the liquidator by providing a record of such claim with an information utility. However, where the information relating to the claim is not recorded in the information utility, the financial creditor may submit claim with supporting documents to prove the claim -Section 38(2) of Insolvency and Bankruptcy Code, 2016.

An operational creditor may submit a claim to the liquidator in manner, along with supporting

documents required to prove the claim as may be specified by the Board - Section 38(3) of Insolvency and Bankruptcy Code, 2016.

A creditor who is partly a financial creditor and partly an operational creditor shall submit claims to the liquidator to the extent of his financial debt in the manner provided in Section 3 8(2) and to the extent of his operational debt under Section 38(3).

Withdrawal or variation of claim within 14 days - A creditor may withdraw or vary his claim under this Section within fourteen days of its submission - Section 38(2) of Insolvency and Bankruptcy Code, 2016.

Verification of claims by liquidator

The liquidator shall verify the claims submitted under Section 38 within the time as specified by the Board. The liquidator may require any creditor or the corporate debtor or any other person to produce any other document or evidence which he thinks necessary for the purpose of verifying the whole or any part of the claim - Section 39 of Insolvency and Bankruptcy Code, 2016.

Admission or rejection of claims by liquidator

The liquidator may, after verification of claims, either admit or reject the claim, in whole or in part. If the liquidator rejects a claim, he shall record in writing the reasons for such rejection - Section 40(1) of Insolvency and Bankruptcy Code, 2016.

The liquidator shall communicate his decision of admission or rejection of claims to the creditor and corporate debtor within seven days of such admission or rejection of claims - Section 40(2) of Insolvency and Bankruptcy Code, 2016.

Determination of valuation of claims

The liquidator shall determine the value of claims admitted under Section 40 of Insolvency and Bankruptcy Code, 2016, in such manner as may be specified by the Board - Section 41 of Insolvency and Bankruptcy Code, 2016

Appeal against the decision of Liquidator

A creditor may appeal to the Adjudicating Authority against the decision of the liquidator accepting or rejecting the claims within fourteen days of the receipt of such decision - Section 42 of Insolvency and Bankruptcy Code, 2016.

On decision of NCLT, further appeal before NCLAT is possible, which will further delay the process.

Avoidance of preferential transactions by liquidator

The corporate debtor is of course aware that order of liquidation is possible. Hence, he may give preference to some transactions where he may be interested.

Meaning of preferential transaction - Corporate debtor shall be deemed to have given a preference, if—

(a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor and

(b) the above transfer has the effect of putting such creditor or a surety or a guarantor in a beneficial

position than it would have been in the event of a distribution of assets being made in accordance with Section 53 of Insolvency and Bankruptcy Code, 2016 - Section 43(2) of Insolvency and Bankruptcy Code, 2016.

Even if any transfer is made in pursuance of the order of a court, such transfer can be held to be deemed as giving of preference by the corporate debtor, if aforesaid circumstances exist - proviso to Section 43(3) of Insolvency and Bankruptcy Code, 2016.

Order of Adjudicating Authority in case of preferential transactions

On an application made by the resolution professional or liquidator under Section 43(1) of Insolvency and Bankruptcy Code, 2016, Adjudicating Authority can pass any of following orders [Section 44(1) of Insolvency and Bankruptcy Code, 2016]:

(a) require any property transferred in connection with the giving of the preference to be vested in the corporate debtor.

(b) require any property to be so vested if it represents the application either of the proceeds of sale of property so transferred or of money so transferred.

(c) release or discharge (in whole or in part) of any security interest created by the corporate debtor.

(d) require any person to pay such sums in respect of benefits received by him from the corporate debtor, such sums to the liquidator or the resolution professional, as the Adjudicating Authority may direct.

(e) direct any guarantor, whose financial debts or operational debts owed to any person were released or discharged (in whole or in part) by the giving of the preference, to be under such new or revived financial debts or operational debts to that person as the Adjudicating Authority deems appropriate.

(f) direct for providing security or charge on any property for the discharge of any financial debt or operational debt under the order, and such security or charge to have the same priority as a security or charge released or discharged wholly or in part by the giving of the preference, and

(g) direct for providing the extent to which any person whose property is so vested in the corporate debtor, or on whom financial debts or operational debts are imposed by the order, are to be proved in the liquidation or the corporate insolvency resolution process for financial debts or operational debts which arose from, or were released or discharged wholly or in part by the giving of the preference.

Order cannot be passed if interest in property was acquired in good faith

The Adjudicating Authority cannot pass order in respect of preferential transaction, if the third party had acquired interest or benefit in property from a person other than the corporate debtor in good faith.

Presumption that interest was not acquired in good faith

If a person, who has acquired an interest in property from another person other than the corporate debtor, or who has received a benefit from the preference or such another person to whom the corporate debtor gave the preference –

(i) had sufficient information of the initiation or commencement of insolvency resolution process of the corporate debtor

(ii) is a related party, it shall be presumed that the interest was acquired or the benefit was received otherwise than in good faith unless the contrary is shown.

A person shall be deemed to have sufficient information or opportunity to avail such information if a public announcement regarding the corporate insolvency resolution process has been made under Section 13 of Insolvency and Bankruptcy Code, 2016- Explanation II to Section 44(1) of Insolvency and Bankruptcy Code, 2016.

In such case, it shall be presumed that the person had not acquired interest in property in good faith and burden is on that person to prove that he had acquired interest in property in good faith-Explanation I to Section 44(1) of Insolvency and Bankruptcy Code, 2016.

Avoidance of undervalued transactions. [Section 45]

If the liquidator or the resolution professional, as the case may be, on an examination of the transactions of the corporate debtor referred to in sub-Section (2) of Section 43 determines that certain transactions were made during the relevant period under Section 46, which were undervalued, he shall make an application to the Adjudicating Authority to declare such transactions as void and reverse the effect of such transaction in accordance with this Chapter.

A transaction shall be considered undervalued where the corporate debtor —

(a) makes a gift to a person; or

(b) enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor, and such transaction has not taken place in the ordinary course of business of the corporate debtor.

Relevant period for avoidable transactions [Section 46]

In an application for avoiding a transaction at undervalue, the liquidator or the resolution professional, as the case may be, shall demonstrate that—

(i) such transaction was made with any person within the period of one year preceding the insolvency commencement date; or

(ii) such transaction was made with a related party within the period of two years preceding the insolvency commencement date.

The Adjudicating Authority may require an independent expert to assess evidence relating to the value of the transactions mentioned in this Section.

Application by creditor in cases of undervalued transactions [Section 47]

Where an undervalued transaction has taken place and the liquidator or the resolution professional as the case may be, has not reported it to the Adjudicating Authority, a creditor, member or a partner of a corporate debtor, as the case may be, may make an application to the Adjudicating Authority to declare such transactions void and reverse their effect in accordance with this Chapter.

Where the Adjudicating Authority, after examination of the application made under sub-Section (1), is satisfied that—

(a) undervalued transactions had occurred; and

(b) liquidator or the resolution professional, as the case may be, after having sufficient information or opportunity to avail information of such transactions did not report such transaction to the Adjudicating Authority,

it shall pass an order—

(a) restoring the position as it existed before such transactions and reversing the effects thereof in the manner as laid down in Section 45 and Section 48;

(b) requiring the Board to initiate disciplinary proceedings against the liquidator or the resolution professional as the case may be.

Order in cases of undervalued transactions. [Section 48]

The order of the Adjudicating Authority under sub-Section (1) of Section 45 may provide for the following:—

(a) require any property transferred as part of the transaction, to be vested in the corporate debtor;

(b) release or discharge (in whole or in part) any security interest granted by the corporate debtor;

(c) require any person to pay such sums, in respect of benefits received by such person, to the liquidator or the resolution professional as the case may be, as the Adjudicating Authority may direct; or

(d) require the payment of such consideration for the transaction as may be determined by an independent expert.

Transactions defrauding creditors. [Section 49]

Where the corporate debtor has entered into an undervalued transaction as referred to in Sub-section (2) of Section 45 and the Adjudicating Authority is satisfied that such transaction was deliberately entered into by such corporate debtor—

(a) for keeping assets of the corporate debtor beyond the reach of any person who is entitled to make a claim against the corporate debtor; or

(b) in order to adversely affect the interests of such a person in relation to the claim, the Adjudicating Authority shall make an order—

  (i) restoring the position as it existed before such transaction as if the transaction had not been entered into; and

  (ii) protecting the interests of persons who are victims of such transactions:

Provided that an order under this Section—

(a) shall not affect any interest in property which was acquired from a person other than the corporate debtor and was acquired in good faith, for value and without notice of the relevant circumstances, or affect any interest deriving from such an interest, and

(b) shall not require a person who received a benefit from the transaction in good faith, for value and without notice of the relevant circum¬stances to pay any sum unless he was a party to the transaction.

Extortionate credit transactions [Section 50]

Where the corporate debtor has been a party to an extortionate credit transaction involving the receipt of financial or operational debt during the period within two years preceding the insolvency commencement date, the liquidator or the resolution professional as the case may be, may make an application for avoidance of such transaction to the Adjudicating Authority if the terms of such transaction required exorbitant payments to be made by the corporate debtor.

The Board may specify the circumstances in which a transactions which shall be covered under sub-Section (1).

Explanation.—For the purpose of this Section, it is clarified that any debt extended by any person

providing financial services which is in compliance with any law for the time being in force in relation to such debt shall in no event be considered as an extortionate credit transaction.

Orders of Adjudicating Authority in respect of extortionate credit transactions [Section 51]

Where the Adjudicating Authority after examining the application made under sub-Section (1) of Section 50 is satisfied that the terms of a credit transaction required exorbitant payments to be made by the corporate debtor, it shall, by an order—

(a) restore the position as it existed prior to such transaction;

(b) set aside the whole or part of the debt created on account of the extortionate credit transaction;

(c) modify the terms of the transaction;

(d) require any person who is, or was, a party to the transaction to repay any amount received by such person; or

(e) require any security interest that was created as part of the extortionate credit transaction to be relinquished in favour of the liquidator or the resolution professional, as the case may be.

Secured creditor in liquidation proceedings [Section 52]

A secured creditor in the liquidation proceedings may—

(a) relinquish its security interest to the liquidation estate and receive proceeds from the sale of assets by the liquidator in the manner specified in Section 53; or

(b) realise its security interest in the manner specified in this Section.

Where the secured creditor realises security interest under clause (b) of Sub-section (1), he shall inform the liquidator of such security interest and identify the asset subject to such security interest to be realised.

Before any security interest is realised by the secured creditor under this Section, the liquidator shall verify such security interest and permit the secured creditor to realise only such security interest, the existence of which may be proved either—

(a) by the records of such security interest maintained by an information utility; or

(b) by such other means as may be specified by the Board.

A secured creditor may enforce, realise, settle, compromise or deal with the secured assets in accordance with such law as applicable to the security interest being realised and to the secured creditor and apply the proceeds to recover the debts due to it.

If in the course of realising a secured asset, any secured creditor faces resistance from the corporate debtor or any person connected therewith in taking possession of, selling or otherwise disposing off the security, the secured creditor may make an application to the Adjudicating Authority to facilitate the secured creditor to realise such security interest in accordance with law for the time being in force.

The Adjudicating Authority, on the receipt of an application from a secured creditor under sub-Section (5) may pass such order as may be necessary to permit a secured creditor to realise security interest in accordance with law for the time being in force.

Where the enforcement of the security interest under Sub-section (4) yields an amount by way of proceeds which is in excess of the debts due to the secured creditor, the secured creditor shall—

(a) account to the liquidator for such surplus; and

(b) tender to the liquidator any surplus funds received from the enforcement of such secured assets.

The amount of insolvency resolution process costs, due from secured creditors who realise their security

interests in the manner provided in this Section, shall be deducted from the proceeds of any realisation by such secured creditors, and they shall transfer such amounts to the liquidator to be included in the liquidation estate.

Where the proceeds of the realisation of the secured assets are not adequate to repay debts owed to the secured creditor, the unpaid debts of such secured creditor shall be paid by the liquidator in the manner specified in clause (e) of sub-Section (1) of Section 53.

Distribution of assets [Section 53]

Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period and in such manner as may be specified, namely:—

(a) the insolvency resolution process costs and the liquidation costs paid in full;

(b) the following debts which shall rank equally between and among the following:—

  (i) workmen's dues for the period of twenty-four months preceding the liquidation commencement date; and

  (ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in Section 52;

(c) wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;

(d) financial debts owed to unsecured creditors;

(e) the following dues shall rank equally between and among the following:—

  (i) any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;

  (ii) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;

(f) any remaining debts and dues;

(g) preference shareholders, if any; and

(h) equity shareholders or partners, as the case may be.

Any contractual arrangements between recipients under Sub-section (1) with equal ranking, if disrupting the order of priority under that Sub-section shall be disregarded by the liquidator.

The fees payable to the liquidator shall be deducted proportionately from the proceeds payable to each class of recipients under Sub-section (1), and the proceeds to the relevant recipient shall be distributed after such deduction.

Explanation.—For the purpose of this Section—

(i) it is hereby clarified that at each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each of the debts will either be paid in full, or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full; and

(ii) the term "workmen's dues" shall have the same meaning as assigned to it in Section 326 of the Companies Act, 2013 (18 of 2013).

Dissolution of corporate debtor [Section 54]

Where the assets of the corporate debtor have been completely liquidated, the liquidator shall make an application to the Adjudicating Authority for the dissolution of such corporate debtor.

The Adjudicating Authority shall on application filed by the liquidator under Sub-section (1) order that the corporate debtor shall be dissolved from the date of that order and the corporate debtor shall be dissolved accordingly.

A copy of an order under Sub-section (2) shall within seven days from the date of such order, be forwarded to the authority with which the corporate debtor is registered.