# FINAL
Paper 13

# CORPORATE AND ECONOMIC LAWS

Study Notes
SYLLABUS 2022

The Institute of Cost Accountants of India
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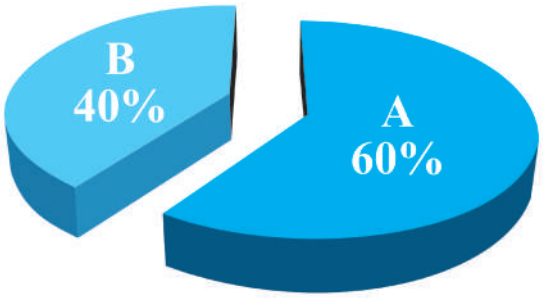
# PAPER 13: CORPORATE AND ECONOMIC LAWS

**Syllabus Structure:**

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

| Module No. | Module Description | Weight |
|---|---|---|
| | **Section A : Corporate Laws** | **60%** |
| 1 | The Companies Act, 2013 | 40% |
| 2 | Insolvency and Bankruptcy Code, 2016 | 10% |
| 3 | Corporate Governance and Social Responsibility and Sustainability | 10% |
| | **Section B: Economic Laws and Regulations** | **40%** |
| 4 | SEBI Regulations | 10% |
| 5 | The Competition Act, 2002 | 5% |
| 6 | Foreign Exchange Management Act, 1999 | 5% |
| 7 | Laws and Regulations related to Banking Sector | 5% |
| 8 | Laws and Regulations related to Insurance Sector | |
| 9 | Specific Legal Provisions related to MSME Sector | 5% |
| 10 | Laws and Regulations related to Cyber Security and Data Privacy | 5% |
| 11 | Laws and Regulations related to Anti-Money Laundering | 5% |



# The Learning Environment - Paper 13

| | |
|---|---|
| **Subject Title** | **CORPORATE AND ECONOMIC LAWS** |
| **Subject Code** | **CEL** |
| **Paper No.** | **13** |
| **Course Description** | The subject offers a detailed coverage of the whole of Companies Act, right from the inception to winding up. It also includes various other laws directly relating to business, other than tax and labour laws. The laws relating to competition, foreign exchange, banking and insurance etc, have been considered in fair amount of detail.<br>The insolvency and bankruptcy law which is of paramount importance given the present NPA problem in Indian banking sector, also features in the course. Regulations relating to corporate governance, sustainability and CSR have also found a place. Thus, the course is a comprehensive compilation of all corporate as well as economic legislations which a professional accountant is expected to be aware of. |
| **CMA Course Learning Objectives (CMLOs)** | 1. Interpret and appreciate emerging national and global concerns affecting organizations and be in a state of readiness for business management.<br>a. Identify emerging national and global forces responsible for enhanced/varied business challenges.<br>b. Assess how far these forces pose threats to the status-quo and creating new opportunities.<br>c. Find out ways and means to convert challenges into opportunities<br>2. Acquire skill sets for critical thinking, analyses and evaluations, comprehension, syntheses, and applications for optimization of sustainable goals.<br>a. Be equipped with the appropriate tools for analyses of business risks and hurdles.<br>b. Learn to apply tools and systems for evaluation of decision alternatives with a 360-degree approach.<br>c. Develop solutions through critical thinking to optimize sustainable goals.<br>3. Develop an understanding of strategic, financial, cost and risk-enabled performance management in a dynamic business environment.<br>a. Study the impacts of dynamic business environment on existing business strategies.<br>b. Learn to adopt, adapt and innovate financial, cost and operating strategies to cope up with the dynamic business environment.<br>c. Come up with strategies and tactics that create sustainable competitive advantages.<br>4. Learn to design the optimal approach for management of legal, institutional, regulatory and ESG frameworks, stakeholders' dynamics; monitoring, control, and reporting with application-oriented knowledge.<br>a. Develop an understanding of the legal, institutional and regulatory and ESG frameworks within which a firm operates.<br>b. Learn to articulate optimal responses to the changes in the above frameworks.<br>c. Appreciate stakeholders' dynamics and expectations, and develop appropriate reporting mechanisms to address their concerns.<br>5. Prepare to adopt an integrated cross functional approach for decision management and execution with cost leadership, optimized value creations and deliveries.<br>a. Acquire knowledge of cross functional tools for decision management.<br>b. Take an industry specific approach towards cost optimization, and control to achieve sustainable cost leadership.<br>c. Attain exclusive knowledge of data science and engineering to analyze and create value. |

| | |
|---|---|
| **Subject Learning Objectives [SLOB(s)]** | **A. CORPORATE LAWS**<br>1. To develop a clear understanding of rationale behind various provisions particularly on accounts, audit and dividends and its effect on the company; (CMLO 4a)<br>2. To obtain in-depth knowledge of various provisions of the Companies Act and Rules that govern the operations of a company at; (CMLO 4b, 4c)<br>3. To have fair idea about insolvency procedures to be undergone by a company; (CMLO 4c)<br>4. To have a detailed understanding of the concepts of corporate governance, CSR and sustainability and regulations associated with them. (CMLO 2c, 4b)<br>**B. ECONOMIC LAWS AND REGULATIONS**<br>1. To have an overview of important SEBI regulations relating to the fund mobilisation through capital market, trading in securities market and takeover of target companies; (CMLO 4a, b)<br>2. To acquire operations oriented knowledge of laws regulating the competitive landscape of businesses in India. (CMLO 4a)<br>3. To develop detailed and application oriented knowledge of provisions relating to management of foreign exchanges. (CMLO 4a, b)<br>4. To obtain an outline of multiple specialised laws and regulations governing banking and insurance sectors in India; (CMLO 4a, b)<br>5. To obtain an application oriented knowledge of special provisions relating to MSME sector; (CMLO 4b, c)<br>6. To understand the role of cyber laws in ensuring data security and privacy issues. (CMLO 4a, b)<br>7. To obtain an overview of the laws and regulations associated with prevention of money laundering in India. (CMLO 4a, b) |
| **Subject Learning Outcomes (SLOC) and Application Skills (APS)** | **A. Company Law:**<br>**SLOC(s):**<br>1. Students will be able to guide the management by providing reference to appropriate provisions of Companies Act while making various operational and financial decisions.<br>2. Students will be able to identify the documents to be prepared and submitted to appropriate authorities to ensure compliance.<br>3. They will be able to guide the management in improving the standard of corporate governance and corporate social responsibility and help them to avoid penal provisions due to non-compliances.<br>4. Students will equip themselves to deal with insolvency cases of customers, and business associates.<br>**APS:**<br>1. Students will develop appropriate skill to prepare documents to be submitted to various regulators in order to achieve compliance.<br>2. They will be skilled to draft para legal documents with accuracy and fairness.<br>**B. Economic Laws and Regulations:**<br>**SLOC(s):**<br>1. Students will be able to assist the management by providing reference to appropriate provisions of general economic laws and regulations while making various operational and financial decisions.<br>2. They will be able to guide the management of entities belonging to specialised sectors by providing appropriate reference to the sector specific legal guidelines and thus improve the compliance.<br>3. They will be able to identify possible threat to data security and privacy and guide the management to take appropriate legal measure to curb the same.<br>**APS:**<br>1. Students will develop appropriate skills to assist management in ensuring legally sustainable operations, ensure compliance with legal and regulatory provisions, prepare documents and reports to be submitted to various regulators in order to achieve compliance. |

**Module wise Mapping of SLOB(s)**

| Module No. | Topics and Sub-topics | Additional Resources (Research articles, case studies, blogs) | SLOB Mapped |
|---|---|---|---|
| **Section A: Corporate Laws** | | | |
| 1 | The Companies Act, 2013 | https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ== | 1. To obtain in-depth knowledge of various provisions of the Companies Act and Rules that govern the operations of a company at each and every stage;<br>2. To develop a clear understanding of rationale behind various provisions particularly on accounts, audit and dividends and its effect on the company. |
| 2 | Insolvency and Bankruptcy Code, 2016 | https://www.mca.gov.in/Ministry/pdf/TheInsolvencyandBankruptcyofIndia.https://ibbi.gov.in/en pdfThe InsolvencyandBankruptcyofIndia.pdf https://ibbi.gov.in/en | To have fair idea about insolvency procedures to be undergone by a company. |
| 3 | Corporate Governance, Social Responsibility and Sustainability | https://www.sebi.gov.in/legal/regulations/apr-2022/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-fourth-amendment-regulations-2022_58408.html | To have a detailed understanding of the concepts of corporate governance, CSR and sustainability and regulations associated with them. |
| **Section B: Economic Laws and Regulations** | | | |
| 4 | SEBI Laws and Regulations | https://www.sebi.gov.in/sebiweb/home/HomeAction.do?doListing=yes&sid=1&ssid=3&smid=0 | To have an overview of important SEBI regulations relating to the fund mobilisation through capital market, trading in securities market and takeover of target companies; |
| 5 | The Competition Act, 2002 | https://www.mca.gov.in/Ministry/actsbills/pdf/The_competition_Act_2002.pdf | To acquire fair knowledge of laws regulating the competitive landscape of businesses in India. |
| 6 | Foreign Exchange Management Act, 1999 | https://legislative.gov.in/sites/default/files/A1999-42_0.pdf | To develop detailed understanding of provisions relating to management of foreign exchanges |
| 7 | Laws and Regulations related to Banking Sector | https://financialservices.gov.in/act-rule/Banking/Banking-Acts | To obtain an overview of multiple specialised laws and regulations governing banking and insurance sectors in India |
| 8 | Laws and Regulations related to Insurance Sector | https://financialservices.gov.in/act-rule/Insurance/Insurance-Acts | |
| 9 | Specific Legal Provisions related to MSME Sector | https://msme.gov.in/circulars/msme-development-act-2006-rules-26-september-2006 | To obtain an overview of special provisions relating to MSME sector; |
| 10 | Laws and Regulations related to Cyber Security and Data Privacy | https://www.meity.gov.in/content/information-technology-act-2000-0 | To understand the role of cyber laws in ensuring data security and privacy issues. |
| 11 | Laws and Regulations related to Anti-Money Laundering | https://dea.gov.in/sites/default/files/moneylaunderingact.pdf | To obtain an overview of the laws and regulations associated with prevention of money laundering in India. |

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1.6 Board Meetings and Procedures
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1.8 Compromises, Arrangements and Amalgamations
1.9 Prevention of Oppression and Mismanagement

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# SECTION - A

# CORPORATE LAWS

# The Companies Act, 2013 1

**This Module includes:**


**1.1 Company Formation and Conversion**

**1.2 Investment and loans**

**1.3 Dividends**

**1.4 Accounts and Audit**

**1.5 Board of Directors and Key Managerial Personnel**

**1.6 Board Meetings and Procedures**

**1.7 Inspection, Inquiry and Investigation**

**1.8 Compromises, Arrangements and Amalgamations**

**1.9 Prevention of Oppression and Mismanagement**

# The Companies Act, 2013

**SLOB Mapped against the Module**

- To obtain in-depth knowledge of various provisions of the Companies Act and Rules that govern the operations of a company at each and every stage;
- To develop a clear understanding of rationale behind various provisions particularly on accounts, audit and dividends and its effect on the company.

**Module Learning Objectives:**

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

- Perform their job based on the understanding of the company law procedures;
- Relate accounting job with other functions of the company particular Board functioning;
- Aware of the penal provisions and shall be serious about their work to avoid non compliances;

# Company Formation and Conversion

# 1.1

## 1.1.1. Incorporation of private companies, public companies, company limited by guarantee and unlimited companies and conversions/reconversion/re-registration.

### 1.1.1.1. Introduction

Companies Act, 1913, was the first structured law on company form of organisation. Some of the concepts of 1913 Act are still present in 2013 Act. This Act continued till 1956, when the first Companies Act of independent India was passed in 1956 and this Act has regulated the most eventful years of growth and stabilisation of corporate India. Govt. made may attempts to introduce a new companies Act and various committees were set up. Replacing an Act of such large magnitude was not small task and many facets were to be seen. After 57 years, the new companies were drafted and passed in 2013.

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 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.

The structural shift is that while in 1956 Act, only 16% was delegated to CG, in 2013 Act. 74 % is Delegated legislation. This has resulted to frequent changes in the Rules.

The Act was amended in May, 2015, 2017 (modified in January 2018) July, 2019 and September, 2020. Relevant provisions of the amendments to the extent covered under syllabus have been incorporated in this study material.

## 1.1.1.2. Definition and Features of Company

**Definition**

Company is an artificial, legal and juristic person, separate from its members having perpetual existence.

"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.

**Features of Company**

**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].

**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. In the normal course, a shareholder is liable to pay for the shares as and when it is called up by the company. In case of default, the unpaid shares may be forfeited and the shareholder no more remains a shareholder.

**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".

There are many companies in India which were formed 100 years before not the people who have formed are no more there but the company remains.

**Separate property as separate owner**

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.

**Transferability of Shares**

In case of companies, 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.

**Common seal**

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 now it is optional. However, where the company has opted to have a common seal, the same shall be used at provided under the Act or the Articles.

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.

**Lifting of the 'Corporate Veil'**

The phrase' lifting the veil' is 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 law ignores 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 Court tend the lift the corporate veil in order to find the realities of situation in case of commission of fraud or improper conduct.

(f) The corporate veil is lifted where the company has abused the corporate personality for an unjust and unequitable purpose.

(g) The Courts invariably lift the corporate veil or 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].

(h) 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.

(i) 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.

(j) 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.

### 1.1.1.3. Nature of Business Organization in India

There are various types of organization doing business in India. Profit may not be motive or objective where there is substantial Govt. investment. This sector is also called social sector as it cater to the needs of the society. We may categorize Public Sector as follows on the basis of Government ownership.

(i) **Public Sector:** This sector comprises of the following.

(a) Govt. Departments like Railways, Ordinance Factories, Postal services etc.

(b) statutory corporations set up and run by the Govt. i.e. Reserve Bank of India created by Reserve Bank of India Act, 1934.

(c) companies with majority holding by Central Government/State Government having independent management by Board of directors.

(ii) **Joint Sector:** where Govt. have investment between 26 to 50%.

Companies may be classified on the basis of their incorporation, number of members, size, basis of control and motive. On the basis of incorporation of the companies, it may be classified into Charter Companies, Statutory Companies and Registered Companies. On the basis of liability, it may be Companies limited by shares/guarantee and unlimited liability companies. Further, on the basis of number of members, they may be classified into One Person Company, private company and public company. On the basis of size, they may be divided into small companies and other companies. On the basis of control, they may be classified into holding company, subsidiary company and associate company. Companies may also under other categories like non profit companies licensed under Section 8, Government companies, foreign companies, Dormant Company and Nidhi Companies, investment companies, producer companies etc.

### 1.1.1.4. Promotion of a Company:

As per Companies Act, 2013 persons whose name appears in the prospectus or identified by the company in the annual return, has control directly or indirectly over the affairs of the company either as a shareholder or a director and according to whose direction, advice or instructions the Board of Directors are accustomed to act. A person should not be regarded as a promoter if he/she acts in its personal capacity.

As per the Securities Exchange Board of India (SEBI) persons who are in control of the issuer or are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to the public. The persons whose name appears in the offer document are known as promoters.

**Promoters' Agreement/ Memorandum of Understanding (MOU):**

When promoters decide to do a business in the nature of a company, they will be meeting and deciding on various issues and ultimately they will choose to make a Memorandum of Understanding (MOU) though it is not mandatory. Promoters or any of the promoters can make contracts in his own name for the benefit of the proposed company. Once registered, promoter will disclose the contracts. Promoter is also duty bound to disclose any interest in the company to any interested person and will not make any secret profit.

Promoters can also make an agreement which will mention various issues relating to formation of the company and rights and liabilities of the company inter se.

Promoters may decide to prepare and sign a Memorandum of Understanding or Memorandum of Agreement (also called Promoters Agreement) while MOU is not enforceable under the law. Having an MOU or MOA is not mandatory and promoters may decide to prepare two initial documents.

- Memorandum of Association (MOA)
- Articles of Association (AOA)

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.

The memorandum and articles of association of a company are the most important documents for the formation of a company and for its functioning thereafter.

The memorandum of association contains the name, situation of registered office, objects, capital and liability and subscription clauses. The articles are its bye-laws or rules and regulations that govern the management and internal affairs and the conduct of its business. Both the documents are required to be registered with the Registrar of Companies at the stage of incorporation of the company.Before dealing with a company, it is advisable to read the memorandum and articles of the company to understand aspects, such as powers of Board, scope of company's activities etc. and its relationship with the outside world.Since Memorandum sets out the constitution of a company and is therefore the foundation on which the structure of the company is built. It defines the scope of the company's activities and its relations with the outside world. Company Secretary in employment should work within the four walls of the MOA and also subject to the provisions of AOA.

### 1.1.1.5. Classification of Companies

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

### 1.1.1.5.1. 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. Many statutory companies has converted into companies when they public issue

### 1.1.1.5.2. 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. 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 debts unlike proprietorship or partnership.

**(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. This is similar to LLP.

**(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.

## 1.1.1.5.3. On the basis of members

**(A) One Person Company (OPC)**

**(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.

(d) A Given that the liability is limited, the OPC is meant for solo entrepreneurs. There must be a nominee, it enabled perpetual existence of the OPC. Various exemptions has been given by the Central Government to OPC such as: exemption from holding the Annual General Meeting of the company, financial statement and Board's report can be signed only by one director, it does not need to include Cash Flow Statement as part of its financial statement etc. There are some industry-specific advantages. But taxes are to be paid at a flat rate on profits.

**(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.

**Exception to limited liability:** Section 3A provides that if the number of members of a private company is reduced below two, and the business is carried on for more than six months, while the number of members is so reduced, every person who is a member of the company during this period shall be severally liable for the payment of the whole debts of the company contracted during that time, and may be severally sued therefor provided the members are cognizant of the fact that the company is carrying business with such less number of members.

**(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.

A tabular difference between a private and public company is placed below.

| Serial No. | Points of difference | Private | Public |
|---|---|---|---|
| 1 | Shareholders | Min-2,-Max-200 | Min 7- no Max. |
| 2 | Directors | Min-2-Max.-15 | Min.-3, Max.-15<br>(may be increased with special resolution) |
| 3 | Finance | Cannot raise from public | Can raise |
| 4 | Transfer of shares | May be restricted | Cannot be restricted |
| 5. | Name | Use the Suffix "Pvt. Ltd". | Use suffix " Ltd". |

**(D) Small Company**

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 ₹4 crores s or such higher amount as may be prescribed which shall not be more than ₹10 crores and turnover of which as per its profit and loss account for the immediate preceding financial year. does not exceed ₹40 crores or such higher amount as may be prescribed which shall not be more than ₹100 crores.

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.

### 1.1.1.5.4. 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.

### 1.1.1.5.5. 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.

Such class of companies, which have listed or intend to list such class of securities, as may be prescribed in consultation with the Securities and Exchange Board, shall not be considered as listed companies."

For the purposes of the proviso to clause (52) of section 2 of the Companies Act, 2013, the following classes of companies shall not be considered as listed companies, namely:-

a) Public companies which have not listed their equity shares on a recognized stock exchange but have listed their –

(i) non-convertible debt securities issued on private placement basis in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008; or

(ii) non-convertible redeemable preference shares issued on private placement basis in terms of SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013; or

(iii) both categories of (i) and (ii) above.

b) Private companies which have listed their non-convertible debt securities on private placement basis on a recognized stock exchange in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008;

c) Public companies which have not listed their equity shares on a recognized stock exchange but whose equity shares are listed on a stock exchange in a jurisdiction as specified in Section 23(3) of the Companies Act, 2013.

**(B) Unlisted Company**

Unlisted Company means company other than listed company. They are also called closely held companies. It may be mentioned here that out of a substantial number of companies registered as Public companies, who can approach the capital market, a very small percentage of companies have issued shares to public and are listed. It means although promoters are forming public limited companies, they are not interested or ready for public issue. Few promoters don't want to dilute their stake to public.

## 1.1.1.5.6. Other Types of Companies

**(A) Government Company**

According to Section 2 (45) of the Companies Act, 2013, a 'Government company' means any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

**Example:** Coal India Limited is Govt. company, whereas Coal India has many subsidiaries, which are also Govt. companies.

**(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 during the last two financial years or has not filed financial statements and annual returns during the last two financial years, 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.

**(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 51% 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. It is formed on the basis of a JV agreement between two or more companies and registered as a company with the JV partners share the responsibilities and involvement. There may be an arrangement of venturing a business jointly without forming a company. This is called " non corporate joint venture" or" contractual joint venture"

**(H) Nonprofit Company:** Section 8 company is a company established for promoting commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object', provided the profits, if any, or other income is applied for promoting only the objects of the company and no dividend is paid to its members Section 8 Companies are registered under the Companies Act, 2013.

**(I) Sectoral Companies**

Sectorial companies are companies registered under the Companies act but specialising in particular sector which is regulated by a registry authority of the Govt.. These are the companies which are required to follow the provisions of Companies Act, as because they are registered companies and have to follow sectoral legislation, a law applies to the sector. Therefore, we have banking company, which has to follow Banking Regulation Act as well as Companies Act and are also subject to RBI directives, RBI being the reagulator. Same is the case in case for companies dealing in Insurance , electricity, etc.

**(J) Non-Banking Financial Company (NBFC):** With the growth in financial sector during last three decades, NBFCs have been recognised a large sector of business. A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, It engaged in the business of loans and advances, acquisition of shares/ stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or A non-banking institution is a company and has principal business of receiving deposits.

**(K) Banking Companies:** A company registered under Companies Act and engaged in banking business as stipulated under banking Regulation Act. In India, no company can commence banking operation without having a banking license to be issued by Reserve Bank of India. Banking companies to have a name where the "banking" word shall feature so that public in general know it is bank.

**(L) Insurance Company:** A company registered under Companies Act and engaged in insurance business as stipulated under the Insurance Act. In India, no company can commence insurance business without having a license to be issued by Insurance Regulatory and Development Authority (IRDA). Insurance companies to have a name where the "insurance" word shall feature so that public in general know it is bank. Details are available elsewhere in this study material.

### 1.1.1.6. Conversion of a Public Company into 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. 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 deem 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.

### 1.1.1.7. Large partnership to be registered as company or when companies must be registered

According to Section 464 of the Companies Act, 2013, no association or partnership consisting of more than 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 a fine that may extend upto one lakhs rupees and shall also be personally liable for all liabilities incurred in such business which 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.

## 1.1.1.8. 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 6 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. These provision are to be read with Companies(Incorporation) Rules as amended.

**(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.

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. Same provision also applicable for promoter and first director in this regard.

## 1.1.1.8.1. Steps for formation of Company

The Companies (Incorporation) Amendment Rules, 2020 w.e.f 23rd February, 2020 introduced new web form SPICe+ for incorporation of the Companies replacing the old e-form SPICe.

SPICe+ is an integrated Web form offering 11 services by various concerned Central Government Departments. and three State Government (Maharashtra, Karnataka & West Bengal), thereby saving as many procedures, time and cost for Starting a Business in India.

As per Rule 38 of the Companies (Incorporation) Rules, 2014, the Application for incorporation of a company shall be made in SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC-32) along with e-Memorandum of Association (e-MOA) in Form No. INC-33 and e-Articles of association (e-AOA) in Form no. INC-34.

The application under shall be accompanied by form AGILE-PRO-S (INC-35) containing an application for registration of the following numbers, namely:-

(a) GSTIN with effect from 31st March, 2019

(b) EPFO with effect from 8th April, 2019

(c) ESIC with effect from 15th April, 2019

(d) Profession Tax Registration with effect from the 23rd February, 2020

(e) Opening of Bank Account with effect from 23rd February, 2020.

(f) Shops and Establishment Registration.

Spice is an online service platform. Service Services offered through SPICe+ are: Name Reservation, Incorporation, DIN allotment, Mandatory issue of PAN, Mandatory issue of TAN, Mandatory issue of EPFO registration, Mandatory issue of ESIC registration, Mandatory issue of Profession Tax registration(Maharashtra, Karnataka & West Bengal), Mandatory Opening of Bank Account for the Company and Allotment of GSTIN (if so applied for), Shops and Establishment Registration. After deployment of SPICe+ web form, RUN is applicable only for change of name of existing companies.

**Establishment of Central Scrutiny Centre**

The Central Government has established a Central Scrutiny Centre (CSC) for carrying out scrutiny of Straight Through Processes (STP) e-forms filed by the companies under the Companies Act, 2013 and the rules made thereunder which has come into force from March 23, 2021.

The CSC shall function under the administrative control of the e-governance Cell of the Ministry of Corporate Affairs.

Establishment of Central Scrutiny Centre (CSC) (Notification No: S.O.1257 (E), Dated March 18, 2021)

The Central Government has established a Central Scrutiny Centre (CSC) for carrying out scrutiny of Straight Through Processes (STP) e-forms filed by the companies under the Companies Act, 2013 and the rules made thereunder which has come into force from March 23, 2021.

The CSC shall function under the administrative control of the e-governance Cell of the Ministry of Corporate Affairs.

## 1.1.1.8.2. Formation of One Person Company (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) No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.

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

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

i) OPC cannot convert voluntarily into any kind of company unless 2 years have expired from the date of incorporation, except where the paid up share capital is increased beyond ₹50 lakh or its average annual turnover during the relevant period exceeds ₹2 crore.

j) If One Person Company or any officer of such company contravenes the provisions, they shall be punishable with fine which may extend to ₹10,000 and with a further fine which may extend to ₹1,000 for every day after the first during which such contravention continues.

Rule 3 of the Companies (Incorporation) Rules 2014 says, only a natural person who is an Indian citizen whether resident in India or otherwise:-

(a) shall be eligible to incorporate a One Person Company;

(b) shall be a nominee for the sole member of a One Person Company. Where a natural person, being member in One Person Company accordance with this rule becomes a member in another such Company by virtue of his being a nominee in that One Person Company, such person shall meet the eligibility criteria specified in rule 3(2) within a period of 180 days. Where a natural person, being member in One Person Company in accordance with this rule becomes a member in another such Company by virtue of his being a nominee in that One Person Company, such person shall meet the eligibility criteria specified in rule 3(2) within a period of 180 days.

### 1.1.1.8.3. Effect of registration

On incorporation, 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. It will be an artificial juristic person

### 1.1.1.8.4. Certificate as Conclusive Evidence

Section 35 of the 1956 Act, provided for a Certificate of Incorporation given by the Registrar on registration . Tough 2013 Act do not have a section to replace the earlier section, Certificate of incorporation is accepted as conclusive evidence of existence of the company, by all judicial and administrative authorities.

### 1.1.1.8.5. 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.

(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].

### 1.1.1.9. Doctrine of ultra vires

Directors of the company cannot perform something which is beyond the scope of the Memorandum. A transaction may be good in law but may not be within the powers of the company and hence ultra vires , the company. Shareholders, while drafting the Memorandum , have already decided the outer boundaries both for themselves and also for the Board of Directors. Shareholders can decide to change or modify the objects and other clauses of the memorandum but as long as it is not done, they cannot overshoot the existing memorandum provisions with which the company is registered. There may be an action taken by Board of Directors but is permissible by the company. In such situation, company may ratify the action of the Board, However, ultra vires action by the company cannot be ratified even when all members agree to do that.

### 1.1.1.10. Commencement of business, etc.

As per Section 10A read with Rule 23A of the Companies (Incorporation) Rules, 2014, every company incorporated after the commencement of the Companies (Amendment) Act, 2019 and having a share capital shall not commence any business or exercise any borrowing powers unless:

(a) a declaration in form INC-20A is filed by a director within a period of one hundred and eighty days of the date of incorporation of the company in such form and verified by a Company Secretary or a Chartered Accountant or a Cost Accountant. in practice, with the Registrar that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him on the date of making of such declaration;

(b) The company has filed with the Registrar a verification of its registered office in form INC-22 as provided in sub-section (2) of section 12 of the Companies Act, 2013;

(c) If case of default the company shall be liable to a penalty of ₹50,000 and every officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues but not exceeding an amount of ₹1 lakh; and

(d) Where no declaration has been filed with the Registrar under clause (a) of sub-section (1) within a period of one hundred and eighty days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the company is not carrying on any business or operations, he may, without prejudice to the provisions of sub-section (2), initiate action for the removal of the name of the company from the register of companies under Chapter XVIII.

### 1.1.1.11. 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. Authorities can ask for any documents which gives right to possession of the office space.

**(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 ₹1,000 for every day during which the default continues but not exceeding ₹1 lakh.

In case, the Registrar is convinced with evidence that company is not carrying on any business, he may initiate action to strike off the name of the company.

### 1.1.1.12. 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.

### 1.1.1.13. 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.

**Contents of Memorandum of Association**

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.

### 1.1.1.14. 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.

Various guidelines have been issued on viability and use if names and are stipulated in Companies (incorporation) Rules.

(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 rejected 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:

i. either direct the company to change its name within a period of 3 months, after passing an ordinary resolution.

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

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

### 1.1.1.14.1. Extension of Reservation of name in certain cases

Upon payment of fees provided below through the web service available at www.mca.gov.in, the Registrar shall extend the period of a name reserved under rule 9 by using web service SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC-32), upto:

(a) 40 days from the date of approval under rule 9, on payment of fees of rupees of one thousand rupees made before the expiry of twenty days from the date of approval under rule 9;

(b) 60 days from the date of approval under rule 9 on payment of fees of ₹2,000 made before the expiry of forty days referred to in clause (a) above;

(c) 60 days from the date of approval under rule 9 on payment of fees of ₹3,000 made before the expiry of twenty days from the date of approval under rule 9:

However, the Registrar shall have the power to cancel the reserved name in accordance with sub-section (5) of section 4 of the Companies Act. 2013.

### 1.1.1.15. Alteration of the Memorandum

It is likely that with the passage of time, the company will grow or diversify. Shareholders, therefore, have the right to modify nay issues which they cloud not foresee initially. This is done by alternation of the Memorandum and Articles, as and when needed. Section 13 of the Companies Act, 2013 provides the provisions that deal with the alteration of the memorandum. The provision says that:

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

(2) 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) 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) The alteration of the memorandum changing the place of the registered office from one State to another shall not have any effect unless it is approved by the Central Government.

(5) The Central Government shall dispose of the above shifting within 60 days, satisfying 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,

(6) A company shall file with the Registrar such orders of CG, along with the shareholders' resolution.

(7) 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) 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) 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) 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.

**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 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.

## 1.1.1.16. Articles of Association

**Definition of AoA**

The articles of association are 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. 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) Model articles:** A company may adopt all or any of the regulations contained in the model articles applicable to such company.

**(g) 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.

**(h) 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.

### 1.1.1.17. 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 Central Government on an application.

(c) Every alteration of the articles and a copy of the order of the CG 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 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) 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 ₹1,000 for every copy of the articles issued without such alteration. [Section 15]

### 1.1.1.18. Copies of memorandum, articles, etc., to be given to members

Copies of memorandum and articles of association, every agreement and every resolution referred in Section 117 shall, on being so requested by a member, be sent within 7 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.

### 1.1.1.19. Privacy in management of companies

**Doctrines of constructive notice**

In consequences of the registration of the memorandum and articles of association of the company with the Registrar of Companies, a person dealing with the company is deemed to have constructive notice of their contents. 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. Where 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. Persons in charge of management cannot be prevented from wrong doing on the pretext 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.

### 1.1.1.20. Doctrine of Indoor Management

The aforesaid doctrine of constructive notice do not assume 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. The law will assume that those information which an outsider has reasonable access to and should have known with minimal efforts before dealing, cannot be a basis of indoor management case in his favour.

### 1.1.1.21. 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.

## 1.1.2. Formation of Not-for-Profit making Companies

For various reasons and objectives, people form companies not for profit. The surplus generated in the company, if any, is used for the fulfilment of the objectives of the company and no profit is distributed to the shareholders. A not-for-Profit organization also known as a non-business entity or social enterprise. 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. Such 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) prohibit the payment of any dividend to its members.

The Central Government may, by licence on such conditions as it deems fit, allow that 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 association of persons as a company under Section 8 of the Act, with following features.

(1) The company 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 shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

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

(5) where the Central Government is convinced 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 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.

(6) The Central Government may, by order, revoke such licence on being convinced the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest, 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.

(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.

(8) 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 incorporation under this section shall mention permanent 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 fine which shall not be less than ₹25,000 but which may extend to ₹25 lakh.

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.

### 1.1.2.1. License Under Section 8 for Existing Companies

Persons desirous of getting a licence under section 8, shall make an application in form INC-12. The MOA shall be in form INC 13 and declaration by professionals shall in in INC-14.

An estimated income and expenditure statement for next 3 years, shall also have to be furnished.

An existing company can also be converted into a non profit company. Application can be made in INC-12 with. MOA and AA. Declaration. Financial stamen and audit report of previous years.

## 1.1.3. 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 and 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. Section 379 provides that provisions of section 380 to 386, 392 and 393 shall apply to foreign companies with or without exemption.

### 1.1.3.1. 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.

### 1.1.3.2. 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.

### 1.1.3.3. 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.

### 1.1.3.4. 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, equity or preference, or combination thereof, 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.

### 1.1.3.5. 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.

Any alteration of the above documents shall be informed to Registrar within 30 days of alteration.

### 1.1.3.6. 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, unless exempted.

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.

### 1.1.3.7. 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 situate.

(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, billheads and letter paper, 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:

(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.

### 1.1.3.8. 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.

### 1.1.4. Conversion of LLPs into Private Limited Companies and vice versa.

Choosing form of business is voluntary for the entrepreneur subject to restrictions of law. The provisions of the Companies Act, 2013 read with rules made thereunder provides for the conversions of companies from one type of company to other another type of Company.

The company can convert in to following type of companies:

Conversion of a private company into a public company

Conversion of a public company into a private company

Conversion of one person company to private company/ public company

Conversion of private company to one person company

Conversion of section 8 company into any other kind of company

Conversion of LLP into company

Conversion from private company into limited liability partnership

Conversion from unlisted public company into limited liability partnership

we will discuss only two types of conversion i.e. from LLP to company and vice versa.

#### 1.1.4.1. Conversion of LLP into Company.

An LLP can be converted into a Pvt. Ltd. company as per the provisions contained in Section 366 of the Companies Act, 2013 and the Companies (Authorised to Registered) Rules, 2014.

This step can be initiated in 2 ways as enumerated below:

(i) Incorporation of a new corporate entity.

(ii) Conversion of existing entity (e.g. LLP/ Partnership Firm) into a Company.

The process of conversion is a step by step procedure, which is a technical process but if handled with expert knowledge may be time and cost saving, as well. Ministry of Corporate Affairs has passed a notification on 31st May, 2016 in such notification its allowed conversion of LLP into Company. These rules called as "the Companies Authorized to register Amendment Rules, 2016.

However, there are various requirements which need to be satisfied for converting an LLP into a Private Limited Company, for instance, an LLP must have at least 7 partners (however as per Companies Amendment Act, 2017 LLP with 2 partners can be convert into Company), approval from all the partners is required, advertisement in newspaper is to be done in a local and a national newspaper, a No Objection Certificate (NOC) is required from the ROC where such LLP is registered and then all the incorporation process has to be undertaken which includes:

**The following process is to be followed:**

**Approval of Name**

Hold a meeting of the partners to decide the name of the company summoned for the purpose of registering the LLP under Section 366 of the Companies Act, 2013.To authorize partners to take all steps necessary and to execute all papers, deeds, documents etc. pursuant to registration of the LLP as a Company.

One of the major advantages is that the business can be run under the same name as that of the LLP except that in addition to the name of the LLP the words 'limited' or 'private limited' has to be added. The name once accepted by the authority will be valid for 60 days.

**Securing DSC and DIN**

In case all 2 or 7 members, as the case may be, who are future directors of the company after conversion, do not have the Digital Signature Certificate (DSC) and Director Identification Number (DIN) for all the future directors of the company must be obtained. For obtaining the DIN, an application form must be filed on MCA portal. DIN application is processed & approved by central government via the office of regional director, the ministry of corporate affairs.

**Filing form no. URC – 1**

For the purposes of sub-section (2) of section 366 of the Companies Act, 2013, the provision of Chapter II of the Act relating to incorporation of company and matters incidental thereto shall be applicable mutatis mutandis for such registration:

Provided that there shall be two or more members for the purposes of registration of a company under this sub-rule:

Provided further that a company with less than seven members shall register as a private company.

A company shall attach and provide the required documents and information to the Registrar along with Form No. URC. 1 in the following manner, namely:-

**(a) In case of an application by a Limited Liability Partnership or firm for registration as a company limited by shares-**

(i) a list showing the names, addresses, and occupations of all persons named therein as partners with details of shares held by them respectively, showing separately shares allotted for consideration in cash and for consideration other than cash along-with the source of consideration and distinguishing, in cases where the shares are numbered, each share by its number, who on a day, not being more than six clear days before the day of seeking registration, were partners of the Limited Liability Partnership or firm as the case may be;

(ii) a list showing the particulars of persons proposed as the first directors of the company, along with Director Identification Number (DIN), passport number, if any, with expiry date, residential addresses and their interests in other firm or body corporate along with their consent to act as directors of the company;

(iii) in case of a firm, deed of partnership, bye-laws or other instrument constituting or regulating the firm and in case the deed of partnership was revised at any time in the past, copies of the principal and all subsequent deeds including the latest deed, along with the certificate of the registration issued by the Registrar of Firms, in case the firm is registered;

(iv) written consent or No Objection Certificate from all the secured creditors of the applicant;

(v) written consent, from the majority of members whether present in person or by proxy at a general meeting, agreeing for such registration, provided that there shall be two or more members for the purposes of registration of a company under this sub-rule:

Provided further that a company with less than seven members shall register as a private company.

**(b) Conversion of company into LLP**

Any existing private company or existing unlisted public company can be converted into LLP by complying with the Provisions of clause 58 and Schedule III and IV of the LLP Act.

**Board Meeting**

Pass Resolution for Conversion of Company into LLP and to authorize any director to file all the necessary forms with MCA. Take the written consent of all the shareholders for conversion of Company into LLP.

**Name Availability approval**

File web based Form RUN-LLP with ROC. Board Resolution Board resolution passed by the Company approving the conversion into LLP shall be attached with the aforesaid form.

**Agreement**

Limited liability partnership agreement shall have the following issues:

**Name of LLP**

- Name of Partners & Designated Partners
- Form of contribution
- Profit Sharing ratio
- Rights & Duties of Partners
- Proposed Business
- Rules for governing the LLP

It is not necessary to have the LLP Agreement signed at the time of incorporation, as the details of the same needs to field in e-form 3 within 30 days of incorporation but in order to avoid any dispute between the partners as to the terms & conditions of the agreement after the conversion into LLP, it is required to be drafted various documents to authenticate registered office and other statements etc. are to be filed.

**Filling of application for conversion:**

File E-FORM- 18 with ROC along with following Attachments:

Statement of shareholders. It is the document given by each shareholders giving their consent and statement.

Statement of Assets and Liabilities of the company duly certified as true and correct by the auditor.

In case all 2 or 7 members, as the case may be, who are future directors of the company after conversion, do not have the Digital Signature Certificate (DSC) and Director Identification Number (DIN) for all the future directors of the company must be obtained. For obtaining the DIN, an application form must be filed on MCA portal. DIN application is processed & approved by central government via the office of regional director, the ministry of corporate affairs.

**Filing form no. URC – 1**

For the purposes of sub-section (2) of section 366 of the Companies Act, 2013, the provision of Chapter II of the Act relating to incorporation of company and matters incidental thereto shall be applicable mutatis mutandis for such registration:

Provided that there shall be two or more members for the purposes of registration of a company under this sub-rule:

Provided further that a company with less than seven members shall register as a private company.

A company shall attach the following manner, namely:-

(a) In case of an application by a Limited Liability Partnership or firm for registration as a company limited by shares-

  (i) a list showing the names, addresses, and occupations of all persons named therein as partners with details of shares held by them respectively, showing separately shares allotted for consideration in cash and for consideration other than cash along-with the source of consideration and distinguishing, in cases where

the shares are numbered, each share by its number, who on a day, not being more than 6 clear days before the day of seeking registration, were partners of the Limited Liability Partnership or firm as the case may be;

(ii) a list showing the particulars of persons proposed as the first directors of the company, along with Director Identification Number (DIN), passport number, if any, with expiry date, residential addresses and their interests in other firm or body corporate along with their consent to act as directors of the company;

(iii) in case of a firm, deed of partnership, bye-laws or other instrument constituting or regulating the firm and in case the deed of partnership was revised at any time in the past, copies of the principal and all subsequent deeds including the latest deed, along with the certificate of the registration issued by the Registrar of Firms, in case the firm is registered;

(iv) written consent or No Objection Certificate from all the secured creditors of the applicant;

(v) written consent, from the majority of members whether present in person or by proxy at a general meeting, agreeing for such registration;

Provided that there shall be two or more members for the purposes of registration of a company under this sub-rule:

Provided further that a company with less than seven members shall register as a private company.

# Investment and Loans

# 1.2

## 1.2.1. Procedure for Inter-Corporate Loans, Investments, giving of Guarantee and Security

### 1.2.1.1. Loan and Investment by Company (Section 186)

Like individuals, companies also have some surplus money from time to time and they make short term/ long term investment. However, "investment" here denotes long term.

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.

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

(a) A company shall unless otherwise prescribed, make investment through not more than two layers of investment companies:

It 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.

(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 or one hundred per cent of its free reserves and securities premium account, whichever is more, without prior approval by means of a special resolution. This requirement will not apply in case of holding company in relation to its wholly owned subsidiary or joint venture company.

(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 ₹25,000 but which may extend to ₹25 lakh and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 2 years and with fine which shall not be less than ₹25,000 but which may extend to ₹1 lakh.

### 1.2.1.2. 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.

**Example :** ABC Ltd. holds 100% of XYZ Ltd. which is a private limited company, where at least two members shall be there. ABC Ltd. is one member. ABC Ltd can, therefore, nominate someone as shareholder but only one, since this is the minimum requirement of members which it will fall below to statutory limit of two members.

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

(1) from depositing with a bank, any shares or securities for the collection of any dividend or interest payable thereon.

(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:

(3) from depositing with, or transferring to, any person any shares or securities, by way of security for the repayment of any loan.

(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 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.

## 1.2.2. 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. Deposits used to be a very good source for short term capital. It used to be a regular course of income of for retired persons. However, with series of defaults by companies, investors lost faith on the companies. Presently, few companies are trusted for keeping deposits. Companies, now, have various alternate sources.

### 1.2.2.1. Prohibition on Acceptance of Deposits from Public [Section 73]

(a) No company can 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 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, with the mandate of a resolution in general meeting and subject to such rules as may be prescribed 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 shall be repaid with interest in accordance with the terms and conditions.

(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. The detailed procedure is mentioned under Companies (Acceptance of Deposits) Rules, 2014. Some of the Rules are summarised and placed below for understanding.

### 1.2.2.2. Terms and Conditions of Acceptance of Deposits by Companies (Rule 3)

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

(1) No 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 6 months or more than 36 months from the date of acceptance or renewal of such deposit.

However, a company may, accept or renew such deposits for repayment earlier than 6 months:-

a) not exceeding 10% of the aggregate of the paid up share capital and free reserves of the company, but shall be repayable not earlier than three months.

(b) Maximum limit of deposit outstanding at any point of time shall be 35%, 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, up to 10%.

b) any other deposit, up to 25%.

(d) Rate of brokerage shall as per RBI guidelines.

**Eligible company for acceptance of deposits:** Rule 2(a) of Companies (AD) Rules defines "eligible company" which means a public limited company with net worth ₹100 cr. and turnover of minimum ₹500 cr. and have consent of shareholders through special resolution to accept public deposits.

(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.

### 1.2.2.3. Creation of Security (Rule 6)

(a) Every eligible company inviting secured deposits shall provide for security by way of a charge on its assets 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.

(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.

### 1.2.2.4. Appointment of Trustee for Depositors (Rule 7)

(a) No 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. Trustees shall not be related to the directors and shall not have pecuniary interest on the company.

(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.

### 1.2.2.5. Duties of Trustees (Rule 8)

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 are 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.

### 1.2.2.6. Meeting of Depositors (Rule 9)

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.

### 1.2.2.7. 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

(b) repay within three years from such commencement or on or before expiry of the period for which the deposits were accepted, whichever is earlier:

(c) 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.

(d) 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 reuppes but which may extent to 2 crore rupees or with both.

### 1.2.2.8. 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.

### 1.2.2.9. 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.

Acceptance of Deposits without compliance of the Act, Rules and notifications could attract penalty and prosecution as per the Act.

### 1.2.2.10. 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, 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.

### 1.2.2.11. Acceptance of Deposits from Public by Certain Companies [Section 76]

(a) Notwithstanding anything contained in Section 73, a public company, having such net worth of ₹100 cr. or turnover of ₹500 cr. as may be prescribed, may accept deposits from persons other than its members

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.

Acceptance of deposits without compliance of the Act Rules and notifications would attract penalty and prosecution as per the Act.

### 1.2.12. 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 ₹1 crore 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 ₹25 lakhs but which may extend to ₹2 crores.

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.

## 1.2.3. Public Deposits and Debt Instruments

A company needs take loan while running the company which is very common. There are many sources of loan. However, the most common instrument is debenture or bonds. We will discuss in brief, the types of debentures and matters relating to issue of debentures.

**Debentures**

**Definition as per Companies Act, 2013?**

A debenture is a type of long term debt instrument which acknowledges debt. Debentures are backed only by the general creditworthiness and reputation of the issuer. Both corporations and governments frequently issue this type of bond to secure capital. Debentures may be secured or unsecured.

As per Section 2(30) of The Companies Act, 2013 "Debenture" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether consisting a change on the assets of the company or not.

**Types of Debenture:**

The major types of debentures are redeemable, irredeemable, convertible, non-convertible, fully, partly, secured, unsecured, fixed, floating rate, zero coupon, deep discount. Following are the various types of debentures vis-a-vis their basis of classification:

**Redeemable and Irredeemable (Perpetual) Debentures**

Redeemable debentures carry a specific date of redemption on the certificate. The company is legally bound to repay the principal amount to the debenture holders on that date. On the other hand, irredeemable debentures, also known as perpetual debentures, do not carry any date of redemption. This means that there is no specific time of redemption of these debentures. They are redeemed either on the liquidation of the company or when the company chooses to pay them off to reduce their liability by issues a due notice to the debenture holders beforehand.

**Convertible and Non-Convertible Debentures**

Convertible debenture holders have to convert their holdings into equity shares. The rate of conversion and the period after which the conversion will take effect are declared in the terms and conditions of the agreement of debentures at the time of issue. On the contrary, non-convertible debentures are simple debentures which will continue to be debentures till redemption. However, if option is given to the investor to convert or not to convert the debenture into shares, this kind of debenture is called optionally convertible debentures.

**Fully and Partly Convertible Debentures/Optionally Convertible Debentures**

Convertible Debentures are further classified into two – Fully and Partly Convertible. Fully convertible debentures are completely converted into equity whereas the partly convertible debentures have two parts. Convertible part is converted into equity as per agreed rate of exchange based on terms of issue. Non-convertible part remains as redeemable debenture which is repaid after the expiry of the agreed period.

However, option may also be given to the debenture holder either to continue as debenture holder or convert into shareholder. If such option exists in the terms of issue. This will amount to optionally convertible debenture.

**Example:** ABC ltd. issues debenture of ₹100 which will be repaid after 10 years with annual interest rate of 9%. This is non convertible denture. Alternatively, ABC Ltd. concerts ₹100 into 10 shares of ₹10 each after 5 years. This is fully convertible denture. Alternatively, out of ₹100, ₹50 is converted into 5 shares of ₹10 each after 5 years and the balance remain as debenture, which will be repaid after 10 years. This is partly convertible debenture. Alternatively, AB ltd. gives an option to the debenture holder either to convert or not to convert the debenture into shares after 5 years. This is a optionally convertible debenture.

**Secured and Unsecured Debentures**

When the debenture is secured by the charge on some asset or set of assets it is known as secured or mortgage debenture and when it is issued solely on the credibility of the issuer is known as the naked or unsecured debenture. In case of unsecured debenture, the Debenture holder is like any other unsecured creditor. In case of secured debenture, there is a security created by the company on its assets. In case of issue of debenture on private placement basis, the security can be decided by the issuer company and the investor. Public issue of debentures has to be secured, if the maturity period is more than 18 months. In such case, a SEBI registered debenture trustee is appointed, to whom the security is mortgaged with a condition that if the company fails to repay interest or principal, the debenture trustee shall have right to sale off the property and satisfy the claims of debenture holders both interest and principal.

**Fixed and Floating Rate Debentures**

Fixed rate debentures have fixed interest rate over the life of the debentures. The floating rate debentures have the floating rate of interest which is dependent on some benchmark rate and goes on fluctuating depending on market conditions.

**Zero Coupon Debentures**

Zero coupon debentures do not carry any coupon rate (interest) or we can say that there is zero coupon rate. The debenture holder will not get any interest on these types of debentures. In such case a warranty is issued with a debenture which may have entitlement to get a share at discount. This compensates the interest foregone. However, zero coupon rate debentures may be issued at discount and are normally called “discounted bonds”. If the maturity period is long it is called “deep discount bond”.

# Dividends

# 1.3

## 1.3.1. Profits and Ascertainment of Divisible Profit

Investors remain invested in a company for capital appreciation, i.e., increase in the value of shares and dividend. 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. It determines the attraction for a particular company.

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

'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. Many companies pay major part of the profits as dividend whereas some companies retain the profit as reserves. The former is called good payout company and later is bad payout company. Share prices, many times, depend on dividend payout policy of the company.

**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 and are related as percentage of the face value of shares.

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'). This interim dividend is regularized in AGM.SEBI has introduced disclosure of dividend policy. A note on the same is annexed to this chapter.

Nonprofit companies under Section 8 of the Act are prohibited by their constitution from paying any dividend to its members.

Dividends are normally declared as percentage to the face value of shares. However, in recent times, absolute amount, i.e. ₹7.50 per share, is also used. Reason being variation in face value of various companies, which sometimes, the shareholder is not aware of.

## 1.3.2. Declaration and Payment of Dividend

According to Section 123 (1) of the Act No dividend shall be declared or paid by a company for any financial year except :

(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 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

["Provided that in computing profits any amount representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded; 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

No Dividend shall be declared or paid by a company from its reserves other than free reserves.. The carried over previous losses and accumulated depreciation has to be set off against current year's profit. Further, companies failing to repay interest or principal of public deposits under Section 73 and 74 of the Act, shall not declare dividend.

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]

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.

Dividend shall be departed out of current year's profit only. The carry over accumulated depreciation and losses, if any, shall be adjusted with current years profit. Further, companies failing to repay interest or principal of public deposit under section 73 and 74 of the Act, shall not declare dividend.

### 1.3.2.1. Declaration of Dividend out of Reserves

There may be a situation when a constantly paying dividend company, owing to inadequacy or absence of profits in any financial year, the company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred to the free reserves, such declaration of dividend shall be made in compliance of Rules as discussed below.

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:

Provided that this sub-rule shall not apply to a company, which 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.

(3) The amount so drawn shall first be utilized 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.

(4) 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.

### 1.3.2.2. 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 5 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.

### 1.3.2.3. Interim Dividend [123(3)]

The Board of Directors of a company may declare interim dividend during any financial year or at any time during the period from closure of financial year till holding of 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. The interim dividend shall be ratified in AGM, along with any further dividend to be called as final dividend.

Interim dividend has become very common no., with few blue ship companies declaring interim dividend almost every year. Finance Ministry has issued a guideline to Central PSUs to declare dividend each quarter after the quarterly result, if there is adequate profit.

### 1.3.2.4. Payment of Dividend [123(5]

Procedure for treatment of payment of interim and final dividend is same. Dividend, once declared in AGM, cannot be revoked.

(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) Capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares should not be confused with payment of dividend as both are separate issues.

### 1.3.2.5. Punishment for failure to distribute Dividends (Section 127)

(a) On non-compliance of provisions of 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 and with fine which shall not be less than one thousand rupees for every day during which such default continues

(b) 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.

(c) 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.

### 1.3.3. Unpaid and unclaimed Dividend- Treatment and Transfer to Investor Education and Protection Fund.

It has been observed that in many cases, few shareholders are not traceable. The documents sent to them is returned to the company. Before IEPF, the unpaid dividend used to be with the company for three years and thereafter was transferred to Central Govt. wherefrom shareholders can claim. This rule has been modified with establishment of IEPF.

(a) As per section 125 of 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 money received for allotment of any securities and due for refund.

(3) Matured deposits for allotment of any securities

(4) Matured debentures.

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

(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 money out of the Fund for carrying out the objects.

For the purpose of administration of IEPF, the Investor Education and Protection Fund, 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 utilization of Funds by the Committee, proforma for applications for registration of associations, institutions or organizations and also for seeking financial assistance under IEPF, etc.

(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.

(2) donations given to the Fund by the Central Government, State Governments, companies or any other Institution.

(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 as penalty 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) Transfer to IEPF and claim by shareholder

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

(1) 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).

(2) The amount shall be remitted within a period of 90 days of such amount becoming due to be credited to the IEPF.

(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.

(4) 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 (shareholder or his legal representative)

(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.

**Dividend Distribution policy**

On the 8th July, 2016 SECURITIES AND EXCHANGE BOARD OF INDIA has notified amendment in (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) by inserting "Dividend Distribution Policy as 43A.

(1) The top one thousand listed entities based on market capitalization (calculated as on March 31 of every financial year) shall formulate a dividend distribution policy which shall be disclosed in their annual reports and on their websites.

(2) The dividend distribution policy shall include the following parameters:

(a) the circumstances under which the shareholders of the listed entities may or may not expect dividend;

(b) the financial parameters that shall be considered while declaring dividend;

(c) internal and external factors that shall be considered for declaration of dividend;

(d) policy as to how the retained earnings shall be utilized; and

(e) parameters that shall be adopted with regard to various classes of shares: Provided that if the listed entity proposes to declare dividend on the basis of parameters in addition to clauses (a) to (e) or proposes to change such additional parameters or the dividend distribution policy contained in any of the parameters, it shall disclose such changes along with the rationale for the same in its annual report and on its website. it shall disclose such changes along with the rationale for the same in its annual report and on its website.

(3) The listed entities other than those specified at sub-regulation (1) of these regulation may disclose their dividend distribution policies on a voluntary basis in their websites and provide a web-link in their annual reports. ."

**Draft Dividend Policy Statement of Listed Company**

**Preamble**

The board of directors (the "board") of ABC Ltd. understands the importance of shareholders' confidence and trust in the company. in order to preserve the same with transparency and to ensure that there is no conflict of interest or any apprehension in the minds of its shareholders, the board of the company, has adopted the dividend distribution policy ("policy") and procedures with respect to dividends declared/ recommended by the company in accordance with the provisions of Regulation 43A of The Securities and Exchange Board of India (listing obligations and disclosure requirements) regulations, 2015 ("listing regulations") as amended from time to time. this policy has been adopted by the board of the company at its meeting held on the policy shall also be displayed in the annual report and also on the website of the company.

**Purpose of the Policy**

The purpose of this policy is to facilitate the process of dividend recommendation or declaration and its pay-out by the company which would ensure a regular dividend income for the shareholders and long term capital appreciation for all stakeholders of the company. The profits earned by the company can either be retained in business or used for acquisitions, expansion or diversification, or it can be distributed to the shareholders. The company may choose to retain a part of its profits and distribute the balance among its shareholders as dividend.

The company would ensure to strike the right balance between the quantum of dividend paid and amount of profits retained in the business. The board will refer to the policy while declaring/ recommending dividends on behalf of the company.

**Types of Dividends**

**(a) Interim dividend**

The interim dividend may be declared by the board one or more times in the financial year as may be deemed fit.

**(b) Final dividend**

The final dividend is paid once for the financial year after the annual accounts are prepared. The board of directors of the company has the power to recommend the payment of final dividend to the shareholders for their approval at the annual general meeting of the company. The declaration of final dividend shall be included in the ordinary business items that are required to be transacted at the annual general meeting.

**(c) Special dividend**

The board may declare/recommend special dividend as and when it deems fit.

**Basis**

The dividend will be declared on per share basis only in percentage terms to face value.

**Dividend Declaration and Distribution**

Dividend shall be declared or paid only out of –

1) current financial year's profit:
   a. after providing for depreciation in accordance with law;
   b. after transferring to reserves such amount as may be prescribed or as may be otherwise considered appropriate by the board at its discretion and as per applicable law.

   or

2) the profits for any previous financial year(s) after providing for depreciation in accordance with law and remaining undistributed;

   or

3) out of 1) & 2) both.

In case of inadequacy or absence of profits in any financial year, the company may also declare/ pay dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, provided such declaration/payment of dividend shall be made only in accordance with the provisions of the Companies Act, 2013 and rules specified therein.

The Board of Directors shall endeavor to take a decision for dividend distribution with an objective to enhance shareholders value. However, the decision regarding pay-out is subject to several parameters which form part of this policy.

The dividend once declared or approved will be paid/ distributed within the statutory period permitted by law.

**Financial parameters considered while declaring dividend**

The financial parameters that may be considered before declaring dividend are profitability, cash flow and future requirement of fund and profitability of the company.

a. due to operation of any other law in force;
b. due to losses incurred by the company and the board considers it appropriate not to declare dividend for any particular year;
c. due to any restrictions and covenants contained in any agreement as may be entered with the lenders;
d. uncertainty of the earnings/financial results of the company; and
e. the availability of opportunities for reinvestments of surplus funds;
f. any other corporate action resulting in cash outflow.

# Accounts & Audit

# 1.4

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

## 1.4.1. Maintenance of Books of Accounts; Safe Preservation of Records and Accounting Policies

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.

**Maintenance of Books of Accounts**

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:

(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.

**Financial Year:** means period ending on 31st march of every year and where it has been incorporated on or after the 1st day of January of a year, the period ending on 31st march of the following year, provided that Central Government may allow different financial year for subsidiary, joint venture or associate company registered out of India.

(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.

### 1.4.1.1. 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.

### 1.4.1.2. 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.

### 1.4.1.3. 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.

### 1.4.1.4. 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.

### 1.4.1.5. 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.

### 1.4.1.6. 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) Fine which shall not be less than ₹50,000 but which may extend to ₹5 lakh.

### 1.4.1.7. 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.

### 1.4.1.8. 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.

### 1.4.1.9. 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)].

### 1.4.1.10. 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.

### 1.4.1.11. 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.

### 1.4.1.12. 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.

Section 129A has been inserted by Amendment of 2020. It provides that Central Government may require such class or classes of companies to

(i) prepare the financial results of the company in such period and form as may be prescribed

(ii) obtain approval of the Board of Directors, complete audit or limited review of the financial statement and file the same within 30 days of close of the relevant period.

### 1.4.1.13. 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 (NFRA) is limited to advise the Central Government on the accounting standards recommended by ICAI for adoption by companies. Alongwith Financial Reporting Authority, the existing Accounting Standards notified under the Companies Act, 1956 shall continue to apply.

### 1.4.1.14. 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, 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 web address, if any, where annual return referred to in sub-section (3) of section 92 has been placed;

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.

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, (Companies where nominatory and Remuneration Committee applies) 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:

(i) by the auditor in his report and

(ii) 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) 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.

q) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year along with the web address where the policy is hosted. Salient features of the policies including on directors appointment & remuneration be mentioned in the Board Report, besides website disclosure.

r) 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.

s) 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) **s**hall be prepared based on the stand alone financial statements of the company [2][and 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) shall contain the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the Form AOC-2.

3) shall contain the following information and details, namely:-

**(A) Conservation of energy-**

(i) the steps taken or impact on conservation of energy;

(ii) the steps taken by the company for utilising alternate sources of energy;

(iii) the capital investment on energy conservation equipments;

**(B) Technology absorption-**

(i) the efforts made towards technology absorption;

(ii) the benefits derived like product improvement, cost reduction, product development or import substitution;

(iii) in case of imported technology (imported during the last three years reckoned from the beginning of the financial year)-

(a) the details of technology imported;

(b) the year of import;

(c) whether the technology been fully absorbed;

(d) if not fully absorbed, areas where absorption has not taken place, and the reasons thereof; and

(iv) the expenditure incurred on Research and Development.

**(C) Foreign exchange earnings and Outgo-**

The Foreign Exchange earned in terms of actual inflows during the year and the Foreign

Exchange outgo during the year in terms of actual outflows.

[1]["Provided that the requirement of furnishing information and details under this sub-rule shall not apply to a government company engaged in producing defence equipment".]

**(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)**

Board report includes various significant element, one of which is Directors' Responsibility Statement. Directors' Responsibility Statement is a new topic of Corporate Governance.

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)]**

If a company contravenes any provisions of this Section, the penalty would be ₹ 3 lakh for the company and ₹ 50,000 for every officer in default.

### 1.4.1.15. 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 ₹ 500 crores or more, or turnover of ₹1,000 crores or more or a net profit of ₹5 crores or more during immediately preceeding 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 directors 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 or where the company has not completed the period of 3 years, during such immediately preceding 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 and under such unspent amount relates to any ongoing project transfer such amount to a fund specified under Schedule VII within a period of 6 months of expiry of financial year. Any amount remaining unspent relating to any ongoing project shall be transferred by the company within 30 days of the close of financial year to a special account to be used for the purpose of the project during next 3 years, failing which the unspent amount of the end of the 3rd year shall be transferred to fund under Schedule VII.

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.

### 1.4.1.16. 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.
If the copies of the documents are sent less than twenty-one days before the date of the meeting, they shall, notwithstanding that fact, be deemed to have been duly sent if it is so agreed by members-
(a) holding, if the company has a share capital, majority in number entitled to vote and who represent not less than ninety-five per cent. Of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or
(b) having, if the company has no share capital, not less than ninety five percent. of the total voting power exercisable at the meeting:

(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 listed company having a subsidiary or subsidiaries shall place separate audited accounts in respect of each of subsidiary on its website, if any: Provided also that a listed company which has a subsidiary incorporated outside India (herein referred to as "foreign subsidiary")—

(a) where such foreign subsidiary is statutorily required to prepare consolidated financial statement under

any law of the country of its incorporation, the requirement of this proviso shall be met if consolidated financial statement of such foreign subsidiary is placed on the website of the listed company;

(b) where such foreign subsidiary is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the holding Indian listed company may place such unaudited financial statement on its website and where such financial statement is in a language other than English, a translated copy of the financial statement in English shall also be placed on the website.]

(i) 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.

(j) 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.

### 1.4.1.17. 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.

### 1.4.1.18. 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 when adopted [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)]**

(i) 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.

(ii) 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.

(iii) 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 30 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 ten thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day during which such failure continues, subject to a maximum of two lakh rupees , 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 liable to a penalty of `ten thousand rupees and in case of continuing failure, with further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of fifty thousand rupees..

## 1.4.1.19. Internal Audit (Section 138)

Section 138 of the Companies Act, 2013 came into force from 1st April, 2014 which provides first time new provision for internal audit. 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:

i) paid up share capital of ₹50 crores or more during the preceding financial year, or

ii) turnover of ₹200 crores or more during the preceding financial year, or

ii) 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

iv) outstanding deposits of ₹25 crores or more at any point of time during the preceding financial year, and

c) every private company having:

i) turnover of ₹200 crores or more during the preceding financial year, or

ii) 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.

(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" or "Cost Accountant" shall mean a "Chartered Accountant" or a "Cost Accountant", as the case may be, whether engaged in practice or not.

(b) The internal auditor may or may not be an employee of the company.

## 1.4.2. Statutory Auditor, Special Auditor and Cost Auditor - Appointment, Resignation, Removal, Qualification, Disqualification, Rights, Duties and Liabilities

### 1.4.2.1. 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:

(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.

### 1.4.2.2. 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 crores or more.

(2) all private limited companies having paid up share capital of ₹20 crores 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 5 consecutive years) shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of his term.

(2) An audit firm which has completed its term (i.e., two terms of 5 consecutive years) shall not be eligible for re-appointment as auditor in the same company for 5 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 5 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 a period which shall not be later than the date of the first annual general meeting of the company held, within the period specified under sub-section (1) of Section 96, after three years from the date of commencement of this Act..

(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.

### 1.4.2.3. 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 Rule 6 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:

i) 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 5 consecutive years or 10 consecutive years, as the case may be.

ii) 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.

iii) For the purpose of rotation of auditors:

- a break in the term for a continuous period of 5 years shall be considered as fulfilling the requirement of rotation.
- 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 5 years.

### 1.4.2.4. 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.

### 1.4.2.5. 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 3 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.

### 1.4.2.6. 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:

i) the Central Government and one or more Government companies.

ii) any State Government or Governments and one or more Government companies.

iii) the Central Government, one or more State Governments and one or more Government companies.

iv) the Central Government and one or more corporations owned or controlled by the Central Government.

v) the Central Government, one or more State Governments and one or more corporations owned and controlled by the Central Government.

vi) one or more corporations owned or controlled by the Central Government or the State Government.

vii) more than one Government company.

### 1.4.2.7. 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.

### 1.4.2.8. 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.

### 1.4.2.9. 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.

### 1.4.2.10. 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 liable for a penalty of ₹50,000 or amount equal to the remuneration of auditor, whichever is less, and for further ₹ 500 for every day of containing offence subject to maximum of ₹ 2 lakhs.

### 1.4.2.11. 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.

### 1.4.2.12. Eligibility, qualifications and disqualifications of auditors (Section 141)

### 1.4.2.12.1. 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.

### 1.4.2.12.2. 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 Lakh 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 Lakh. 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 Lakh, the corrective action to maintain the limits as specified above shall be taken by the auditor within 60 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 Lakhs, 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 Lakh.

(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:

- Public Companies and
- Private Companies having paid up capital of ₹100 crores 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) a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company..

### 1.4.2.13. 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.

### 1.4.2.14. 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.

### 1.4.2.15. Powers and duties of auditors and auditing standards (Section 143)

#### 1.4.2.15.1. 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 and associate companies in so far as it relates to the consolidation of its financial statements with that of its subsidiaries and associate companies.

### 1.4.2.15.2. 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.

(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:

(i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

(ii) 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.

(iii) 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:

i) 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;

ii) 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;

iii) 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.

iv) 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.

v) 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.

vi) 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 be ₹ 1 lakh for unlisted company and ₹ 5 lakhs for listed company.

### 1.4.2.16. 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.

### 1.4.2.17. Audit of accounts of branch office of company [Section 143(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:

i) the company's auditor, or

ii) by an accountant, or

iii) 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.

### 1.4.2.18. 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.

### 1.4.2.19. 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.

### 1.4.2.20. 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.

### 1.4.2.21. 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 lakh.

**(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:

(1) With fine which shall not be less than ₹10,000 but which may extend to ₹1 lakh,

**(C) Penalty on auditor [Sections 147 (2) & (3)]**

(a) If an auditor of a company contravenes any of the provisions of Section 139, 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 or four times the remuneration of the auditor, whichever is less

(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 lakhs 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 members or creditors of the company 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.

Provided that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

### 1.4.2.22.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. This audit is in addition to statutory financial audit under section 143 for Regulated Sections and Non Regulated Section as per Cost Audit Rules.

(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 recommended by the Audit Committee and shall be ratified by shareholders.

### 1.4.3. Company Auditor Report Order (CARO) Rules

MCA has notified now Companies (Auditor's Report) Order, 2020 on 25th February, 2020 which replaced CARO, 2016. It is a new format of reporting of statutory audit having additional reporting requirements decided in consultation with National Financial Reporting Authority (NFRA) CARO, 2020 is applicable for all statutory audits commencing on or after 1.4.2020 corresponding of Financial Year 2019-20. However, by notification, applicability of CARO has been deferred by one year. Now, CARO will be applicable for the accounts of financial year 2020-21. CARO 2020 is applicable to every company including a foreign company as defined in clause (42) of Section 2 of the Companies Act 2013.

### 1.4.3.1. The following classes of companies are outside the purview of the CARO 2020.

(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:

i) Paid up share capital of which does not exceed ₹ 4 crores or such higher amount as may be prescribed which shall not be more than ₹ 10 crores, and

i) Turnover of which as per its last profit and loss account does not exceed ₹ 40 crores or such higher amount as may be prescribed which shall not be more than ₹ 100 crores.

(2) The following company shall not qualify as a small company:

i) A holding company or a subsidiary company.

ii) A company registered under Section 8 of the Act.

iii) 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 2020:

(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 crores 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.

### 1.4.3.2. Matters included in CARO 2020 are discussed below:

### 14.3.2.1. Property, Plant & Equipment (PPE) [clause 3 (i)]

(a) Whether the company is maintaining proper records showing full particulars including quantitative details and situation of PPE & full particulars of intangible assets.

(b) Whether these fixed asset have been physically verified by management at reasonable interval, whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account,

(c) Matters relating to title deeds not in the name of the company, revaluation and effects thereof etc.

(d) Whether the company has revalued its PPE or intangible assets and in this respect any material discripencies of 10% or more has been observed.

(e) Whether any proceeeding have been initiated or pending against the company for holding any benami property.

#### 1.4.3.2.2. Inventory [Clause 3 (ii)]

(a) Whether physical verification of inventory has been conducted at reasonable interval by the management, any material discrepancies of 10% or more has been noticed on such verification and if so, whether the same has been properly dealt with in the books of account

(b) Whether during any point of time, the company has been sanctioned working capital limits in excess of ₹5 crores.

#### 1.4.3.2.3. Investment / providing any guarantee or security or granted loan and advances [Clause 3(iii)]

Whether the company has granted any loans, secured or unsecured to companies, firms, LLP or other parties.

(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 overdue for more than 90 days and whether reasonable steps have been taken by the company for recovery of principal.

#### 1.4.3.2.4. Compliance with Sec 185 & 186 of the Companies Act: Loan to director and investment by the company [Clause 3 (iv)]

#### 1.4.3.2.5. Acceptance of 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) Nature of contraventions, due to non compliance

#### 1.4.3.2.6. Maintaining of Cost Records [Clause 3(vi)]

If the companies required to maintain records whether such records have been maintained and non- compliance, if any.

#### 1.4.3.2.7. Depositing Statutory Dues [Clause 3 (vii)]

(a) Whether the company is regular in depositing statutory dues with the appropriate authorities including GST, 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 6 months from the date they become payable, shall be indicated by the auditor.

(b) In case disputed statutory dues, the amount involved and the forum where dispute is pending.

#### 1.4.3.2.8. Reporting of Transactions not covered in books of Accounts [Clause 3(viii)]

Whether any transactions not recorded in the books of accounts have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961) and properly recorded in the books of accounts.

#### 1.4.3.2.9. Repayment of Loan [Clause 3(ix)]

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.

#### 1.4.3.2.10. Money raised through IPO and further public offer [Clause 3(x)]

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

#### 1.4.3.2.11. Disclosure regarding Fraud [Clause 3(xi)]

Whether any fraud by the company or any fraud on the company by its officers and employees has been noticed or reported u/s 143(12) during the year: if yes, the nature and the amount involved is to be indicated.

#### 1.4.3.2.12. 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. Details of any default in payment of interest on deposits or repayment.

#### 1.4.3.2.13. Related Party Transaction [Clause 3(xiii)]

Whether the company has complied with section 188 of the Companies Act, 2013 in respect of related party transactions and with appropriate disclosure.

#### 1.4.3.2.14. Internal Audit [Clause 3(xiv)]

**(a)** Whether the company has an internal audit system commensurate with the size and nature of its business;

**(b)** Whether the report of the Internal Auditors for the period under audit were considered by the statutoty auditor.

#### 1.4.3.2.15. Non Cash Transaction [Clause 3(xv)]

Whether the company has entered into any non-cash transactions with directors or presons connected with them and if so, whether provisions of section 192 of The Companies Act, 2013 have been complied with.

#### 1.4.3.2.16. Registration under Section 451A of the 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.

Other matters to be reported by the Auditor relates to cash losses, resignation of statutory auditors, material uncertainty, transfer of fund under Schedule VII, adverse auditor remark in other company of the group etc.

**1.4.3.2.17. Report on cash losses [Clause xvii]:** Whether the company has incurred cash losses in the financial year and in the immediately preceding financial, if so, the amount of cash losses to be indicated.

**1.4.3.2.18. Reporting on auditor's resignation [Clause xviii]:** Whether there has been any resignation by the statutory auditor during the financial year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditor.

**1.4.3.2.19. Reporting on financial position [Clause xix]:** Whether there is, as per auditor's opinion, material uncertainty and the company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the date of balance sheet.

**1.4.3.2.20. Reporting on CSR compliance [Clause xx]:** (a) Whether unspent CSR amount in respect of other than ongoing projects has been sent to a Fund as specified in Schedule VII to the companies Act; (b) whether unspent CSR amount in respect of ongoing project has been transferred to special designated Bank account.

**1.4.3.2.21. Reporting on consolidated financial statement [Clause xxi]:** Whether there have been any qualification or adverse remarks by the respective auditors in the CARO reports of the companies included in the consolidated financial statements, if so, details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remark to be indicated.

**ICAI's Guidance Note on CARO 2020**

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, 2020 on 13th June 2020. 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 2020 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. It would suspended the guidance on CARO 2016.

# Board of Directors and Key Managerial Personnel

1.5

## 1.5.1. Directors and Key Managerial Personnel - Appointment, Reappointment, Resignation, Removal

Chapter XI and Chapter XIII of the Companies Act, 2013 contain the provisions as to Board of Directors and Managerial Personnel.

### 1.5.1.1. Nature of Company Management

Shareholders are the owners of the company. They can anytime decide to run themselves or may like persons to act on their behalf for management of the company and highest level of such inclusion of outside person is director, who will be member of the Board of Directors. The hierarchy of the entities and their status is captured in brief in the table below.

| Level/ Entity in Management | Type of Powers | Reference |
|---|---|---|
| Shareholders | Powers not given/delegated to the Board of Directors. | Section 180 of the Companies Act, 2013 and Articles of Association of the company. |
| Board of Directors | All powers of decision making about the company unless reserved for the shareholders. | Section 179 of the Companies Act, 2013. |
| Chairman | Executive/ Non- Executive functions of the company. Chairing the Company meetings. | Section 104 of the Companies Act, 2013. |
| Chairman and Managing Director (CMD) | Exercises both Chairman and Managing Director's Power. | |
| Managing Director | Has substantial powers of the management of the company. Works under the supervision and control of the Board of Directors. | Section 196 of the Companies Act, 2013. |
| Whole Time Director/ Functional Director | Full time employee of the company. Looks after specified functions of the company. | |

### 1.5.1.2. Concept of Director

When a person chooses to form a company, either he, his relatives or any of the promotors may hold the post of directors. Else the promoters (those controlling the company) may appoint outsiders, who are competent in the area, to become director and manage the company. In former case, we call them owner/promoter director. In later case, we call them professionals.

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

authorized by the Board of directors of the Company, do not possess any individual 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 organizational 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.

### 1.5.1.3. Position of Directors

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. Directors are the ones to make any decisions related to the company. He is the person who has the required knowledge and the intention to run a company. Since an artificial person cannot have all these characteristics, directors are appointed and entrusted with the concerned business. A director is in fact a director or controller of the company's affair'. The team of directors is known as the Board of Directors. A director may, however, work as an employee in a different capacity. He is also a custodian of the assets which are owned by the shareholders and run the company in best interest of the stakeholders.

The senior management positions mainly consist of manager, whole time director or a managing director. These occupy the prominent position in the decision making of the company. Companies shall have a duly constituted Board of Directors.

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.

### 1.5.1.4. 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 shall be 15**

If the company wants to appoint more than 15 directors, it can do so after passing a special resolution. This is not applicable in case of Government and section 8 (non profit) company.

**(c) Women director**

At least one woman director shall be on the Board of such class or classes of companies as may be prescribed. 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, under any category of director.

(1) every listed company.

(2) every other public company having.

a) paid–up share capital of ₹100 crores or more; or

b) turnover of ₹300 crores 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.

**(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)]

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 has relaxed the minimum stay in India for 182 days for the year 2019-20 and 2020-21.

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.

**(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 orclasses of companies shall have at least 2 directors as independent directors:

(1) the Public Companies having paid up share capital of ₹10 crores or more, or

(2) the Public Companies having turnover of ₹100 crores or more, or

(3) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding ₹50 crores. (figures as on last day of the audited final statement)

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.

As per Section 149(6) of the Companies Act, 2013, An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,—

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(ii) who is not related to promoters or Directors in the company, its holding, subsidiary or associate company;

[5][(c)[who has or had no [12][pecuniary relationship, other than remuneration as such director or having transaction not exceeding ten per cent. of his total income or such amount as may be prescribed,] with the company,

its holding, subsidiary or associate company, or their promoters, or Directors, during the two immediately preceding financial years or during the current financial year;]

[13][(d)none of whose relatives—

(i) is holding any security of or interest in the company, its holding, subsidiary or associate company during the two immediately preceding financial years or during the current financial year:

Provided that the relative may hold security or interest in the company of face value not exceeding fifty lakh rupees or two per cent. of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed;

(ii) is indebted to the company, its holding, subsidiary or associate company or their promoters, or Directors, in excess of such amount as may be prescribed during the two immediately preceding financial years or during the current financial year;

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or Directors of such holding company, for such amount as may be prescribed during the two immediately preceding financial years or during the current financial year; or

(iv) has any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to two per cent. or more of its gross turnover or total income singly or in combination with the transactions referred to in sub-clause (i), (ii) or (iii);]

(e) who, neither himself nor any of his relatives—

(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

Provided that in case of a relative who is an employee, the restriction under this clause shall not apply for his employment during preceding three financial years.

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent. or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, Directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

(f) who possesses such other qualifications as may be prescribed.

Independent director shall have get himself registered with ID portal maintained by Indian Institute of Corporate Affairs (IICA). They have to pass an examination conducted by IICA. No examination shall be required for persons:

(i) Experience of 10 years as KMP;

(ii) 10 years as an advocate, practicing CA/CMA/CS;

(iii) Working in pay scale of directors, equivalent in CG/SG in matter relating to commerce, corporate, finance, industry etc,.

(iv) IICA shall send annual report of capacity building of each of the registered director to the company where he is director.

### 1.5.1.5. Appointment of Directors [Section 152]

(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) Every director shall be appointed by the company in general meeting, unless any specific method of appointment is provided in the Articles of Association. [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)]

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.

### 1.5.1.6. Rotational and non-rotational directors

Out of total number of directors, at least 2/3rd shall be liable to retire by rotation. Articles may provide that more than 2/3rd or all directors shall be rotational directors. Out of such 2/3rd, 1/3rd must retire in every AGM, (Directors appointed by CG, BIFR, FI/Banks shall not be taken in to account for calculating the number of rotational directors) Non rotational directors, shall, unless otherwise expressly provided in this Act, be appointed by the company in general meeting.

(a) 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.

(b) The retiring directors 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.

(c) 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. By default, and unless there is proposal to appoint any other person or not to reappoint him, his proposal for reappointment shall be placed in the meeting, unless he suffers from any disqualification.

### 1.5.1.7. 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.

(5) Section 162 is applicable to the case.

**Non applicability of section 152 (6) and 152 (7)**

The provisions relating to retirement, 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.

### 1.5.1.8. Right of persons other than retiring directors to stand for directorship (Section 160)

(1) A person who is not a retiring director 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 proposal of such member to consider him as a candidate for director.

(2) Such notice must come along with the deposit of ₹1,00,000 and 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 on such resolution. Requirement of deposit shall not apply if the appointment of director is recommended by Nomination and Remuneration committee/Board.

(3) 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:

i) 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.

ii) 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

iii) by placing notice of such candidature or intention on the website of the company, if any.

iv) 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) Section 160 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.

### 1.5.1.9. 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. Normally, the articles of most of the companies have provisions for additional director. There are some person who is very much needed for the company but they cannot be taken as employee. In order the get the services, guidance and expertise of such persons, Board of directors have been given the power to select a person as director till next AGM.

**Example:** Mr. Ahuja, CMD of a Govt. of India Steel plant retired on 30.11/21. Next day he was appointed as additional director in large private steel company as additional director (full time) as he was an expert in steel industry. He will continue till next AGM.

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.It may be mentioned that whether an alternate director shall be appointed or not and who shall be appointed is the prerogative of the Board and not the decision of the original 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. It is worth mentioning here "nomination" do not mean "appointment". The person appointed shall have to be appointed in the proper manner.

**(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:

a) 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.

b) 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.

### 1.5.1.10. Appointment of Directors elected by Small shareholders (Section 151)

There was persistent demand from the small shareholders to have a director nominated by them to look after the interest of small shareholders. This has been considered in the new Act. 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 moto 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.

(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.

### 1.5.1.11. Option to adopt principle of proportional representation for appointment of Directors (Section 163)

As per this Section, Notwithstanding anything contained in this Act,-

a) 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 in the normal way , as provided in sub-section (4) of section 161.

The above section 163 of the Companies Act, 2013, shall not apply to:

i) 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;

ii) 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.

### 1.5.1.12. Disqualifications for appointment of Director (Section 164)

According to this section:

(1) A person shall not be eligible for appointment as a director of a company, IF:

a) he is of unsound mind and stands so declared by a competent court.

b) he is an undischarged insolvent.

c) he has applied to be adjudicated as an insolvent and his application is pending.

d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than 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.

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.

i) he has not complied with the provisions of 165(1) relating to holding of maximum number of directorship.

(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 or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared on preference shares 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)]

Provided that where a person is appointed as a director of a company which is in default of clause (a) or clause (b), he shall not incur the disqualification for a period of six months from the date of his appointment

(3) 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].

Provided that the disqualifications referred to in clauses (d), (e) and (g) of sub-section (1) shall continue to apply even if the appeal or petition has been filed against the order of conviction or disqualification

(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, ore

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.

### 1.5.1.13. Resignation of Director (Section 168)

Acceptance of directorship is voluntary and continuation also is voluntary. There cannot any compulsion on continuation of the office. The law provides that:

(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.

### 1.5.1.14. Removal of Directors (Section 169)

It is normal that the appointing authority can only be the removing authority. However, since the appointment has a procedure, the removal also has a procedure. Section 169 of the Companies Act, 2013 provides the provisions for removal of directors.

(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 only.

(b) the directors appointed on the principle of proportional representation under section 163 cannot be removed by an ordinary resolution as aforesaid.

(c) A special notice from member(s) 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, 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 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 tenure of 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.

### 1.5.1.15. Vacation of office of Director (Section 167)

(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.

Provided that where he incurs disqualification under sub-section (2) of section 164, the office of the director shall become vacant in all the companies, other than the company which is in default under that sub-section.

(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.

Provided that the office shall not be vacated by the director in case of orders referred to in clauses (e) and (f)-

(i) for thirty days from the date of conviction or order of disqualification;

(ii) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed of; or

(iii) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed of.]

(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.

(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 fine which shall not be less than Rupees 1 lakh but which may extend to Rupees 5 lakhs. [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)].

**Managing director**

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.

**Whole Time Director [Section 2(94)]**

Whole-time director' includes a director in the whole time employment of the company. They are also considered as executive directors as they are executives of the company. There are some companies where a particular function is attached to the director, i.e. Director (Finance), Director ( Commercial) etc.

**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. Though , legally, managing director and manager are almost same, we hardly hear know companies with manager instead of managing director. It is gathered that the concept originated from tea gardens where garden manager used to have substantial powers of management.

### 1.5.1.16. 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:

(1) No company shall appoint or employ a managing director and a manager at the same time.

(2) 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.

(3) No company shall appoint or continue the employment of any person as managing director, whole- time director or manager who:

(a) is below the age of 21 years or has attained the age of 70 years. Person who has attained the age of seventy years may be appointed by the passing of a special resolution.

(b) is an undischarged insolvent or has at any time been adjudged as an insolvent, or

(c) has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them, or

(d) has at any time been convicted by a court of an offence and sentenced for a period of more than six months.

(4) 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 :

(a) 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.

(b) he had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974:

(c) where he is a managerial person in more than one company, he draws remuneration from one or more companies subject to the ceiling provided in section V of Part II.

(d) 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,

i) for taking up employment in India; or

ii) for carrying on a business or vacation in India.

(e) Where an appointment not approved by AGM, any Act done by him deemed to be invalid.

### 1.5.1.17. Procedure of Appointment [Section 196 (4)]

(a) 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 60 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)]. It is not applicable for specified Public Company, Govt. Company by notification.

### 1.5.1.18. Appointment of Key Managerial Personnel (Section 203)

**(a) Every company belonging to such class or classes of companies as maybe 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 crores or more shall have whole-time key managerial personnel.

**(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.

**(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 of other company, approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting.( unanimous Board resolution)

(3) 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.

### 1.5.2. Payment of Remuneration to Directors and Key Managerial Personnel and Disclosure

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 Non Convertible Debentures 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 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 by special resolution in general meeting this limit may be exceeded |
| More than one Managing director/ Whole time director/ manager | 10% of the net profits to all such Directors and manager taken together | With the approval of the company by special resolution 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 by special resolution 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 by special resolution 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(NRC) if the company is covered under sub-section (1) of section 178, (companies required to have NRC) 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 ₹1 lakh per meeting of the Board or committee thereof. 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. Insurance premium paid for fidelity guarantee against misfeasance and misgovernance shall not be treated as remuneration.

**(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) 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 approval required under this section, he shall refund such sums to the company, within two years or such lesser period as may be allowed by 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 approved by the company by special resolution within two years from the date the sum becomes refundable. [Section 197(10)].

**(g) Disclosure by listed company [Section 197(12)]**

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.

(2) The Board's report shall include a statement showing the name of top 10 remunerating employees of the company, who:

i) If employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than ₹1.25 crores.

ii) 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 rupees eight lakh fifty thousand rupees per month.

iii) 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) Receiving Commission [Section 197 (14)]**

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.

**(j) Contravention [Section 197 (15)]**

If any person contravenes the provisions of this section, he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees

**(k) Statement by auditor [Section 197 (16)]**

The auditor of the company shall, in his report under section 143, make a statement as to whether the remuneration paid by the company to its Directors is in accordance with the provisions of this section, whether remuneration paid to any director is in excess of the limit laid down under this section and give such other details as may be prescribed

**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 unless the company is an investment company<br>b. profits on sales by the company of forfeited shares;<br>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;<br>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:<br>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;<br>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.<br>f. any amount representing unrealised gains, notional gains or revaluation of assets |

Sums specified in section 198(4) shall 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.

Sums specified in section 198 (5) shall not be deducted:

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.

#### 1.5.2.1. Central Government or company to fix limit with regard to remuneration (Section 200)

(a) 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, considering the following.

(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) The Central Government or the company shall also have regard to the following matters, namely:

(1) the Financial and operating performance of the company during the 3 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.

### 1.5.3. Power of the Board of Directors and Restrictions on the Powers of Directors

#### 1.5.3.1. Power of the Board of Directors

Section 179 of the Act, provides Powers of Board. According to this section:

(a) the powers of directors are co existence with the company itself. 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 authorized to exercise and do.

Powers of the Board may be restricted under articles of association and also in general meeting. Companies Act also provides few powers can only be exercised by the company only.

(b) Powers of the Board are to be exercised collectively and no individual director, unless specifically authority, shall not have any powers of the Board, However, executive directors, being employees shall have powers as per regulation of the company.

(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 dully 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;

(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.

(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)].

### 1.5.3.2. Restrictions on Powers of Board (Section 180)

Fact cannot be overlooked that a company is an institution owned and controlled by the shareholders. The inherent, residuary and ultimate powers rest with the shareholders. 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:

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 u 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

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 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 20% 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 20% 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 and securities premium, apart from temporary loans obtained from the company's bankers in the ordinary course of business.

Every special resolution shall specify the total amount up to which monies may be borrowed by the Board of Directors [Section 180 (2)].

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:

i) 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

ii) 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 may be conditional and shall have to be complied with.

### 1.5.3.3. Shareholders Intervention in Board functions

Shareholders, being the ultimate stakeholders of the company, may intervene in Board functioning and management under exceptional cases. Some of which are discussed below.

(i) Malafide intention of majority of directors; If the Board itself turn out to be wrong doers.

(ii) Incompetent Board; For some reason, The Board has become incompetent to act. For example, all Board members have become indirectly interested in a particular resolution or technically there is no Board and immediately Board cannot be constituted.

(iii) Deadlock situation where majority decision cannot be taken or powers bot vested to directors shall remain with the shareholders or a situation where confusion prevails as to powers of the Board.

### 1.5.4. Obtaining DIN

DIN (Directors Identification Number) is a unique number allotted to a person acting as director and there cannot be two DIN of the same person like Adhar and PAN. '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.

#### 1.5.4.1. 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 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 applicant, who intends to be appointed as director of an existing company shall make an application electronically in Form DIR-3, to the central Government for allotment of a Director Identification Number (DIN) along with such fees as provided under the companies (Registration offices and Fees) Rules, 2014. Provided that in case of proposed directors not having approved DIN, the particulars of maximum three directors shall be mentioned in Form No.INC-32 (spice) and DIN may be allotted to maximum three proposed directors through Form INC-32 (spice)

(b) The applicant shall download Form DIR-3 from the portal, fill in the required particulars sought therein, verify and sign the form through digital signature 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.

(c) 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 company secretary in full time employment of the company or by the managing director or director or CEO or CFO of the company in which the applicant is intended to be appointed as director in an existing company

(d) 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.

#### 1.5.4.2. Allotment of Director Identification Number (Section 154)

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.

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 defects or incompleteness by resubmitting the application within a period of 15 days 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.

### 1.5.4.3. 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).

### 1.5.4.4. 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.

### 1.5.4.5. 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.

### 1.5.4.6. 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.

### 1.5.4.7. 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 makes any default in complying with any of the provisions of section 152, section 155 and section 156, such individual or director of the company shall be liable to a penalty which may extend to fifty thousand rupees and where the default is a continuing one, with a further penalty which may extend to five hundred rupees for each day after the first during which such default continues.

### 1.5.4.8. Cancellation or Surrender or Deactivation of DIN

The Central Government or any officer authorised may, upon being satisfied on verification of particulars or documentary proof attached with the application received cancel or deactivate the DIN in case:

(a) the DIN is found to be duplicated

(b) the DIN was obtained in a wrongful manner or by fraudulent means

(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.

### 1.5.4.9. Intimation of changes in particulars specified in DIN application

(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 30 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.

### 1.5.5. Compensation for Loss of Office

It may be mentioned that loss of office means cessation/end of the job of the director. 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/amalgamation of the company, 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/e amalgamated company.

(2) where the director resigns from his office in normal course, 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 amount of compensation 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, during such 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. If the director/ manger has rendered services as a professional, that can be paid and shall not be considered as " compensation.

### 1.5.6. Waiver of Recovery of Compensation

In case any compensation has been wrongly paid the same can be recovered under this Act. In addition to above, 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 recovered 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.

### 1.5.7. Making Loans to Directors, Disclosure on Interest of as Director, Holding of Office or Place of Profit by a Director/ Relative

#### 1.5.7.1. 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, or give any guarantee or provide any security in connection with any loan taken by :-

(a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or

(b) any firm in which any such director or relative is a partner.

(2) A company may advance any loan including any loan represented by a book debt, or give any guarantee or provide any security in connection with any loan taken by any person in whom any of the director of the company is interested, subject to the condition that—:

(a) a special resolution is passed by the company in general meeting:

Provided that the explanatory statement to the notice for the relevant general meeting shall disclose the full particulars of the loans given, 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 and any other relevant fact; and

(b) the loans are utilised by the borrowing company for its principal business activities.

Explanation- For the purposes of this sub-section, the expression "any person in whom any of the director of the company is interested" means—:

(a) any private company of which any such director is a director or member;

(b) 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

(c) 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.

**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 rate of prevailing yield of one year, three years, five years or ten years Government security closest to the tenor of the loan; or.

(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.

### 1.5.7.2. 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- Rupees`5 lakhs and maximum- Rupees `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- Rupees `5 lakhs and maximum- Rupees `25 lakhs, or, with Both .

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.

### 1.5.7.3. Disclosure of Interest by Director (Section 184)

It is a basic issue of governance that directors should not have any conflict of interest but in practical situation, there may be some directors who are directly or indirectly interested in some issues or other which also is company's interest and thereby face a situation of conflict of interest. Directors occupy a fiduciary position in relation to the stakeholders and personal relation should not vitiate his duty. Law has made a resolution of this ethical dilemma

of directors. Section 184 is applicable on all directors of the company and all types of Companies.

(a) 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) 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, directorship or in any other capacity. He should ensure that the notice of disclosure is placed in the meeting.

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.

Consequences of non disclosure:

(i) 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.

(ii) Penalty: If a director of the company contravenes the provisions of sub-section (1) or subsection (2) of section 184, such director shall be liable to penalty of Rupees 1 lakhs.

(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 or the body corporate.

### 1.5.7.4. Related Party Transactions

Related party transaction is transaction between the director, promoters, KMP, the companies with parties who are related. The related party shall not vote. This, however, will not apply where 90% of the shareholders are promoters, relatives or related parties. The type of transaction is mentioned at para 1.7.6.

Shareholders approval will not be required if -

(a) transaction is in ordinary course of business other than transaction which are not on answer length basis.

(b) transaction between a holding company and its wholly owned subsidiary.

Every such, contract shall be disclosed in Board's Report with justification of entering. Such contracts, if not ratified, shall be voidable and parties benefited shall be liable to indemnify the company.

The expression 'office or place of profit' means any office or place:

(i) 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;

(ii) 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.

### 1.5.7.5. 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, no company shall enter into any contract or arrangement with a related party with respect to—

(a) sale, purchase or supply of any goods or materials;

(b) selling or otherwise disposing of, or buying, property of any kind;

(c) leasing of property of any kind;

(d) availing or rendering of any services;

(e) appointment of any agent for purchase or sale of goods, materials, services or property;

(f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and

(g) underwriting the subscription of any securities or derivatives thereof, of the company:

Provided that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a resolution:

**Omnibus approval for related party transactions on annual basis (Rule 8A)**

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 ₹1 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.

### 1.5.7.6. 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 10%. of the turnover of the company or ₹100 crores, 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 10% of the net worth of the company or ₹100 crores, whichever is lower.

(3) Leasing of property of any kind and the amount involved exceeds ten percent of net worth of the company or 10%. of turnover of the company or ₹100 crores.

(4) Availing and rendering of any kind of services, directly or through appointment of agent and which involves amount exceeding 10%. Of the turnover of the company or ₹50 crores, 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 ₹2.5 lakhs.

b) Remuneration for underwriting of subscription of any securities or derivatives of the Company exceeding one percent of net worth of the company.

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.

### 1.5.7.7. Interested Director

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.

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].

# Board Meetings and Procedures

# 1.6

### 1.6.1. Board Meetings, Minutes and Registers

Board of directors are responsible for management of the company. Board manages company through meetings where various issues are discussed and decided upon. However, board an also decide on the basis of resolution by circulation

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. The procedure aspects of board meeting has to be read with following additional regulations

i) Listing Obligations and Disclosure Requirement (LODR) of SEBI

ii) Companies (Meeting of Board and its Powers) Rules, 2014.

#### 1.6.1.1. Frequency of Board Meetings

(a) Every company shall hold the first meeting of the Board of Directors within 30 days of the date of its Incorporation and thereafter minimum of 4 meetings shall be held every year provided that the gap between two consecutive board meetings shall not be more than 120 days unless exempted by the Central Government . Section 173(1)

**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. This provision will not apply where OPC is having only one director.

(b) 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.

(c) As per Secretarial Standards, where a company is required to appoint Independent Directors under the Act, such Independent Directors shall meet at least once in a calendar year.

#### 1.6.1.2. Participation in Board Meeting

(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.

(b) Such audio visual means should be capable of recording and recognizing the participation of the directors and of recording and storing the proceedings of such meetings along with date and time.

(c) The Central Government may by restrict matters which shall not be dealt with in a meeting through video conferencing and other audio visual means.

(d) 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:

i) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;

ii) 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 authorized participants at the Board meeting;

iii) to record proceedings and prepare the minutes of the meeting;

iv) 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.

v) to ensure that only the concerned director is attending the meeting through video conferencing and

vi) 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.

### 1.6.1.3. Notice of the Meeting

(a) Section 173(3) provides that, 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.

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, 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. 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.

(iii) 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.

(iv) 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.

(v) 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.

Otherwise, it shall be assumed that the director shall attend the meeting in person.

(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 only.

(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 along with Notice of the Board Meeting.

(vi) Each meeting and 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. 26$^{th}$ January, Independence Day i.e. 15$^{th}$ August, Gandhi Jayanti i.e. 2$^{nd}$ October and such other day as may be declared as National Holiday by the Central Government.

**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.

### 1.6.1.4. Quorum for meetings of Board (Section 174)

A quorum is the minimum number of qualified persons who must be present 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. Presence of requisite Quorum validate decision taken at a meeting.

(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 quorum.

(c) The continuing directors may act notwithstanding any vacancy in the Board; but, if the number is reduced below the quorum fixed by the Act for a meeting of the Board, the continuing( remaining) 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 two.

(e) Interested director means every director of a company who is in anyway, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement which is placed in agenda of the meeting.

**Notes:**

(1) Section 8 Companies under 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) In case of committee meetings, 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.

### 1.6.1.5. Passing of resolution by circulation (Section 175)

It is always desirable that the business of the Board is discussed and decided in the board meeting only. However, there may be instances where a decision of the Board is to be taken but there no time to call a meeting or immediate meeting is not possible for some reason. Though the Act requires certain business to be approved only at meetings of the Board, the law has provided to deal with such a situation by passing resolution through circulation without holding a meeting.

(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

(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 7 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 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. Appointment of Director(s) in casual vacancy subject to the provisions in the Articles of the company. To be subsequently approved in the immediate next general meeting.
10. According sanction for related party transactions which are not in the ordinary course of business or which are not on arm's length basis.
11. Sale of Subsidiaries
12. Purchase and Sale of material tangible/intangible assets which are not in the normal course of business.
13. Approve Payment to Director for loss of office.
14. Items arising out of separate meeting of the Independent Directors if so decided by the Independent Directors.

**Corporate Actions**

1. Authorize 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 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.
8. Details of any joint venture or collaboration agreement.
9. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
10. Significant labour problems and their proposed solutions. Any significant development in Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.
11. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.
12. Non-compliance of any regulatory, statutory or listing requirements and shareholder services such as non-payment of dividend, delay in share transfer etc.

### 1.6.1.6. Minutes of the Meeting of the General Meeting/Board Meeting [Section 118]

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.

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.

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 names of the dissenting directors should be recorded.

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 are to be signed by the chairman of the meeting or the net meeting.

The minutes kept in accordance with the provisions of this Section shall be evidence of the proceedings recorded therein [Section 118(7)] and all recording shall be considered valid and authentic.

No document purporting to be proceeding of a general meeting shall be circulated at the expense of the company.

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. Accordingly, two Secretarial Standards viz. SS-1: Meetings of the Board of Directors and SS-2: General Meetings have been notified,

### 1.6.1.7. 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 in electronic form, 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.Any member shall be furnished within 7days of request, with fees, a copy of the minutes of general meeting.

(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) Therefore, 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) The recording of the minutes 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) If any default is made in complying with the provisions of this section in respect of any meeting, the company shall be liable to a penalty of ₹25,000 and every officer of the company who is in default shall be liable to a penalty of ₹5,000.

### 1.6.1.8. Registers

Any document, register, minutes may be kept in electronic mode and form as may allowed by the Govt.The company has to maintain if its registered office 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]

(s) Place of keeping and Inspection of Registers, returns etc. [Section 94]

Registers and returns are to be kept at registered office. 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)].

The registers, 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, which is recommendary, in nature. 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.

### 1.6.1.9. Powers of the Board (Section 179)

Since Board of Directors are responsible for management of the company, the Act has given adequate general authority to the Board.

(a) Board of Directors shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorized to exercise and do. The Board shall be subject to the provisions of this Act, or the Memorandum or Articles, or 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 to be exercised or done by the company in general meeting. However, 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.

(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.

(f) 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.

(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.

### 1.6.1.10. 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.

(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. (substantially the whole of the undertaking shall mean twenty per cent or more of the value of the undertaking as per balance sheet of the preceding financial year.

Here the 'Undertaking' means an unit of business 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) 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 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 mater, E-Form 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 in relation to borrowing shall specify the total amount up to which monies may be borrowed by the Board of Directors.

(c) 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

### 1.6.2. Corporate Governance and Audit Committee

To promote good corporate governance, few provisions have been inserted in the Companies Act, 2013, most for listed companies but some apply to unlisted companies also. For the listed companies, apart from compliance of the Act, LODR has be introduced by SEBI which contains many provisions for better corporate governance. These compliances can be taken as "regulatory corporate governance'' and discussed in this chapter.

#### 1.6.2.1. Composition of the Board

#### As Per Companies Act, 2013

According to Section 149 of the Companies Act, 2013 the board of directors of each company consists only of natural persons or individuals.

The minimum number of directors in a limited liability company is 2, for a public company it is 3 directors and an OPC must have at least 1 director.

However, the maximum number of directors in the company is 15. The company can increase the number of directors above 15 by special resolution of the general meeting.

#### In a listed company

As per Regulation 17 of Securities and Exchange of India (Listing and Disclosure Obligations) 2015, the composition of the board of directors in a listed company is as follows:

1. The board has a combination of executive and non-executive directors with at least one female director and at least fifty percent of the members of the board consist of non-executive directors.
2. If the chairman of the board of directors is a non-executive director, at least one-third of the board of directors is made up of independent directors, and if the said entity has an executive chairman, then at least half of the board of directors must consist of independent directors.

#### 1.6.2.2. Committees of The Board

It has been felt that all the members of the Board of directors cannot enter into details of every issue relevant to the company. If committees are made on specific issues, it would possible to go deeper into the affairs. With this in mind, the concept of committee has been introduced in companies. These provisions are now in the Act itself and in LODR. The committees are as follows.

| Obligations | Audit committee | NRC committee | Stakeholders relationship committee | Risk management committee |
|---|---|---|---|---|
| Composition | Minimum 3 directors Majority independent directors | at least 3 directors<br>All shall be non executive director NED<br>Atleast 50 % shall be independent | Board shall decide | Majority from Board |
| Chairperson | Independent director | Independent director | Non executive director | Member of the Board |

**CSR committee**

Section 135 of the Act provides for the applicability of the CSR provisions on corporates. Sub-section (1) of section lays down that every company having

- net worth of ₹ 500 crores or more; or
- turnover of ₹ 1,000 crores or more;
- net profit of ₹ 5 crores

during immediately preceding financial year shall be required

(a) to constitute a CSR Committee of the Board consisting

(b) formulate CSR policy

(c) spend at least 2% of the average net profit of last three years, during the financial year.

**Constitution of CSR Committee**

(i) There will be at least three directors in the committee with at least one independent director;

(ii) Unlisted public company or a private company, falling under the financial threshold but not required to have IDs, shall not have any ID in the committee.

(iii) Private company having 2 directors only shall have 2 directors in the committee

(iv) In case of Foreign company, person who is authorized to receive notice on behalf of the company and any other person nominated by the company.

Every company which ceases to be a company covered under section 135 as per the limits specified thereunder for three consecutive financial years shall not be required to constitute a CSR Committee and comply with the provision of section 135, till such time that it meets the criteria specified.

**Functions of CSR Committee**

(i) To institute a transparent monitoring mechanism for implementation of CSR projects;

(ii) To recommend the CSR Policy and modification thereto, if any;

(iii) To recommend projects for approval of Board.

### 1.6.2.3. Remuneration of Directors

The following disclosures on the remuneration of directors shall be made under section corporate governance in 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.

#### 1.6.2.4. Board Procedure

(1) Board meetings shall be held at least, four times a year, with a maximum gap of 120 days 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 holds directorship.

#### 1.6.2.5. 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.

#### 1.6.2.6. 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.

#### 1.6.2.7. 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.

#### 1.6.2.8. Audit Committee (Section 177)

Section 177 of the Act provides for Audit committee. According to this section:

(a) 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 read along with rule 4 of Companies have prescribed the following classes of companies that shall constitute Audit Committee:

  (1) all public companies with a paid up capital of ₹10 crores or more.

  (2) all public companies having turnover of ₹100 crores or more.

  (3) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding ₹50 crores 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.

(c) 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. "With Independent Directors forming a majority' is not required in case of Section 8 Companies. Majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement. The composition of the Audit Committee shall be disclosed in the Board 's report.

(d) Responsibility of Audit Committee: like any other committee, shall be recommendary in nature, but if the Board had not accepted any recommendation, the same shall be disclosed in such report along with reasons thereof. 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 as in case of Govt. company, appointment is made by CAG.

(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.

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.

(e) The Audit Committee shall have authority to investigate into any matter in relation to the items specified above for this purpose may obtain professional advice from external sources and have full access to information contained in the records of the company.

(f) Role of auditor in Audit Committee:

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.

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.

(g) Board Report shall disclose the constitution of Audit Committee and where Board has not accepted any recommendation of the Audit Committee, the same shall be disclosed.

(h) 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 victimization 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:

i. Persons who use such mechanism means employees and directors who avail the vigil mechanism.

ii. The audit committee shall oversee the vigil mechanism 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.

iii. 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.

iv. 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.

v. 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.

### 1.6.3. Duties and Liabilities of Directors

Board of Directors, collectively, 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. Therefore, there are various kinds of functions to be exercised by the Board.

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.

They 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 (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 of the shareholders. He serves an individual manager to use his knowledge,

skills, attributes. Even the shareholders group which has nominated the director cannot instruct him how he shall exercise their powers.

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.

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. However, since directors are appointed by shareholders, who are the owners of the trust/company; supremacy of the shareholders shall prevail.

### 1.6.3.1. Duties of Directors

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 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, 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.

(f) He shall not assign his office.

The duties of directors are also mentioned in other provisions of the Act rules. The code of conduct which is now introduced also specifies few duties.

### 1.6.3.2. Liabilities of Directors

The liabilities of the directors may be grouped under certain heads for convenience of consideration and discussion. They are:

#### 1.6.3.2.1. 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.

#### 1.6.3.2.2. 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.

#### 1.6.3.2.3. 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.

#### 1.6.3.2.4. 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.

### 1.6.4. Powers Related to Political Contributions

Section 182 of the Act provides for prohibitions and restrictions regarding political contributions. According to this section:

(a) 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) There is no limit on the amount of contribution.

(d) such contribution shall be made through a resolution passed at a meeting of the Board of Directors.

**Political contribution would amount to:**

(a) such donation or subscription or payment was given or made which can reasonably be regarded as likely to affect public support for a political party.

(b) the amount of expenditure incurred, directly or indirectly, for publication in politically connected publication for political benefit.

(c) 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.

# Inspection, Inquiry and Investigation

# 1.7

**B**efore 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. Inspection, by itself, is routine and is not negative unless there is such report on inspection.

**Purpose**

The purpose of an inspection is to confirm that the company, organization or individual is obeying the law. regulations and guidelines.

**(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. Inquiry denotes a negative action unless clean report is made.

**(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. Inspection is not negative and a routine procedure but inquiry and investigation is always negative. Sometimes, inspection leads to investigation. For inquiry and investigation, there has to be some reason, like information, complaint etc.

Chapter XIV of the Companies Act, 2013 provides for Inspection, Inquiry and Investigation.

### 1.7.1. Power to call for information, Inspect Books and Conduct Inquiries [Section 206(1) & (2 )]

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

(a) to furnish in writing such information or explanation; or

(b) to produce such documents, within such reasonable time, as may be specified in the notice.

(2) On the receipt of a notice under sub-section (1),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.

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.

### 1.7.2. 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, the Registrar shall record his reasons in writing for issuing such notice.

### 1.7.3. 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 and carry out such inquiry as he deems fit after providing the company a reasonable opportunity of being heard, if the Registrar is satisfied, on the basis of information available with or furnished to him, or on a representation made to him by any person that

(a) 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

(b) 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.

(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.

### 1.7.4. Inspection by Central Government [Section 206 (5)]

The Central Government also, if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by an Inspector or by any statutory authority. Failure to furnish information would make the officers of the company liable for penalty.

### 1.7.5. Conducting Inspection and Inquiry

(a) Duty of director, officer or employee [Section 207 (1)]

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.

### 1.7.5.1. 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.

### 1.7.5.2. 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 one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one 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.

### 1.7.6. Search and Seizure

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:

### 1.7.6.1. Circumstances or 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 any director or auditor or company secretary in practice or company secretary of the company, 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, and Search ; and

b) seize such books and papers as he considers necessary.

(2) The Registrar or inspector shall return the books and papers seized under subsection (1), as soon as may be, and in any case not later than one hundred and eightieth day after such seizure, to the company from whose custody or power such books or papers were seized:

Provided that the books and papers may be called for by the Registrar or inspector for a further period of one hundred and eighty days by an order in writing if they are needed again:

(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.

### 1.7.7. Report on Inspection

Section 208 of the Act provides that person making the inspection shall submit a report to the Central Government along with such documents, if any and such report may, if necessary, include a recommendation for further investigation.

### 1.7.8. Investigation into affairs of the company

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 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:

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

(3) in public interest, it may order an investigation into the affairs of the company.

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.

### 1.7.9. Investigation by Serious Fraud Investigation Office

The Central Government have established an office called the Serious Fraud Investigation Office (SFIO) to investigate frauds relating to a company.

Section 212 of the Act provides for Investigation into affairs of Company by the Serious Fraud Investigation Office (SFIO). According to this section:

(a) 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.

(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 Serious Fraud Investigation Office (SFIO),

the Central Government may, by order, assign the investigation into the affairs of the said company to the SFIO.

(b) 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, the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to facilitate SFIO to investigate.

(c) The Director, Serious Fraud Investigation Office 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.

(d) 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)]

(e) The SFIO shall submit an interim report and on completion , final report to the Central Government, if the Central Government.

(f) Any person concerned by making an application in this regard to the court may get a copy of the report.

(g) The Central Government may, after examination of the report, 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)].

### 1.7.10. Investigation into company's affairs in other cases. . (Section 213)

The National Company Law Tribunal may register applications under following situations:

(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

(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, the Tribunal may order, that the affairs of the company ought to be investigated by the Central Government shall appoint one or more competent persons as inspectors to investigate into the affairs of the company provided that if after investigation the allegations are proved, every officer of the company who is in default shall be punishable for fraud in the manner as provided in section 447, which deals with punishment for fraud.

### 1.7.11. Investigation of ownership of Company

(1) 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:

(a) who are or have been financially interested in the success or failure, whether real or apparent, of the company, or

(b) who are or have been able to control or to materially influence the policy of the company or

(c) who have or had beneficial interest in shares of a company or have been significant beneficial owner of the company.

Section 217 of the Act provides for procedure, powers, etc., of Inspectors as under:

(a) 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 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) to give to the Inspector all assistance in connection with the investigation.

(b) The Inspector shall not keep in his custody, any books and papers produced 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.

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.

(c) The Inspector, being an officer of the Central Government making an investigation, shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, 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.

(d) 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.

(e) 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.

### 1.7.12. 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 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 and

(2) during the pendency of any proceeding against any person concerned in the conduct and management of the affairs of 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 and

(b) If the company does not receive permission within thirty days of making of application the company, other body corporate or person concerned may proceed to take against the employee, the action proposed. The decision of the Tribunal is appealable.

### 1.7.13. Powers of the Inspector

If the company does not receive permission within thirty days of making of application the company, other body corporate or person concerned may proceed to take against the employee, the action proposed. 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.

### Power of the Inspector

Section 219 of the Act provides for power of Inspector to conduct investigation into affairs of related companies, etc. as under:

(a) 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) 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.

### 1.7.14. Seizure of documents by Inspector

Section 220 of the Act provides for seizure of documents by Inspector as under:

(a) Where in the course of an investigation 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:

(b) 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.

(c) 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

### 1.7.15. Imposition of Restrictions Upon Securities

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 3 years as may be specified in the order. The Tribunal may freeze assets of the company and impose restriction upon securities during the pander of the investigation; Non-compliance shall attract major penalty.

### 1.7.16. Actions to be Taken in Pursuance of Inspector's Report.

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.

(b) 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)].

### 1.7.17. Expenses of Investigation.

Section 225 of the Act lays down the following provisions in respect of expenses of investigation:

(a) the 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.

# Compromises, Arrangements and Amalgamations

# 1.8

Chapter XV of the Companies Act, 2013 (Section 230 to Section 240) provides for Compromises, Arrangements and Amalgamations. Rule referred in this chapter denotes Companies (Compromise, Arrangement and Amalgamation) Rules, 2014 and amendments thereto.

## 1.8.1. Introduction

We are in the era of business alliances and joint ventures, companies are finding ways to regroup business verticals by separating companies, merging companies and selling and purchasing controlling stake in companies. Though there are basic business strategic issues, they have to be done within boundary of law.

**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 give up their rights entirely. it will not be compromise.There can be no 'compromise' unless there is a dispute. Compromise is a logical sequence to settle dispute without any third party intervention.

**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)]. Arrangement can be between various class of shareholders or between creditors and shareholders.

**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.

**Note:** The word Amalgamation is not defined anywhere in Companies Act 2013.

## 1.8.2. Compromise or arrangement under Companies Act, 2013,

Compromise or arrangement under Companies Act, 2013, is possible:

(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 following entities may apply to NCLT.

a) company or

b) of any creditor or

c) member of the company, or

d) the liquidator,

(b) NCLT may 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. The application to the Tribunal can be made jointly also.

(1) Application shall have 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, 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 .

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.

### 1.8.3. Procedural aspects relating to notice

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 key managerial personnel, directors, promoters, non-promoter members, depositors, creditors, debenture holders, deposit and debenture trustee, and key managerial personnel of holding company, subsidiary and associate companies, employees of the company.

(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.

(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) Any objection to the compromise or arrangement can 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.

(10) Notice to be sent to the regulators seeking their representations under section 230(5). It 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, and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement who represent by them shall be made within a period of 30 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.

(11) Approval and sanction of the scheme

At a meeting if, 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.

(12) 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:

(i) In case of convertible preference 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.

(ii) the protection of any class of creditors.

(iii) 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.

(iv) 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:

(13) Compromise or arrangement is to be in conformity with the accounting standards to be confirmed by company's auditor.

(14) Order of Tribunal to be filed with the Registrar under section 230 (8)

within a period of thirty days of the receipt of the order. Further, a statement of compliance needs to be filed with ROC within 210 days.

(15) 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.

(16) Compromise includes takeover

Section 230 (11) states that any compromise or arrangement may include takeover offer made in such manner as may be prescribed. A member of a company along with other member holding not less than 3/4th shares of the company and such application is filed to acquire remaining share (Notification dated 2/2/20). In case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board.

### 1.8.4. 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, it:

(a) shall have power to supervise the implementation of the compromise or arrangement; and

(b) may, give such directions in regard to any matter or make such modifications in the scheme of compromise or arrangement as it may consider necessary for the proper implementation.

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.

(c) Tribunal may require the liquidator or the company to report on the working of the scheme.

### 1.8.5. Merger and Amalgamation of Companies [Section 232]

(a) U/s 232(1), 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 is required to be transferred to another 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 Section 230 shall apply mutatis mutandis.

(b) Such order shall also require 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 specifying 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 6 months before the first meeting of the company summoned for the purposes of approving the scheme.

The Tribunal, after satisfying itself that the procedure of holding meeting 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.

(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:

(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:

(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:

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.

(11) Any property or liabilities, shall be transferred to the transferee company and the liabilities shall be 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.

(12) Certified copy of the order to be filed with the registrar Section 232(5) within thirty days of the receipt of certified copy of the order.

(13) 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.

(14) Annual statement certified by CA/CS/CMA to be filed with Registrar every year until the completion of the scheme.

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.

### 1.8.6. Merger and Amalgamation of certain Companies [Section 233]

It 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. On 1/2/21, Central Govt. has prescribed holding company, two or more start-up companies, one or more start-up company with one or more small 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. Small company –defined :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 ₹ 4 crores or such higher amount as may be prescribed which shall not be more than ₹ 10 crores, or

(b) turnover of which as per its last profit and loss account does not exceed ₹ 40 crores or such higher amount as may be prescribed which shall not be more than ₹ 100 crores.

Start-up company defined-amendment in Rule-start-up company means a private company, recognised under notification of Department of Promotion of Industry and International Trade.

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.

### 1.8.7. Merger of small Companies/holding and subsidiary Companies

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, with the Registrar of the place where the registered office of the company is situated; and

(d) the scheme is approved by majority representing 9/10th 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 21 days along with the scheme to its creditors for the purpose or otherwise approved in writing.

(e) 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.

### 1.8.8. 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.

### 1.8.9. Miscellaneous provisions

(i) 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. If there are any objections or suggestions, he may communicate the same in writing to the Central Government within a period of 30 days, failing which, it shall be presumed that he has no objection to the scheme.

(ii) Application by Central Government to the Tribunal

If the Central Government forms 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 stating its objections and requesting that the Tribunal may consider the scheme under Section 232.

(iii) Tribunal's Action to Central Government's application

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.

(iv) Registrar having jurisdiction over transferee company has to be communicated

A copy of the order confirming the scheme shall be communicated to the Registrar 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.

### 1.8.10. Effect of Registration of the Scheme

the registration of the scheme as above shall be deemed to have the effect of dissolution of the transferor company without process of winding up.

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.

(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.

(e) The 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.

### 1.8.11. Merger or Amalgamation of the Company with Foreign Company

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.

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, 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. A foreign company may merge with an Indian company and vice versa after obtaining permission from RBI (Rule 25A).

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.,

### 1.8.12. purchase of minority shareholding

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.

Rule 27 of the relevant Rules provides for methodology of valuation by registered valuer for fixation of price of the shares of minority. Company shall within two weeks from the receipt of the amount of the share consideration, verify the details of minority shareholders. Cut-off date for, any corporate action (benefits to transferee) to be announced in advance.

### 1.8.13. Amalgamation by Central Govt. on public interest

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.

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.

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.

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.

### 1.8.14. Registration of offers and scheme

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 only be circulated after registration.

Registrar may refuse registration which may be appealed to the NCCT.

# Prevention of Oppression and Mismanagement

# 1.9

### 1.9.1. Majority Rule but Minority Protection

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 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. Companies Act also recognizes the power of the Board in decision making.

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 authorized 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.

It is quite obvious that the group of shareholders having majority shall control the management and decision making process. This process is universal in any body Corporate , association or company.

Certain decisions need to be taken regarding the management of the company and these decisions are generally taken by the majority members. 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.

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.

### 1.9.1.1.Power of Majority

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. subject to the provisions of the Company's memorandum and articles of association and the provisions of the Act or any other statute, or constitute a fraud on minority depriving it of its legitimate rights.

**The Principle of Non-interference**

The general principle of company law is that every member holds equal rights with other members of the company in the same class. 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.

The justification for the rule laid down in Foss v. Harbottle is that the will of the majority prevails. 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].

**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.

(b) the provisions of the Companies Act, 2013.

### 1.9.1.2. Action may be taken 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 majority 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. 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.

**(c) Wrongdoers in management 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].

**(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..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 by shareholders**

Individual member is entitled to all the rights and privileges according to his status as a member. He 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'.

**(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.

### 1.9.2. Prevention of Oppression and Mismanagement

#### 1.9.2.1.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. Law provides for the grounds on which case of oppression can be made.

The meaning of the term 'oppression' as explained by Lord Cooper in the Scottish case of Elder v. Elder & Watson Ltd. [(1952) Scottish Cases 49], which has been cited with approval by Wanchoo. J (afterwards C.J.) of the Supreme Court in Shanti Prasad Jain v. Kalinga Tubes Ltd. [(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]

### 1.9.2.2. Right to apply to Tribunal (Section 244)

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: (Tribunal may, waive all or any of the requirements)

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.

(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.

### 1.9.2.3. Application by CG to Tribunal for relief in cases of oppression, etc. (Section 241).

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 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, 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.

(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 and all applications shall be made before the Principal Bench of the Tribunal.

### 1.9.2.4.Central Govt.'s power to refer

Companies Amendment Act,2019 have inserted sub-section 3 to section 241, enabling Central Govt. to make a case of oppression and mismanagement, under following situations.

a) Any person management guilty of fraud, misfeasance, persistent negligence or breach of duty and trust,

b) Business not conducted with sound business principles or prudent commercial practices,

c) Management conducted in many injuries to interest of the trade, industry or business to which the company pertains

d) Business carried out with an intention to defraud its creditors, members or in fraudulent or unlawful purpose or in a manner prejudicial to public interest,

### 1.9.2.5. Powers of Tribunal (Section 242)

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.

(a) 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 or any other person , 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 managerial persons

(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) 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, make any interim order also

(e) Where an order of the Tribunal makes any alteration in the memorandum or articles of a company, the company shall not have power, to make any alteration inconsistent with the order, either in the memorandum or in the articles.

### 1.9.2.6. Consequences 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.

Person considered unfit by Tribunal under section 242(4A) shall not hold any office of director or connected with management of a company for 5 years, unless approved by the Central Government and the Tribunal. Such person shall not be entitled to any compensation for loss of office regardless of such provision in any document.

Notwithstanding anything contained in any other provision of this Act, or any other law for the time being in force, or any contract, memorandum or articles, on the removal of a person from the office of a director or any other office connected with the conduct and management of the affairs of the company, that person shall not be entitled to, or be paid, any compensation for the loss or termination of office

(b) Any person who knowingly acts as a managing director or other director or manager of agreements 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 fine which may extend to Rupees ₹5 Lakhs

### 1.9.2.7. Class Action (Section 245)

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.

(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 or

(2) breach of any provision of the same

(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 conduct or any likely act or conduct on his part.

(8) to seek any other remedy as the Tribunal may deem fit.

(b) 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.

(c) 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.

(d) Any order of 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.

(e) 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 Rupees ₹5 lakhs but which may extend to Rupees ₹25 lakhs and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years and with fine which shall not be less than Rupees ₹25,000 but which may extend to Rupees ₹1 lakh.

(f) Nothing contained in this Section shall apply to a banking company.

(g) 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.

### 1.9.2.8. 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) relating to fraud and damages shall apply 'mutatis mutandis', in relation to an application made to the Tribunal under Section 241 or Section 245.

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. How many minimum members are required to form a public limited company?
   a) 3
   b) 4
   c) 6
   d) 7
2. In order to be a Govt. Company, 51% shares shall be held by: -
   a) Central Govt.
   b) State Govt.
   c) Both Central and State Govt. jointly
   d) Any or all of the above
3. In case of "limited" companies, what is limited?
   a) Shares
   b) Liability of members
   c) Capital of the company
   d) Powers of the shareholders
4. Restriction in transfer of shares can be there in____
   a) Private Ltd. company
   b) Public Ltd. Company
   c) Govt. company
   d) Unlimited company
5. Foreign company is a company, registered out of India and_____
   a) Having a place of business in India
   b) Conducts any business in India
   c) Need not have any business in India
   d) Either (a) or (b)
6. Company which do not have any significant accounting transaction is called:
   a) Asocial Company
   b) Non-functional company
   c) Dormant company
   d) Sleeping company

7. Life Insurance Corporation is: -
   a) A statutory corp. but not PFI
   b) A statutory corp. and PFI
   c) Govt. Company
   d) None of the above
8. Persons who sign the MOA are called:
   a) Promoters
   b) Shareholders
   c) Subscribers to MOA
   d) Members
9. Certificate of incorporation is issued by: -
   a) Regional director
   b) Registrar of companies
   c) Central Govt.
   d) None of the above
10. Declaration by professional at the time of incorporation of a company means declaration by:
   a) Practicing CS
   b) Practicing CA
   c) Practicing CMA
   d) Any of the above.
11. Change of registered office within a city, town or village requires:
   a) Special Resolution
   b) Board Resolution
   c) Approval of CG
   d) None of the above
12. Section 8 companies cannot:
   a) Generate surplus
   b) Make profit
   c) Distribute dividend
   d) Profit is to given to Govt.

13. ABC Ltd. is registered in India with 100% shares being held by KYZ Ltd., a company registered in UK having no business in India. ABC Ltd. is a:

    a) An Indian Company

    b) Foreign company

    c) Wholly owned subsidiary of a foreign company but Indian Company

    d) Does not come under definition of foreign company

14. ABC Ltd. has 35% shares in XYZ Ltd. The majority of directors of XYZ Ltd. are appointed and removed by ABC Ltd. XYZ Ltd. is:

    a) Subsidiary of ABC Ltd.

    b) Not a subsidiary of ABC Ltd.

    c) Depends on Board of ABC Ltd.

    d) Depends on Board of XYZ Ltd.

15. A guarantee company is similar to:

    a) Unlimited company

    b) LLP

    c) Partnership

    d) Sole proprietorship

16. Once a company is converted into LLP, intimation to ROC has to been made within:

    a) 10 days

    b) 15days.

    c) 20 days.

    d) 30 days

17. Which chapter of the Companies Act, 2013, deals with foreign companies?

    a) XX

    b) XXI

    c) XXII

    d) XXIII

18. In case of secured debentures of public issue, the security is created in favour of:

    a) Public

    b) SEBI

    c) Merchant banker

    d) Debenture trustee

19. Fully convertible debenture is a:
    a) debt instrument
    b) equity instrument
    c) hybrid instrument
    d) None of the above
20. Register of deposit:
    a) is voluntary
    b) is mandatory but particulars may vary
    c) is mandatory with particulars as per Rules
    d) Not to be maintained at all
21. A debenture trustee can be:
    a) Any bank
    b) Any NBFC
    c) any merchant banker
    d) Any entity registered with SEBI as such
22. " loan" in parlance to Companies Act, means:
    a) short term loan for revenue purpose
    b) long term loans
    c) cash credit
    d) working capital
23. In case of deposits by the company,
    a) no brokerage can be given
    b) any amount of brokerage can be given
    c) rate of brokerage shall be as per RBI Regulations
    d) rate of brokerage shall be as per SEB Regulations
24. Once declared in AGM, dividend-
    a) May be revoked
    b) Cannot be revoked
    c) May be reduced
    d) Payment can be delayed
25. IEPF stands for-
    a) Investor Employment and Protection Fund
    b) Investor Education and Publicity Fund
    c) Investor Entrepreneurship and Protection
    d) Investor Education and Protection Fund

26. Once declared, the amount of dividend shall be transferred to special dividend A/c within-
    a) 3 days
    b) 5 days
    c) 10 days
    d) 15 days
27. A practicing Chartered Accountant may be appointed as Auditor for term of:
    a) 3 years
    b) 5 years
    c) 8 years
    d) 10 years
28. Directors Responsibility Statement is a part of: -
    a) Annual Accounts
    b) Auditors' Report
    c) Board Report
    d) None of the above
29. NFRA stands for:
    a) National Financial Reporting Authority
    b) National Fiscal Reporting Authority
    c) Non-Financial Reporting Authority
    d) National Financial Reforms Authority
30. A statutory Auditor shall be-
    a) ACS
    b) CMA
    c) Practicing CA
    d) Any of the above
31. In normal course, the Board's Report is signed by –
    a) Chairman without Authority of Board
    b) Chairman with Authority of Board
    c) MD
    d) Any director
32. CAG stands for:
    a) Controller of Audit of Govt.
    b) Comptroller of Auditor General
    c) Company Auditor General
    d) None of the above

33. The Financial statements are to be filed with the Registrar within-
    a) 15 days of AGM
    b) 31st October of any year
    c) 30 days of AGM
    d) 60 days of AGM
34. In case of private company, internal auditor has to be appointed if the turnover is:
    a) ₹ 100 Crores or more
    b) ₹ 150 Crores or more
    c) ₹ 200 Crores or more
    d) ₹ 300 Crores or more
35. Auditors Report is addressed to:
    a) Board of directors
    b) Central Govt.
    c) Audit Committee
    d) Shareholders
36. CARO,2020 is effective from: -
    a) 1.4.2019
    b) 1.4.2020
    c) 1.4.2021
    d) 1.4.2022
37. First Auditor is appointed by-
    a) CG
    b) CAG
    c) Board of Directors
    d) Shareholders
38. Auditor can render the following additional service to the company where he is auditor:
    a) Internal Audit
    b) Accounting and book keeping
    c) Investment Advisory services
    d) None of the above

39. Additional director's tenure is up to___

a) Next Board meeting

b) Next AGM

c) 5 years from the date of appointment

d) Date of superannuation

40. Alternate director may be appointed when the additional is out of India for at least_____

a) 1 month

b) 2 months

c) 3 months

d) 4 months

41. A women director has to be there is the company is:

a) A listed company

b) With turnover of ₹300 crore or more

c) Either of the above

d) None of the above

42. Section 184 of the Companies Act provides for:

a) Ordinary

b) Board

c) Special

d) None

43. A whole time director is appointed for a term of:

a) 2 years.

b) 3 years.

c) years.

d) years.

44. If a person other than retiring director is proposed, a cheque of ____ is to be deposited with the proposal.

a) ₹ 50,000

b) ₹ 75,000

c) ₹ 1 lakh

d) ₹ 2 lakhs

45. A director may be appointed by small shareholder. Small shareholder means, shareholders who hold shares worth of face value of maximum, _____

    a) ₹ 5,000

    b) ₹ 10,000

    c) ₹ 15,000

    d) ₹ 20,000

46. A company may remove a director with –

    a) Board Resolution

    b) Ordinary resolution of shareholders

    c) Special Resolution of shareholders

    d) Approval of ROC

47. Managing Director's appointment is ratified in AGM through-

    a) Ordinary

    b) Special

    c) No AGM resolution is required

    d) None of the above

48. Section 203 provides for appointment of

    a) KMP

    b) CS

    c) MD

    d) WTD

49. The eligibility and conditions of appointment of MD is mentioned in Schedule

    a) I

    b) II

    c) IV

    d) V

50. Maximum remuneration to all managerial personnel is-

    a) 5%

    b) 8%

    c) 11%

    d) 15%

51. Independent directors are not entitled to get-

    a) Sitting fee

    b) Reimbursement of expenses

    c) Stock option

    d) Commission on profit

52. Board's Report is addressed to-

    a) Central Govt.

    b) Stock exchange

    c) Members

    d) ROC

53. Power of Board of directors may be restricted subject to:

    a) Companies Act

    b) Articles of Association

    c) Resolution of general meeting

    d) Any or all of the above

54. Related party transaction is provided under Schedule:

    a) 188

    b) 189

    c) 190

    d) 191

55. Majority of audit committee members shall be:

    a) Executive director

    b) Non-executive

    c) Independent

    d) None of the above

56. Independent directors, separately. shall meet _____ in a calendar year.

    a) Once

    b) Twice

    c) Thrice

    d) Not meet

57. For Board meeting, quorum as per the Act is:

    a) One third of the total no. of directors

    b) Two third of the total no. of directors

    c) One third of the total no. of director or two, whichever is higher

    d) Half of the total no. of directors

58. If _____ of the directors require that a resolution under circulation be placed in the Board meeting for decision, it has to be complied with.

    a) All director

    b) Two-third

    c) One-third

    d) Three-fourth

59. Minutes of the Board meeting are to be signed by-

    a) Chairman of the company

    b) Chairman of the present meeting or next meeting

    c) Chairman of the company, whether he was present in the meeting or not

    d) None of the above

60. Minutes of Board meeting are to be preserved for-

    a) 5 years

    b) 8 years

    c) 10 years

    d) Permanently

61. Minutes are supposed to be kept at:

    a) Registered office

    b) Head office

    c) Any office

    d) Any of the above

62. SFIO stands for:

    a) Serious Fraud Institution Office

    b) Serious Fraud Investigating Organization

    c) Serious Fraud Investigating Office

    d) None of the above

63. The decision to authorize buy back by Board can be made by-
    a) Resolution by circulation
    b) Only in board meeting
    c) Any of the above
    d) None of the above
64. In case chairman is executive, at least_____ of the Board members shall be independent director.
    a) 1/3rd
    b) 2/3rd
    c) 1/2
    d) Majority
65. Majority of members of the audit committee shall be-
    a) Executive directors
    b) Non-executive director
    c) Nominated director
    d) Independent directors
66. Board of directors are supposed to address their report to –
    a) Central Govt.
    b) NCLT
    c) SEBI
    d) None of the above
67. The provisions relating to investigation are provided in which chapter of the Act?
    a) XIIB
    b) XIII
    c) XIV
    d) XV
68. If a company wants to punish an employee or officer of a company, it has to take permission of:
    a) ROC
    b) CG
    c) NCLT
    d) High Court
69. The investigating officer has the power of inspection, taking evidence etc. as per-
    a) Civil Procedure Code
    b) Criminal Procedure Code
    c) Companies Act
    d) None of the above

70. In case of merger, the transferor company is:

    a) Continues to exist

    b) Dissolved

    c) Shall have to go through liquidation process

    d) Goes under the tribunal control

71. The Auditors has to confirm in the scheme that

    a) It is in conformity with the Accounting Standard

    b) It is in compliance with the Companies Act

    c) Both (a) and (b)

    d) None of the above

72. On amalgamation, the following are transferred to the transferee company:

    a) Rights

    b) Liabilities

    c) Both above

    d) None of the above

73. When a transferor company is a listed company and transferee company is any unlisted company, the transferee company_____.

    a) Becomes a listed company

    b) Continues to an unlisted company and can never be a listed company

    c) Continues to be an unlisted company unless it is listed by complying with listing requirement

    d) Any of the above

74. Powers of the majority is subject

    a) Companies Act,

    b) Common law

    c) Memorandum of association

    d) All of the above

75. Any Act done by directors beyond authority, is considered as;

    a) unauthorized

    b) illegal

    c) ultra vires

    d) None of the above

76. A case of oppression, application may be made on:

a) fraud on minority

b) ultra vires act

c) breach of duty

d) Any or all of the above

77. Application has to be made for relief of oppression to:

a) Central Govt.

b) NCLT

c) ROC

d) None of the above

78.Powers of the tribunal is listed in section:

a) 240

b) 241

c) 242

d) 243

79. Statutory auditor can also function as:

a) Internal Auditor

b) Financial Adviser

c) Accounting Solutions Advisor

d) Tax Auditor

80. A CFO of a company has to be a:

a) Chartered accountant

b) Cost accountant

c) MBA

d) None of the above.

81. Sitting fee of Board meetings and Board Committee meetings:

a) shall have to be same

b) may not be same

c) shall have to be different

d) None of the above

82. Disclosure of interest by director is:

    a) one time feature at the time of appointment

    b) annual feature

    c) event based, being interested due to some event

    d) all or any of the above

83. Quorum of aboard meeting is…….total strength of the Board:

    a) 1/4th

    b) 1/3rd

    c) half

    d) 1/3rd or two whichever is higher

84. In case of merger of A ltd with B Ltd., A lTd is:

    a) liquidated

    b) dissolved

    c) sold

    d) closed down

85. Dividend Distribution Policy of a company is decided by:

    a) Board of directors

    b) shareholders in general meeting

    c) Stock exchange

    d) SEBI

86. Rate of interest in deposit is guided by :

    a) SEBI

    b) RBI

    c) MCA

    d) MOF

87. No eligible company shall accept or renew deposit from its members up to:

    a) 5 %

    b) 10%

    c) 15%

    d) 20%

88. Interim dividend is decided by:
    a) Board of Directors
    b) AGM
    c) CMD
    d) Audit Committee
89. Books of accounts can be inspected by:
    a) MD only
    b) any director
    c) any shareholder
    d) any public on payment of fees
90. Accounting Standards are prescribed by:
    a) Central Govt.
    b) SEBI
    c) Institute of Chartered Accountants of India
    d) None of the above
91. The Board Report is signed by:
    a) MD
    b) any director
    c) CS
    d) None of the above
92. Zenith Ltd. Is a company registered in USA and doing business in USA. As per Indian law, this is a:
    a) foreign company
    b) not a foreign company
    c) It will be a foreign company once it starts business in India
    d) both (b) and (c) is correct.
93. A sectorial company is supposed to comply with:
    a) Companies act only
    b) Sectorial laws only
    c) Both Companies Act and sector laws
    d) All statements are correct
94. Articles of association can be altered by:
    a) Ordinary resolution
    b) Special resolution
    c) Resolution requiring special notice
    d) None of the above

95. Shifting of register office from one state to another, would require:

    a) special resolution only

    b) special resolution and Central Govt.(CG) approval

    c) only CG approval

    d) only Board approval

96. The following members of a company shall have the right to apply under Section 241, for oppression namely:

    a) in the case of a company having a share capital, not less than one hundred members of the company;

    b) 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;

    c) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.

    d) Any of the above.

97. SFIO stands for:

    a) Serious Fraud Investigation office

    b) Serious Fault Investigation office

    b) Serious Fund Inquiry office

    b) None of the above.

**State True or False**

1. Private companies can invite finance from public.
2. A public company shall have minimum 5 directors.
3. A subsidiary of Govt. Company is also a Govt. company.
5. A foreign companies are free from any kind of compliances
6. Pre incorporation contracts can be ratified by the company after incorporation
7. CSR is mandatory for companies having net profit of Rs. 5 crore and above during the previous Financial Year.
8. Unlisted companies need not have independent directors.
9. ABC Ltd. holds 30% shares of BCD Ltd. but ABC Ltd. has the right to appoint and remove majority of Board of Directors of BCD Ltd. BCD Ltd. shall be considered subsidiary of ABC Ltd.
10. Maximum tenure of preference shares for non infrastructure companies can be 20 years.
11. Non Profit companies cannot generate surplus.

12. Appointment of auditors can be made for five years at a time but shall be ratified in each AGM.
13. Only listed companies are supposed to have women director.
14. The CMD of the company cannot be chairman of audit committee.
15. The CMD of the company cannot be chairman of CSR committee.
16. Maximum period of redemption of debenture is 20 years.
17. Board has unlimited powers to take loan on behalf of the company.
18. CFO is not a KMP.
19. CS has to sign the annual financial statement
20. The financial year of a company under Companies act and income Tax act is same, unless special approval is taken.

**Fill in the blanks**

1. An OPC may have maximum _____ directors.
2. A partnership of more than ___ partners, need to be registered as a company
3. A company shall have to intimate the registered office on or after _____ day of incorporation
4. A public company with a net worth of ₹……..crores can accept public deposit
5. A company may invest through not more than ……...layers of investment.
6. Maximum investment with Board approval is……..…….of the paid up capital, free reserves and share premium account
7. For inter corporate investment ……..……..…resolution of the Board is required.
8. Dividend is payable within _____days of declaration
9. Dividend is transferred to IEPF after ____ years
10. Books and accounts are to be retained for at least _____ years
11. Companies are supposed to maintain accounts on_____
12. The maximum sitting fee for attending Board meeting is _____ per meeting
13. Company Secretary is compulsorily to be appointed as one of the KMPs if the paid up capital is min. ____.
14. A minimum ____ days' notice is to be given for Board meeting.
15. Audit committee shall have min. of _____directors
16. The first meeting of the Board of Director shall be held within_____ days of incorporation of the company
17. The Inspecting authority can cease documents and keep it for max. _____ days.

18. The provision relating to merger of small/holding and subsidiary company, if mentioned under section_____.
19. Any person aggrieved by the assessment of compensation, in case of merger may appeal to NCCT within____ days.
20. One Board meeting is supposed to held in each……..
21. Compromise happens between the stakeholders, in case ……..
22. Auditors Report is addressed to……
23. Any qualification in the audit report is to be replied by.……
24. Auditor appointed in casual vacancy shall continue up to.……
25. For removal of Auditors, ……notice has to be given by shareholders.
26. In case of Govt. Company, Auditor is appointed by ……
27. Auditors' report shall be as per……..
28. Overall managerial remuneration is ……..% of the net profit of the company during the financial year.
29. In normal course, books of accounts are to be kept at……office of the company.
30. Directors' Responsibility Statement is all about……..
31. Preference shares issued by infrastructure companies are to be redeemed within …..years of issue
32. When debentures do not have any interest payable, it is called……coupon rate debentures.
33. A shareholder, who has not claimed his dividend for more than 7, years, shall claim from ……..
34. In case of public issue of debentures, debenture are secured by mortgaging assets to ……..
35. Partnership with more than ……... partners shall have to be registered as company.
36. For certificate of commencement of business, form …….. is to be filed.
37. In case of compromise, the statement of compliance, after the order has been passed, is to be filed within ……. days .
38. For merger of a foreign company with Indian company, prior approval of ……also will be required.
39. The will of the majority shall prevail was settled in famous case of……..
40. The threshold limit of combined assets of individual domestic companies combination is……
41. One of the objects of the Competition Act is to ……..competition

**Short Essay Type 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. Dividend must be paid only out of profits. Explain.
7. Explain the law relating to treatment of unpaid dividend.
8. Who are KMPs and which categories of companies are supposed to have KMPs?
9. Differentiate between:
    a) interim and final dividend
    b) Internal Audit and Statutory Audit
    c) Audit of Public limited non Govt. Company and Govt. Company
    d) executive and non-executive director
    e) rotational and non-rotational Director
    f) CMD and MD
    g) non-executive director and Independent director
10. Write short notes on-
    a) Memorandum of Association
    b) Doctrine of ultra vires
    c) Perpetual succession
    d) Unlimited liability
    e) Corporate body
    f) Authorised capital
    g) Certificate of incorporation
    h) Deposit Repayment Reserve Account
    i) Return of deposits.
    j) Registrar of Deposits
    k) Deposit Insurance

l) IEPF

m) Financial Statement

n) Accounting Standard

o) Internal Audit

p) Cost Audit

q) additional director

r) alternate director

s) women director

t) nominee director

u) SFIO

v) Powers of inspectors for investigation under Companies Act

w) Related body corporate

**Essay Type Question**

1. Explain the doctrine of indoor management. How it is opposite to doctrine of constructive notice?
2. Differentiate between a private company and a public limited company. What steps the private company need to take if it wants to be converted into a public limited company?
3. What are the services which an auditor is not supposed to take up ?
4. Discuss the provisions relating to placing of accounts in AGM and filing with the Registrar.
5. Discuss the disqualifications of an Auditor.
6. Write a detailed note on independence of Auditor
7. Discuss the appointing authority and tenure of additional director and normal director.
8. Discuss various provisions relating to nomination of director.
9. Discuss situations when the office of director shall become vacant.
10. Discuss the role of Central Govt. in investigation into affairs of any company, under the Act.
11. What are the various types of inquiries and investigation under the Companies Act,2013?
12. Discuss the role of Central Govt. in investigation into affairs of the Act.
13. What are the various types of inquiries and investigation under the CA,2013
14. Define the term 'Compromise'. How is it different from arrangement?

15. Explain the stepwise procedure for merger and amalgamation under the Companies Act, 2013.
16. What options are given to the minority shareholders?
17. Discuss the powers of Central Government to provide for amalgamation in the public interest
18. Discuss the concept of majority rule.
19. What are the remedies available to minority shareholders.
20. What are the powers of Central Government to prevent Oppression and Mismanagement?

**Case Study (Solved)**

1. ABC limited is a company with paid up capital of ₹ 50 cr. and turnover of ₹ 310 cr. Mr. Rajesh Kumar, who is promoter and MD of the company wants to run the company complying with all laws and regulations. The chairman is non executive and is an eminent academician. There are two more directors, one is Director (Finance), Mr Joshi and Director (commercial) Mr. Nirmal Kumar, who is related to the promoter. Company is in the process of taking substantial loan for capital investment from SBI, where SBI will nominate a director in the Board.

   The MD wants to clarify the following issues from you. Pl clarify with references, if any.

   (i) Is the present Board properly constituted? If not, what is the non compliance.

   (ii) Can Mr. Nirmal Kumar be considered as independent director?

   (iii) Is there any need of women director?

   (iv) What will be the status of the director nominated by SBI? If she is a women, would satisfy the requirement of women director.

   **Solution:**

   (i) Company is an unlisted company with four directors which is properly constituted. However, since the turnover is more than ₹300 cr., a women director is required.

   (ii) No, since he is related to the promoter.

   (iii) Yes. Answered in (i) above.

   (iv) He or she will be classified as nominee director. Yes, if she will be considered to fulfil the requirement. Rule 3 of companies (appointment and qualification of directors) Rule 2014 refers.

2. Kapoor and Sons Ltd is a listed company with Mr. S K Kapoor as CMD and main stakeholder. Board comprises of the following.

   (a) Mr. S K Kapoor, as CMD

   (b) Mr. K Murli, Director (Finance)

   (c) Mr. B B Singh, Director (Commercial)

   (d) Mr K Shekhar, ind. Dir. Appointed in AGM in Sept, 2020

   (e) Mr.B. Ramesh, Ind. Dir., appointed in AGM is August, 2019

(f) Mr. Mahesh Singh, nominee of IDBI

(g) Smt. Rekha Singh, ind. Director, appointed in AGM in Sept 2019

(h) Ms. Rukmini Mathur, non executive, non independent, appointed as additional director in March 22.

With the above directors, please suggest constitution of CSR committee, Audit Committee and Nomination and Remuneration committee as per the Act and Rules.

**Solution:**

I have to suggest constitution of various committees with the existing Board members. I suggest the following.

CSR committee:

In case of CSR committee, there will be at least three directors in the committee with at least one independent director. CSR committee shall be as follows.

(i) Mr. B Ramesh, as chairman

(ii) Ms. Rekha Singh, ind. Director, member

(iii) Mr. K Murli, Director (Finance), member

Since the company has adequate number of independent directors, we can have two instead of one. Since financial issues are involved, D(F) is made member.

Audit committee

(i) Mr K Shekhar, ind. Dir. as chairperson

(ii) Mr. Mahesh Singh, nominee of IDBI

(iii) Ms. Rekha Singh, ind. Director,

As per rule, there has to be three directors, all non executive, the chairman to be independent and majority shall be independent. This has been complied here.

Nomination and Remuneration committee

(i) Ms. Rekha Singh, ind. Director, chairperson

(ii) Mr. B Ramesh, member

(iii) Ms. Rukmini Mathur ,member

All members need to be non executive and /or independent.

3. The last Board meeting of ABC Structurals Ltd., a public limited company was held on 25th January, 2022. The MD wants that in the next Board meeting the annual financial statements to be placed and approved. The Accounts manager feels that the financial statements shall be ready latest by 15h June only. Mr Ahuja is the chairman of audit committee, who will not be in India during the whole of June. MD feels that we get the financial statements approved through video board meeting. Presently, there is no chairman in the company/ MD chairs the Board meetings.

**Solution:**

MD of the company need to know and understand and comply with the following.

(i) As per section 173(1) Next board meeting shall have to be held within 120 days of the previous meeting. Therefore next Board cannot be held in June. There shall be another meeting to be held when financial statements are ready.

(ii) Rule 4 of Companies (meeting of Board and its powers) Rules prohibits approval of annual financial statements through video meetings.

4. Western India Industries is a public limited company making micro chips. During 2010 to 2015, company made huge profits and declared substantial dividend ranging from 500% to 2000%. In 2016, it made public issue of equity. The share capital was increased to 15 crores from 5 crores. The company drastically reduced the rate of dividend and paid 20 % to 50% during 2016 to 2021.

Few shareholders raided the issue in last 3 annual general meetings but could get support of other shareholders. The chairman clarified that they want invest in new projects which, of course are justified by the annual reports of the Directors.

Your advice is required for following issue.

(i) Can minority shareholders object to lower dividend?

(ii) Does it amount to oppression on minority?

(iii) Shareholders totaling to 75 want to file petition? Is it ok? Where they will file ?

(iv) Do minorities have any forum of grievances?

**Solution:**

(i) The dividend is declared in AGM every year based on the recommendation of Board of Directors. Shareholders cannot pressurize Board to recommend higher dividend but they can declare lower rate of dividend than recommended by Board.

(ii) In normal course, it may not oppression on minority. However, if it can be proved that minorities are being deprived of genuine benefits, petition can be file , which will be subject ti judicial review.

(iii) Petition has to be filed by at least 100 members or shareholders holding 1/10th of the total number of share-holders, whichever is less or any shareholder not less than one tenth of the issued share capital of the company.

(iv) Minorities of listed companies may vent their grievances in Investor Relations committee of the Board or else file petition in NCLT.

5. Jyoti industries is a public limited company. Due to some IR Problem the factory and office was closed. Two accounts officers dealing with finalization of accounts left the company in quick succession and accounts could not be prepared. It is likely that the financial statements will not be placed within the last date if AGM, i.e. 3oth September .MD wants to know the consequences in following situations.

(i) Accounts is not ready and cannot be placed in AGM.

(ii) AGM to be deferred after 30th September

(iii) Accounts are ready but AGM could not be held

(iv) AGM held, accounts placed but not approved

**Solution**

(i) Company has to adjourn the meeting to a date where the accounts shall be ready but such meeting also shall be within 30th September.

(ii) AGM cannot be deferred by the Company. Approval of extension is given by Registrar of Companies. However, the approval for extension shall have to be taken within 3oth September.

(iii) If AGM s could not be held, it would amount to violation of law and extension to be sought.

(iv) If the AGM is held but the accounts are not adopted, the unadopted accounts shall be filed with the Registrar. Where the financial statements are not adopted at annual general meeting or adjourned annual general meeting, such un adopted financial statements along with the required documents shall be filed with the Registrar within 30 days of the date of annual general meeting.

6. Shri R K Chauhan is MD of Dowell Co. Ltd. The audit is going on and there are many issues which the auditor is pointed out which are being clarified but Auditor is not satisfied with the answer. MD wants to know how the auditor can be removed. Auditor also is not comfortable and have threatened to resign. In such situation, MD wants clarification on legal provisions of various situations.

(i) Can the Auditor be removed? What is the procedure?

(ii) What happens if the auditor resigns?

(iii) What happens if the auditor gives a qualified report?

**Solution**

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. The application shall be made to the Central Government within 30 days of the resolution passed by the Board. The Company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution. The auditor concerned shall be given a reasonable opportunity of being heard.

(i) If an auditor is removed, anew auditor has to be appointed by The Board In casual vacancy, thereafter in the next general meeting.

(ii) 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. The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation, in the statement.

(iii) If the auditor gives a qualified report, the same has to be replied by the Directors as annexure to Board Report and shall be circulated/ placed in AGM.

7. Ramesh, Rohit and Madan, all graduate in pharmacy, decide to form a start-up business of manufacturing rare medicine for cancer. Rohit plans big and wants to go to public for finance in course of time. Madan has requested his uncle, an NRI based at USA to invest in the company which he has agreed. Ramesh feels that they should go for section 8 company as the target is not to make money. Madan's uncle wants to know the advantages and disadvantages of public and private company in India.

You are advised to clarify the following issues.

(i) In order to fulfil Rohit's plan, what kind of entity should be preferred and why?

(ii) Can Madan's uncle invest in the company as an NRI?

(iii) Ramesh's idea of section 8 company is ok?

(iv) Prepare small note for Madan's uncle.

**Solution**

(i) Private company cannot call for finance from the public. However, a private company can be converted into public company. It is preferred that a public limited company be incorporated so that finance can be taken from the market.

(ii) Yes, Madan's uncle can invest in the company, subject to FDI restrictions.

(iii) Ramesh's idea of section 8 company is not ok as this is a business, where they are investing as entrepreneur and it is not a NGO or social enterprise.

(iv) Note for Madan's uncle.

Advantages of private company

(a) Many provisions of the companies Act do not apply

(b) Shareholders are limited are normally known.

Disadvantages of private company

(a) Cannot invite fund from public

(b) Cannot increase number of shareholders over 200

8. ABC Ltd. Is a public limited unlisted company with ₹50 crore equity capital of ₹10 each. It has taken over 70% equity of a company called BCG Ltd which is a listed company with equity capital of ₹20 crores divided into share of ₹10 each. ABC Ltd. And BCG Ltd. Have decided to merge.

The CEO of BCG Ltd. has following queries which you have to answer.

(i) Is the decision to merge is in order?

(ii) Is a scheme necessary for merger?

(iii) Is the merger to be approved by shareholders of each of the companies?

(iv) What happens if few shareholders do not consent?

(v) Does require order of NCLT?

**Solution**

(i) Yes. The decision to merge in in order. Companies are free to merge with consent of shareholders and by

following the procedures prescribed under law. However, it will not fall under special category mergers under section 233 of the Act.

(ii) Yes, a scheme is necessary.

(iii) Yes, the scheme has to be approved by 3/4th majority of shareholders in value.

(iv) The dissenting shareholders have to accept the decision of the majority.

(v) Yes. It requires approval of NCLT. Since the transferee company is listed, SEBI regulations have to be complied with, wherever applicable

**Answer:**

**Multiple Choice Questions (MCQ)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | 18 | 19 | 20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| d | d | b | a | d | d | b | c | b | d | b | c | a | a | b | b | c | d | a | c |
| 21 | 22 | 23 | 24 | 25 | 26 | 27 | 28 | 29 | 30 | 31 | 32 | 33 | 34 | 35 | 36 | 37 | 38 | 39 | 40 |
| d | c | c | b | d | b | b | d | a | c | b | b | c | c | d | c | c | d | b | c |
| 41 | 42 | 43 | 44 | 45 | 46 | 47 | 48 | 49 | 50 | 51 | 52 | 53 | 54 | 55 | 56 | 57 | 58 | 59 | 60 |
| c | d | c | c | d | b | a | a | d | c | c | c | d | d | c | a | c | c | b | d |
| 61 | 62 | 63 | 64 | 65 | 66 | 67 | 68 | 69 | 70 | 71 | 72 | 73 | 74 | 75 | 76 | 77 | 78 | 79 | 80 |
| a | c | b | c | d | c | c | c | a | b | a | c | c | d | c | d | c | c | d | d |
| 81 | 82 | 83 | 84 | 85 | 86 | 87 | 88 | 89 | 90 | 91 | 92 | 93 | 94 | 95 | 96 | 97 | | | |
| b | d | d | b | a | b | b | a | b | a | d | d | c | b | b | d | a | | | |

**State True or False**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | 18 | 19 | 20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| F | F | T | F | F | F | T | F | T | T | F | F | F | T | F | F | F | F | T | T |

**Fill in the blanks**

| | | | |
|---|---|---|---|
| 1 | Fifteen | 2 | 50 |
| 3 | 30 | 4 | 100 |
| 5 | 2 | 6 | 60 |
| 7 | unanimous | 8 | 30 |
| 9 | 7 | 10 | 8 |
| 11 | Accrual basis | 12 | 1 Lakh |
| 13 | 5 Crores | 14 | 7 |

| | | | |
|---|---|---|---|
| 15 | 3 | 16 | 30 |
| 17 | 180 | 18 | 234 |
| 19 | 30 days | 20 | quarter |
| 21 | dispute | 22 | shareholders |
| 23 | Board of Directors | 24 | conclusion of the ensuing AGM |
| 25 | special | 26 | CAG |
| 27 | CARO | 28 | 11% |
| 29 | registered | 30 | accounting standards |
| 31 | 30 | 32 | zero |
| 33 | IEPF | 34 | debenture trustees |
| 35 | 50 | 36 | INC-20A |
| 37 | 210 | 38 | RBI |
| 39 | Foss vs. Harbottle | 40 | ₹ 2,000 crore |
| 41 | encourage | | |

# Insolvency and Bankruptcy Code, 2016

2

**This Module Includes**


**2.1 Definitions**

**2.2 Corporate Insolvency Resolution Process**

**2.3 Liquidation of a Corporate Person**

**2.4 Personal Insolvency**

# Insolvency and Bankruptcy Code, 2016

**SLOB Mapped against the Module**

To have fair idea about insolvency procedures to be undergone by a company.

**Module Learning Objectives:**

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

- The concept, reasons of corporate bankruptcy;
- The procedure, remedies available to the company and the creditors under the Insolvency and Bankruptcy Code, 2016 and Rules. Regulations and circulars thereunder.
- Students may be working in a company dealing with companies, under insolvency. The module will make term aware of the cautions they have to take.

# Definitions

# 2.1

## 2.1.1. 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 focusing 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 facilitate lenders in effective and timely recovery or restructuring of defaulted assets and causes undue strain on the Indian credit system. 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. Subsequently, many provisions have been amended. First amendment was on 23/11/2017, by an Ordinance, which was later converted into IBC (Amendment) 2018. Code was further amended in August 2019.

Taking into consideration, the pandemic, the Code was amended on 13 March, 2020 and is deemed to be effective from 28th day of December, 2019. The second amendment Act was notified on 23rd September 2020 and is deemed to have come into force on 5th day of June, 2020.

## 2.1.2. Insolvency and Bankruptcy Code, 2016

The purpose of this Act is as follows —

1. To consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship and availability of credit;

2. Balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues;
3. Establish an Insolvency and Bankruptcy Board of India.

### 2.1.3. Applicability of Insolvency and Bankruptcy Code, 2016

The Insolvency and Bankruptcy Code, 2016 applies to whole of India. 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, or

(b) Under Special Act

(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 debtors:

(g) Partnership firms and proprietorship firms; and

(h) Individuals, other than persons referred to in clause (e).

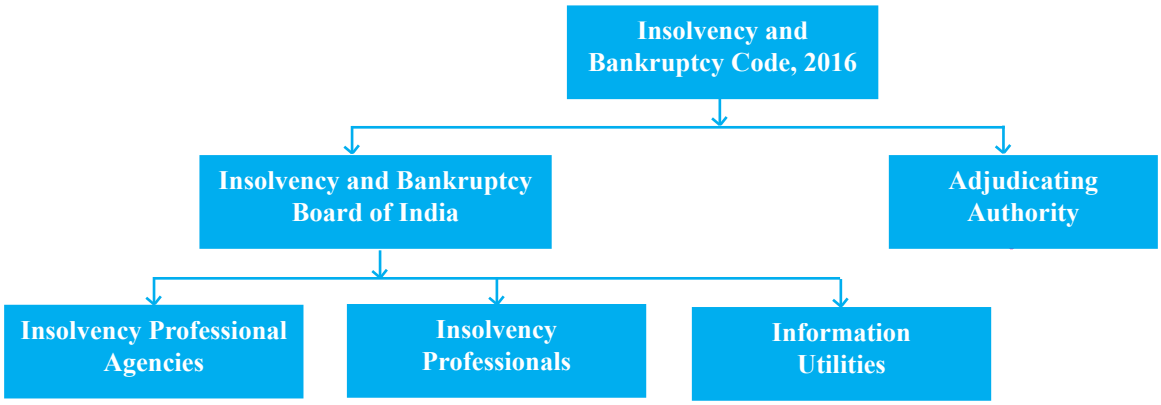
**The Insolvency and Bankruptcy Code is not applicable to corporates in finance sector.** Section 3(7) of Insolvency and Bankruptcy Code, 2016 states that "Corporate person" shall not include any financial service provider. Thus, the Code does not cover Bank, Financial Institutions, Insurance Company, Asset Reconstruction Company, Mutual Funds, Collective Investment Schemes or Pension Funds.

Brief idea about Regulatory Mechanism and Bodies.

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



### 2.1.4. Definitions of terms used in the Code

In the resolution process, there are few terms which needs to understood as be defined

(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 or the pre-packaged insolvency resolution process, as the case may be, 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)]

(20) **Financial position,** in relation to any person, means the financial information of a person as on a certain date; [Section 5(9)]

(21) **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)]

(22) **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)]

(23) **Insolvency resolution process period** means the period of 180 days beginning from the insolvency commencement date and ending on one hundred and eightieth day; [Section 5(14)]

(24) **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)]

(25) **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)]

(26) **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 2%, 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 2%, 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 admitting 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)]

(27) **Resolution plan** means a plan proposed by resolution applicant for insolvency resolution of the corporate debtor as a going concern in accordance with Part ll; [Section 5(26)]. The plan may also include provisions for restructuring of the corporate debtor, including merger, amalgamation & demerger.

(28) **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)]

(29) **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.

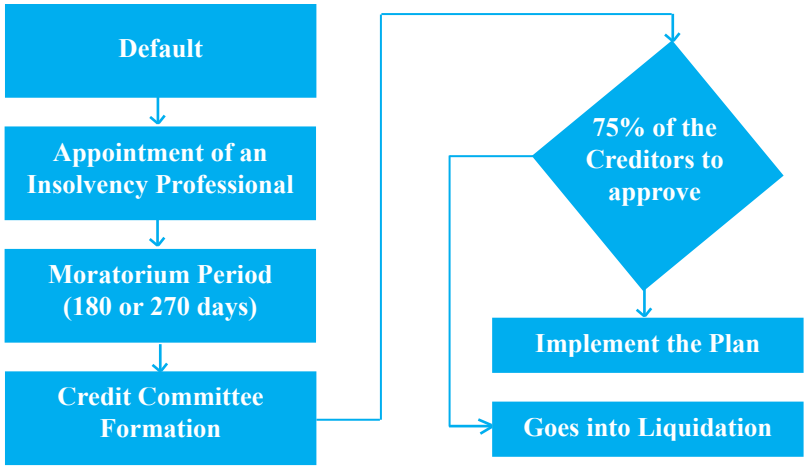
(30) **"Resolution Applicant"** means a person, who individually or jointly with any other person, submit a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25.

# Corporate Insolvency Resolution Process 2.2

Corporate insolvency resolution process can be commenced when a corporate debtor commits a default. Central Govt. may notify minimum amount of higher value of not more than Rs 1 crore for pre-packed insolvency and Resolution process under chapter III-A.

The default should be minimum Rupees one lakh. The amount can be increased by Central Government but shall not exceed Rupees one crore.

The resolution process and timeline can be diagrammatically represented as:




### 2.2.1. 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 the pre-packaged insolvency resolution process, ; or

a financial creditor or an operational creditor of a corporate debtor undergoing a pre-packaged insolvency resolution process; or

(b) a corporate debtor having completed corporate insolvency resolution process twelve months preceding the date of making of the application; or

a corporate debtor in respect of whom a resolution plan has been approved under Chapter III-A, twelve months preceding the date of making of the application; or

(c) a corporate debtor 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) a corporate debtor in respect of him a liquidation order has been made.

### 2.2.2. Persons who cannot be resolution applicant: (Section 29A)

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 submission 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 and at least a period of one year has lapsed from the date of such classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor. However, the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to nonperforming asset accounts before submission of resolution plan:

Provided that the provisions of this clause shall not apply to such resolution applicant for a period of three years from the date of approval of such resolution plan by the Adjudicating Authority under this Code;

(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).

### 2.2.3. 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 who shall be at least 100 numbers in the same class or 10% of total number of creditors of that class, whichever is less. All pending applications as on commencement of Act,2020 shall have to be modified. Application should give record of default and name of the Resolution Professional.

Adjudicating Authority (NCLT) shall, within 14 days, 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 admit or 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.

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 Adjudicating Authority and intimation sent to the financial creditor.

**Admission of application -** If Adjudicating Authority is satisfied that default has occurred, it will admit application and corporate insolvency process shall commence from the date of such admission.

**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.

### 2.2.4. Initiation of Insolvency resolution by operational creditor

Process of insolvency resolution can be initiated by operational creditor on the occurrence 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 with copy of invoice to corporate debtor in prescribed manner.

"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.

The corporate debtor shall within 10 days of receipt demand notice or copy of invoice. If he had paid the unpaid operational debt, he will inform details of electronic transfer or encashment of cheque issued by corporate debtor to operational creditor.

If there is existence of dispute, the same shall be informed or record of pendency of suit or arbitration proceedings, if any.

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.

The application should be in prescribed form, with documents as specified in Section 9(3) of The Code, 2016.

The operational creditor may propose a resolution professional to act as an interim resolution professional.

The application will be admitted within 14 days 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. The operational creditor may propose an IP to be interim IP.

If any of these requirements is not fulfilled, application will be rejected with notice to operational creditor. The corporate insolvency resolution process shall commence from the date of admission of the application. 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.

### 2.2.5. 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 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 corporate debtors or 3/4th of number of partners of corporate debtors.

The Adjudicating Authority shall, within a period of 14 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:

Adjudicating Authority shall, before rejecting an application, give a notice to the applicant to rectify the defects in his application within 7 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. Any default during the period of 25th March, 2020, for one year, shall not be considered as default.

### 2.2.6. Time-limit for completion of insolvency resolution process

The corporate insolvency resolution process shall be completed within a period of 180 days from the date of admission of the application.

The resolution professional shall file an application to the Adjudicating Authority to extend the period of the corporate insolvency resolution process beyond 180 days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of 66% of the voting shares.

Adjudicating Authority, may by order extend the duration of such process beyond 180 days by such further period as it thinks fit, but not exceeding 90 days:

Provided that the process be mandatory completed within 360 days including any extension.

### 2.2.7. 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.

(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.

The public announcement referred to above shall be made immediately after the appointment of the interim resolution professional - Section 13 of Insolvency and Bankruptcy Code, 2016.

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.

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.

Moratorium shall not apply to:-

a) such transactions arrangements or other arrangements as may be notified by the Central Government in consultation with any financial sector regulator - Section 14(3) of Insolvency and Bankruptcy Code, 2016.

b) a surety in a contract of guarantee to a corporate debtor.

"**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.The period during which such moratorium is in place shall be excluded. This provision overrides provision of Limitation Act or any other law.

**Public announcement of corporate insolvency resolution process:** The public announcement of the corporate insolvency resolution process shall contain various information as specified in Section 15(1) of Insolvency and Bankruptcy Code, 2016 and will be made in manner prescribed.

### 2.2.8. Appointment of interim resolution professional

The Adjudicating Authority (NCLT) shall appoint an interim resolution professional on the insolvency commencement date. In case of application by financial creditor or corporate creditor, the IP proposed shall be appointed as interim. IP, if no disciplinary proceedings are pending against him and no other RP is proposed.

### 2.2.8.1. 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].

The interim resolution professional shall make every endeavor 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. 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 , issue instructions to the employees and any action deemed necessary.

### 2.2.8.2. Authority of interim resolution professional

The interim resolution professional will be vested with the management of the corporate debtor shall have all the powers of management as specified in Section 17(2) the Code, which, with marginal variation, is the power of the Board of Directors.

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 on behalf of the corporate debtor.

### 2.2.8.3. Duties of interim resolution professional

As per Section 18(1) of Insolvency and Bankruptcy Code, 2016, the interim resolution professional shall-

(a) collect all information relating to the assets, finances and operations 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.

(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 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.

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.

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.

### 2.2.9. 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 committee of creditors (COC).

The committee of creditors shall comprise all financial creditors of the corporate debtor, provided the financial creditor or his representative is not a defaulter under section 6 of the Act.

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.

Where there is no financial creditor, COC shall be as specified. Where a person is both financial creditor and operational creditor, he will be included as financial creditor to the extent of financial debt, in the COC. He shall considered as operational creditor to the extent of operational debt.

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.

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.

The resolution professional shall be made within a period of seven days of such requisition.

**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. “Related Party” in relation to individual is listed out under section 24A of the Code.

**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 where by a 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 or to replace the interim resolution professional by another resolution professional.

In case of continuation interim resolution professional, they will inform its decision to the Adjudicating Authority but if they decide to replace the interim resolution professional, the resolution professional can be appointed only with approval of Insolvency Board. Till then, the interim resolution professional will continue. The RP may be replaced with 66% of the voting of COC (Section 27) with the approval of adjudicating authority, who will consult IBBI for clearance of the name of IP.

**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. The resolution professional shall exercise powers and perform duties as are vested or conferred on the interim resolution professional.

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.

### 2.2.9.1. Meeting of Committee of Creditors (Section 24)

The members of the committee of creditors may meet in person or by such electronic means as maybe specified which shall be conducted by the resolution professional.

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 .

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.

Each creditor shall vote in accordance with the voting share assigned to him based on the financial debts owed to such creditor to be determined by the Insolvency Professional in the manner specified by the Board.

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 by the Board.

### 2.2.10. Duties of Resolution Professional (Section 25)

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. He can take any or all the actions specified in Section 25(2) of which are within the powers of the Insolvency Professional. 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. He may invite applications for resolution process with the approval of creditors. Present all resolution plans to COC.

### 2.2.10.1. Prior approval of committee of creditors for certain actions by Resolution Professional (Section 28)

In following cases, resolution professional can take action only with prior approval of committee of creditors, with 66% voting in favour, failing which the action by IP will be invalid and action may be taken against IP.

(a) raise any interim finance.

(b) create any security interest over the assets of the corporate debtor.

(c) change the capital structure of the corporate debtor.

(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.

(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 ithe 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.

### 2.2.10.2. Preparation of information memorandum (Section 29)

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 .

The resolution professional can appoint resolution applicant who will submit a resolution plan to the resolution professional. 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 maintain confidentiality (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.

### 2.2.10.3.Submission and approval of resolution plan by resolution applicant (Section 30)

Section 29A provides non-eligibility conditions of resolution applicant.

A resolution applicant may submit a resolution plan along with affidavit stating that he is eligible under 29A to the resolution professional prepared on the basis of the information memorandum.

The resolution plan shall contain following -

(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 or the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority in sub-section (1) of 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 and such other requirements as may be specified by the Board.

### 2.2.10.4. Insolvency Resolution Process Cost

Its 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.

### 2.2.10.5.Approval of resolution plan by Committee of Creditors (Section 30)

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 the Code.Thereafter, it is to be approved by 66% of voting shares of financial creditors after considering its feasibility and viability and such requirement as may be specified by the Board.

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.

After approval of Committee of Creditors, the resolution professional shall submit the resolution plan to the Adjudicating Authority.

### 2.2.10.6. 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 of the Code,it shall by order approve the resolution plan.

The approved plan shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.If resolution plan is rejected by Adjudicating Authority, liquidation process will commence.

# Liquidation of a Corporate Person

# 2.3

**W**here 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; 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.

Committee may take decision to liquidate the corporate debtor any time before confirmation of the resolution plan.

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. If the Adjudicating Authority determines that the corporate debtor has contravened the provision of the resolution plan, it shall pass a liquidation order . 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.

### 2.3.1. Appointment and remuneration of Liquidator

The resolution professional appointed for the corporate insolvency resolution process shall, subject to the submission of the written consent, act as the liquidator unless replaced by the Adjudicating Authority. 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.

The Adjudicating Authority shall by order replace the resolution professional, if-

(a) the resolution plan submitted by the resolution professional was rejected for failure to meet the requirements of the Code;

(b) the Board recommends the replacement of a resolution professional to the Adjudicating Authority for reasons

to be recorded in writing;

(c) the Resolution professional fails to submit written consent.

The Adjudicating Authority may appoint another Insolvency Professional as liquidator on recommendation of the Board.

### 2.3.2.Powers and duties of liquidator

The liquidator will work under overall directions of the Adjudicating Authority and have the following powers and duties.

(a) to verify claim 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.

(d) to take such measures to protect and preserve the assets and properties.

(e) to carry on the business of the corporate debtor for its beneficial liquidation as he considers necessary.

(f) To sell the immovable and movable property and actionable claims of the corporate debtor in liquidation other than to those who are not eligible to be a resolution applicant.

(g) to draw, accept, make and endorse any negotiable instruments

(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.

(i) to obtain any professional assistance from any person or appoint any professional

(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, 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 .

(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

(o) to perform such other functions as may be specified by the Board.

The liquidator may but consult any of the stakeholders entitled to a distribution of proceeds such consultation shall not be binding on the liquidator.

### 2.3.3. Liquidation estate

The liquidator shall form an estate of the assets which will be called the 'liquidation estate' in relation to the corporate debtor.The liquidator shall hold the liquidation estate as a fiduciary for the benefit of all the creditors.

The liquidation estate shall comprise all liquidation estate assets as follows:

(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.

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.

### 2.3.4. Liquidator has powers to access information

The liquidator shall have the power to access any information from the following specified sources.

(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.

The creditors may ask for any financial information relating to the corporate debtor which has to be provided within a period of seven days or provide reasons for not providing such information.

### 2.3.5. Ascertaining claims against corporate debtor (Section 38)

The liquidator shall receive or collect the claims of creditors within a period of 30 days from the date of the commencement of the liquidation process.

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. An operational creditor may submit a claim to the liquidator in manner, along with supporting 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) within 14 days of its submission may be withdrawn.

### 2.3.6. Admission or rejection of claims by liquidator

The liquidator may, after verification of claims, and calling for further documents 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 which may be appealed within 14 days.

### 2.3.7. 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.

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 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.

### 2.3.8.Order of Adjudicating Authority in case of preferential transactions (Section 43)

On an application made by the resolution professional or liquidator under Adjudicating Authority can pass any of following orders:

(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.

(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.

The authority shall not consider any transfer as "not acquired" in good faith, unless circumstances prove so.

### 2.3.9.Avoidance of undervalued transactions. [Section 45]

If the liquidator or the resolution professional, determines that certain transactions were made during the relevant period which were undervalued, he shall make an application to the Adjudicating Authority to declare such transactions as void.

A transaction shall be considered undervalued where the corporate debtor —

(a) makes gift to a person; or

(b) enters into a transaction for a consideration the value of which is significantly less than the market value.

Relevant period [Section 46]

(i) one year preceding the insolvency commencement date; or

(ii) with a related party within the period of 2 years preceding the insolvency commencement date.

If not reported by liquidator/RP, application can also be made by a creditor, member or a partner of a corporate debtor to declare such transactions as void.

Where the Adjudicating Authority shall pass suitable address as deemed fit,which may:

(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.

### 2.3.10.Transactions defrauding creditors [Section 49]

Where the Adjudicating Authority is satisfied that the transaction was done -

(a) for keeping assets of the corporate debtor beyond the reach of any person who is entitled to make a claim

(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

  (ii) protecting the interests of persons who are victims of such transactions:

### 2.3.11. 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 ,the liquidator shall verify such security interest and permit the secured creditor to realise only such security interest which are relevant

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 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.

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 after adjusting actual costs of realisations; and

(b) tender to the liquidator any surplus funds received from the enforcement of such secured assets.

### 2.3.12. Distribution of Assets

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

(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;

(g) preference shareholders, if any; and

(h) equity shareholders or partners, as the case may be.

### 2.3.13.Dissolution of Corporate Debtor

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.

# Personal Insolvency

# 2.4

**C**hapter IV of the ode provides for insolvency process of individuals and partnership.

i) Application of bankruptcy can be made by any creditor singly or jointly against-

a) order under 100(4) relating to defrauding a creditor;

b) order under 115(2) regarding rejection of the repayment plan

c) order under 118(3) on non satisfaction of the debt as per repayment plan.

within 3 months of the order, along with relevant documents of evidence, details of claim, and copy of the order referred above.

ii) The secured and unsecured debt shall be treated separately.

iii) The creditor may propose IP as bankruptcy trustee

iv) Application cannot be withdrawn without permission of adjudicating authority.

### 2.4.1. Effect of application

Interim Moratorium shall commence on the date of application on all properties till insolvency commencement date. During interim moratorium, all litigation shall be stayed and no new litigation an be initiated. However, this subject to any special notification by CG.

### 2.4.2. Insolvency Professional (IP)

The IP proposed shall be continued/rejected by Adjudicating Authority(AA) based on information on IP to be sent by the Board. In case none is proposed, the AA shall request for nomination within 7 days to Board and Board shall nominate within 10 days. COC may with 75% voting replace the Bankruptcy trustee (BT) who may also resign suo moto. Replacement can be done with the consent of the Board and Adjudicating Authority ( section 145 and 146)

### 2.4.3. Adjudication procedure

Adjudicating Authority to send notice within 10 days to creditors with relevant document asking for submission of claim with last date. A public notice shall also be issued. Creditor shall register claim within 7 days of public notice to bankruptcy trustee who shall make a list of creditors within 14 days. BT shall call a meeting of creditors within 21 days of bankruptcy commencing date and in the meeting constitute COC, will decide, along with other businesses. Interested creditors shall not vote.

### 2.4.4. Completion of Administration

The BT shall also call a meeting of COC on completion of distribution of assets/settling claims of creditors with detailed report to be approved by COC within 7 days of receipt and decide to release the BT, BT has to present before AA within 7 days thereafter for his release. BT may also apply for release after one year, in case released by COC.

### 2.4.5. Order

Under section 126, the Adjudicating Authority shall pass an order within 14 days of confirmation of IP/ trustee by the Board, which shall be valid till the debt is discharged.The estate will vest on the trustee. The creditor shall be barred to take legal action against the debtors/properties. Secured creditors shall have to take action to realize within 30 days, failing which his interest shall be forfeited.

Where an order has been passed, the bankrupt shall submit his statement of financial position or any other information required by the trustee.

### 2.4.6. Discharge of Bankruptcy Trustee (BT)

Once the authority passes order of discharge, the BT shall be discharged from his functions and responsibilities subject to conditions. The bankrupt shall be released from all his debts. Any such order may be modified on application by the person effected.BT/IP shall be deemed to have been released on confirmation of appointment for new BT/IP.

### 2.4.7. Disqualification /Restriction on the bankrupt

During bankruptcy proceeding, bankrupt, shall:

i) not be appointed as trustee, public servant, election of local authority,

ii) not to act as director, taking part in formation of companies,

iii) disclose in all transaction about the bankruptcy proceedings,

iv) travel overseas

The functions, powers of the BT and the process to be followed is similar to liquidation process of corporate. The provisions are mentioned in detail in chapter V from section 149 to 178 with chapter heading as- “Administration and Distribution of the Estate of the Bankrupt”

### 2.4.8. Adjudicating Authority (Chapter VI)

Section 179 to 180 provides for the adjudicating authorities, their powers and duties.

i) the Authority shall be the Debt Recovery Tribunal having territorial jurisdiction over the place where individual debtor actually resides or carries on business or works for gain.

ii) The Tribunal shall function as a court as per Civil Procedure Code.

iii) Civil Court shall have no jurisdiction

iv) The decision of DRT can be appealed DRAT within 15days.

v) the decision of DRAT on question of law can be appealed to Supreme Court.

## EXERCISE

**Multiple Choice Questions (MCQ)**

1. The Insolvency and Bankruptcy Code passed by the Parliament in the year:

   a) 2014

   b) 2015

   c) 2016

   d) 2017

2. The Code applies to:

   a) All companies registered under Companies Act;

   b) LLP

   c) Partnership

   d) All of the above

3. The Code applies to:

   a) Bank

   b) Insurance company

   c) Asset reconstruction company

   d) None of the above.

4. An entity in favour of whom security interest is created is called:

   a) unsecured creditor

   b) financial creditor

   c) operational creditor

   d) secured creditor

5. In normal course, the corporate insolvency resolution process shall be completed within a period of…….. days from the date of admission of the application.

   a) 120

   b) 180

c) 210

d) 240

6. The RP has to manage the company as :

a) Loosing concern

b) Going concern

c) Selling concern

d) Profitable concern

7. As per section 22(1)The first meeting of the COC will be held within …… days of constitution.

a) 5

b) 6

c) 7

d) 8

8. A Resolution Professional may be replaced with of the voting rights of the Committee of Creditors

a) 51

b) 66

c) 75

d) 55

9. The adjudicating authority in case of personal insolvency is:

a) NCLT

b) Debt Recovery Tribunal

c) RBI

d) SEBI

10. During bankruptcy proceeding, bankrupt, shall:

a) not be appointed as trustee, public servant , election of local authority,

b) not to act as director, taking part in formation of companies,

c) disclose in all transaction about the bankruptcy proceedings,

d) all or any of the above.

11. Under Insolvency Bankruptcy code 2016 where extension of time is requested, the Corporate Resolution process shall be completed within a period of ..... from the date of admission of the application to initiate such process.

    a) 60 days

    b) 90 days

    c) 180 days

    d) 240 days

12. Insolvency and Bankruptcy code 2016 is not applicable on:

    a) Financial Service Providers

    b) Partnership Firms and Individuals

    c) Limited Liability Partnership (LLP)

    d) Companies Incorporated under Companies Act.

13. With the introduction of IB code, the following laws have been repealed:

    a) Chapter XIX and Chapter XX of Companies Act, 2013

    b) Part VIA, Part VII and Section 391 of Companies Act, 1956

    c) SICA Act, 1985

    d) All the above.

14. The Insolvency and Bankruptcy Board has power of ..... Court in respect of issue of summons, discovery and production of books, inspection of books/registers and issue of commissions for examination of witnesses:

    a) Session Court

    b) High Court

    c) Supreme Court

    d) Civil Court

15. The following institutions are insolvency professional agency

    a) Institute of Cost Accountants of India

    b) Institute of Chartered Accountants of India

c) Institute of Company Secretaries

d) All of them.

16. The authority provided under the IBBI to administer and regulate the Law is:

a) IBBI

b) Insolvency professional

c) Insolvency professional agency

d) None of the above.

17. 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) all of the above

18. A person under IBC is:

a) a Hindu Undivided Family

b) a company

c) a trust

d) All of the above

19. 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 submission 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) All of the above

**State True or False**

1. The Corporate Insolvency Resolution process shall be completed within a period of 180 days from the date of the application.
2. Disqualified Director under Companies Act cannot be resolution applicant as per Section 29A.
3. Secured creditors means a creditors in favour of whom security interest is created.
4. NCLT Stands for National Corporate Law Tribunal.
5. Corporate applicant means corporate creditors.

**Fill in the blanks**

1. Any person to whom the financial debt is legally assigned is also……creditor.
2. Insolvency resolution process ends ……days from the insolvency commencing date.
3. The legal authorisation to suspend or delay repayment is called……
4. The maximum moratorium period can be ……..days
5. For approval of plan, it shall have…….percent voting of creditors.
6. Insolvency resolution process period means the period of……days beginning from the insolvency commencement date
7. The Adjudicating Authority shall, within a period of …….. days of the receipt of the application, by an order, admit the application or reject the application, if it is incomplete.
8. Adjudicating Authority, may by order extend the duration of such process beyond 180 days by such further period as it thinks fit, but not exceeding…… days.

**Short Essay Type Questions**

**Write a note on**

a. Concept of corporate insolvency.

b. Committee of creditors.

c. Liquidation asset.

**Essay Type Questions**

1. Discuss the purpose and objective of the Insolvency and Bankruptcy code.
2. Discuss various provisions related parties in relation to corporate debtor as provided under the code.
3. Discuss role, duty and responsibility of Resolution Professional.

**Answer:**

**Multiple Choice Questions (MCQ)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | 18 | 19 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| c | d | d | d | b | b | c | b | b | a | c | a | d | d | a | a | d | d | d |

**State True or False**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| T | T | T | F | F |

**Fill in the blanks**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|
| Financial | 180 | Moratorium | 270 | 75 | 180 | 14 | 90 |

# Corporate Governance, Social Responsibility and Sustainability

# 3

**This Module Includes:**


**3.1 Corporate Governance - Concepts and Issues**

**3.2 Corporate Governance Practices/Codes in India**

**3.3 Corporate Governance in Family Business**

**3.4 Corporate Social Responsibility- Nature of Activities, Evaluation of CSR Projects**

**3.5 Sustainability Management**

# Corporate Governance, Social Responsibility and Sustainability

**SLOB Mapped against the Module**

To have a detailed understanding of the concepts of corporate governance, CSR and sustainability and regulations associated with them.

**Module Learning Objectives:**

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

- the emerging governance issues in companies;
- better and ideal stakeholder management through balancing of stakeholders' interest.

# Corporate Governance - Concepts and Issues 3.1

Governance tantamount to the process the affairs of the company is managed with regards to fairness, honesty and good practices for the benefit of all stakeholders. This is to be done with systematic, well designed polices and procedures, keeping in view the balance between the interest of various stakeholders.

Therefore, in order to qualify as good governed company, a company has to put in place the mechanics of the functioning of the company with checks and balances between the shareholders, directors, auditors etc. The process of Corporate Governance/CG is more a way of business life than a mere legal compulsion. Companies are forced to comply with conditions / practices by adopting the legal prescription as some companies may not function in the desired ethical manner. Moreover, there should be uniformity in governance , so that stakeholders can compare between the companies..

At various times, various management scientists and philosophers have defined CG, which are as follows.

**Nobel laureate Milton Freidman:**

"CG is the conduct of business in accordance with shareholder desire, which generally means to make money as much as possible, while contributing to the basis rules of society embodied ion law and local customs"

Adrian Cadbury (Chairman of the Cadbury Committee , which proposed CG for listed company in initial years).

"CG is a system by which companies are directed and controlled. It has to do with power and accountability, who exercises in whose behalf and how"

Narayan Murty Committee (Chairman of the CG Committee)

"CG is the acceptance by the of the non alienable rights of the shareholders as true owners of the corporation and their own role as trustees. It is about commitment of values, ethical business conduct and differentiating between personal and corporate fund"

In course of time, with the growth of trade and commerce, business and society, now, have a stronger interface. From the typical concept of profit being the essence of business, now we are into a regime where the stakeholder definition includes not only the share holder but the employees, society, Govt., Customers, creditors, financiers etc. This is a paradigm shift in corporate management from the traditional "management" concept to "governance" concept.

### 3.1.1. Objectives of Corporate Governance

Following can be taken as objectives of CG.

1. Company to justifiably satisfy the stakeholders by balancing conflict of interest amongst the stakeholders;
2. Company adopts transparent, logical and justifiable polices effecting the stakeholders in all areas of management;
3. Ideal composition of the board of directors: to justify independence if decision making; this is now regulated under LODR.

4. Optimum use of resources of the company the resources belong to shareholders and thereafter the employees. Customers, financiers are also effected if the resources available is not properly used.
5. To reduce risks by following risk management through due diligence process.
6. Establishing strong relationship of trust between the company and the stakeholders which enhances the value of the company.

### 3.1.2. Features of Corporate Governance

Let us discuss few features or elements of Corporate governance generally accepted by the industry.

1. **A proper tool for transparency:** disclosing the status of the affairs company at every step to every stakeholders i.e. required to maintain transparency. The concept goes against the theory of suppression of material facts by the company to its stakeholders, may be or may not be, for the benefit of the shareholders only.
2. **Prudent and participative management:** the management should use its full intelligence and knowledge for the benefit of the stakeholders. Hence, it may be taken that management is prudent and wise in its decision making.
3. **Enhancing value of the enterprise:** Any company should grow from year to year, if it wants to satisfy it stakeholders. Value may be monetary or reputation, image, goodwill etc. Better governing companies will have better reputation, trust of the stakeholders and there will be enhancement of business, leading to more profit and better enterprise valuation.
4. **Accountability:** Success and accountability has to go together. Successful companies will make themselves accountable to the stakeholders. There are many combination of relationships, i.e. with the customer, creditors, shareholders, employees. etc. The company cannot say it is accountable to one stakeholder only .It has to be accountable to all stakeholders.
5. **Innovation:** Doing something new or doing the same thing in a novel manner is the essence of growth and sustainability of an enterprise. The governance structure should encourage new things in the company for enhancing value of the company.
6. **Professionalism and specialization:** The basics of professionalism is that the job shall not be compromised at any level and there should not be conflict of interest of the directors and senior managers between his duty and personal gain. It also takes into account the competence of the person doing job having obviously adequate domain knowledge either by academic qualification or track record of experience
7. **Stakeholder recognition:** All stake holders should be recognized and respected. The Company should believe that all these stakeholders have contribution in making the company work and grow.

### 3.1.3.Ethics and Corporate Governance (CG)

Though corporate governance, per se, is the manifestation of ethics, few differences do exist between the two.

| Ethics | Corporate Governance |
|---|---|
| The values and principles considered as foundation. It relates to the inner self of an individual which reflects at the workplace. | The method of governance should be with ethical values but is the methods which are important. |
| Applies at all levels. A manager has to be honest at every level. | Normally applies at top level, corporate policies and procedures are made at higher level only. |
| Emerges naturally | Needs to be studied and experienced. There are established guidelines on these issues which have emerged in course of time. |

| | |
|---|---|
| Regulations are not important | Regulations are important as it needs strict compliance. In most of the countries, corporate governance is regulated. |

### 3.1.4. Management and Corporate Governance (CG)

Few thin line differences may be made out between the two.

| Management | Corporate Governance |
|---|---|
| Objects and targets are considered as foundation | The method of governance with ethical values |
| Applies at all levels | Applies at top level |
| Emerges with situation. In every situation management strategies are to be decided and implemented. | Need to study and experience |
| Regulations not important. Organisation can have its own rules. However, rules of law has to be followed. | Regulations are important |
| Results are more important than the methodology of achieving the result | Methodology of achieving results are more important than results |

### 3.1.5. Emergence and Evolution of Corporate Governance

1. Instances of corporate failures: last two decades have witnessed various corporate failures of some of the reputed and large companies which has resulted to mistrust by the stakeholders on companies in general.
2. Some of the big failures are Xerox, Enron, Global Crossing, Worldcom, MS shoes, Harshad Mehta case, Satyam etc.
3. Rise of institutional investors who are bothered about the company and investment;
4. Increased number of retail investor want various information;
5. Opening of company information in public domain;
6. Regulatory requirements: many regulations apply on ethical and governance issues.
7. Justifying values to wide range of stakeholders
8. Non compliance of regulations becomes a vital disadvantage in assessment of governance level.
9. Disconnect with stakeholders is considered to be a bad practice.
10. Abnormal volatility in share prices gives rise to speculation about good and bad management practices and outsiders are interested to know about the happenings of company.

**Benefits of Corporate Governance**

1. Better governed company is essential for growth and stabilization
2. Reputation of the company will enhance one people know that you are a honest or good governed company.
3. Better use of funds of the company, which may be fines collected from public of the company by the managers. These
4. Better management of resources which are available to the company.
5. Better governed ensures long term and steady growth.
6. Establishing stakeholders' confidence

7. Leverage of competitive advantages
8. Alliances with other companies are easy as others are interested to be associated with your company.

**Theories Corporate Governance through Board Management**

**Stewardship theory:** Directors are regarded as stewards of the company's assets. They decide what is to be done and drive the people of the company

**Agency theory:** directors are considered to be agents of the shareholders and are supposed to run the company for best interest of the shareholders

**Stakeholder theory:** This theory considers wide inclusion of stakeholders, other than shareholders. Hence the directors need to keep a balance between the interests of various stakeholders.

**Trusteeship theory:** The directors are the persons who are given the authority to run the business by the shareholders which may be a huge amount of money. The relationship of trust is very important for performance by directors who take major decisions of the company.

# Corporate Governance Practices / Codes in India

# 3.2

We have imitated may things from the west. It appears that Corporate Governance is yet another thing; but that is not true. No country preached truth more than Indians did. Corporate governance to my mind is nothing but preaching truth in a different nomenclature. Various attributes of corporate governance like transparency, fairness, rigorous audit and accountability are all offshoots of truth in one way or other. Much is being written on the subject than what is being practised or would be practiced in recent times in Indian Industry and this article is yet another addition to the literature bank. Corporate governance prompters would join me in saying that writings on the subject has created awareness amongst the corporate circles.

Many committees have been set up, out of which three committees have made important recommendation on desirable corporate governance. Indian Committees took clue from the Cadbury Committee who recommendations made the concept popular through the world. Let us have a look on the recommendations of the committees on the subject.

**(a) The Cadbury Committee (USA)**

The Adrian Cadbury Committee was set up by the Security and Exchange Commission (SEC) of USA to recommend desirable corporate disclosures. The recommendations of Cadbury Committee are -

(i) Only listed company should constitute audit committees and such disclosure should be made in Annual Report.

(ii) External auditor and finance director should attend the meeting of the audit committees. Other Board members may also have the right to attend.

(iii) Audit Committee should discuss with the external auditor about the scope of audit, co-ordinate where more than one audit firm is engaged. It should be involved up to review audit, audit engagement letter, recommendations of the auditors etc. Audit Committee shall also review the half yearly and annual financial statements before submission to the Board. The committee should have authority to investigate any matter within its terms of reference and shall have full access to information and it should be free to obtain external professional advice.

(iv) Chairman of the Audit Committee should be available to answer question about its working at the Annual General Meeting of the company.

**(b) Rahul Bajaj Committee (INDIA)**

(i) Confederation of Indian Industry constituted a committee to recommend desirable corporate governance practices chaired by none other than Mr. Rahul Bajaj. It is not clear whether the inspiration was the Cadbury Committee. Whatever it may be, this committee made a breakthrough in India on the subject in the most formal way.

**Recommendations**

(i) Only listed company with turnover of 100 crores and paid up capital of 20 crores whichever is less should set up audit committees within 2 years. (obviously from the date it reaches the threshold limit)

(ii) Audit Committee should assist the Board for effective supervision of the financial report process.

(iii) The Committee should interact with the Statutory Auditor and Internal Auditor to ascertain the quality of company accounts.

**(c) K R Chandratre Committee (INDIA)**

Though the Committee was not on Corporate Governance, it made provision for audit committees for proper corporate governance. Dr. K. R. Chandratre, one of the reputed expert on Company Law in the country was appointed chairman of the committee to draft a new Companies Act in the form of Companies Bill which would replace the existing Companies Act, 1956. The said Companies Bill, (1977) have been given to the Government. It has suggested many important changes , some of which have been accepted and incorporated in recent amendment in the Companies Act, 1956. Recommendation on desirable corporate governance through formation of audit committee mentioned below :

**Recommendations**

(i) Companies with paid up capital of five crores should have audit committee and the constitution of such committee should be disclosed in annual report.

(ii) Auditors, Chief Accounts Officer, Internal Auditor, if any, and director in charge of finance shall attend and participate at the meeting but shall not vote.

(iii) Audit Committee should have discussions with auditors periodically about internal control systems; the scope of audit including the observations of the auditors and review of the half yearly and annual financial statements before submission to the Board.

(iv) Audit Committee shall have authority to investigate any matter either on its own or on reference by Board and shall have full access to information contained in the records of the company. It can also seek external professional advice.

(v) Chairman of the Audit Committee shall be present in annual general meeting of the company to provide any clarification on matters relating to audit.

(vi) Punishment have been provided for non compliance which includes imprisonment.

**(d) Kumarmangalam Birla Committee (INDIA)**

Kumarmangalam Committee was set up by SEBI and is different from the previous three. Alike previous committees, it has not taken audit committee only as basis of corporate governance. The Committee was also given a novel report differentiating mandatory and non-mandatory recommendations. Through the terms of reference to their committee is not known to the author it can be said that committee can only recommend.

**Recommendations**

(i) Representative of financial institutions or investment institutions should not be part of Board of Directors, except in case of default or potential default.

(ii) Investing institutions may raise their voice as shareholder only.

(iii) Half of the director in a Board should be independent but where the chairman is non executive, the outside directors may comprise of 1/3rd of the directors.

(iv) Companies with a capital of ₹10 crores and a net worth of ₹25 crores would have to adhere to these guidelines on corporate governance by April 2000. Companies where share capital of five shall comply with the norms by April 2001.

(v) An audit committee should be set up to enhance the credibility of the financial disclosures of the company and promote transparency. The audit committees should have a minimum of three non-executive directors, majority of them independent. At least one director should have financial and accounting knowledge. The committees should meet at least three times a year.

(vi) The audit committee will have to investigate the reasons for financial defaults by companies, such as defaults to depositors, debenture holders, share holders(non-payment of dividend) creditors.

(vii)A remuneration committee should be set up to determine the remuneration packages, including performance-linked incentives, stock options, etc, of executive directors.

(viii)A committee should be formed to study investor complaints.

(ix)The chairman of these committees should be present at the AGMs to answer shareholder queries.

(x) The directors of these committees cannot be members of more than 10 committees across companies and cannot chair more than five committees.

(xi) The annual report should have a separate section on corporate governance regarding the status of compliance.

(xii)Non-executive chairman should be provided office and reimbursed expenses so as to be effective.

(xiii)Annual report should have details of resume and qualifications of newly-appointed directors.

(xiv)The committee has made several recommendations which are voluntary.

(xv) The other recommendations, which are non-mandatory, made by the committee are:

(xvi)Postal ballot should be used by companies.

**Conclusion**

It appears that all the three Indian committees have made audit as a basis of corporate governance. This may be because of the assumption that in India, financial manipulation, mismanagement and dishonesty eats away an otherwise efficient business organisation. The Cadbury committee also stressed the need of audit committee and that trend continued in Indian recommendations also. Let us hope that some of the above recommendations are accepted and made mandatory. Though making something mandatory would loose the basic spirit of desirable corporate governance, which cannot be a result of statute compliance. But unfortunately we live in a business environment where rules are enforced to follow basic management practice.

**Principles of Good Governance**

Policies to be made at top level for various functions of management, which should be based on fairness, honesty. Directors should know the requirements of the stakeholders. The practices should be strictly practised.

The concept and practice would be different at different levels .For understanding we have divided the issues into Board and below Board level.

**(a) Board level**

Board level good governance have been standardised with series of regulations and disclosures by the company to stakeholders and regulators. This is mentioned mostly under the Companies Act and LODR regulations and discussed in detail elsewhere in this study material.

**(b) Below Board level**

Below Board level, each company has its own mechanism for ethics, code of conduct, service rules, discipline etc. It is up to the company to decide to what extent it is serious about the issues. However, code of conduct for senior executives just below the Board level is a stipulation under LODR. Normally, governance practices are formulated and practiced at top level and percolate downwards. This is called "top down approach" to governance. Whistle blower policy, Audit Committee, standard operating procedures, departmental manuals are some of the common mechanisms used to keep ethics and governance in order, in a company.

Companies Act, 2013 has added Schedule IV which defines the qualification, duties and code of ethics to be complied by independent directors

This has been done with the thinking that adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner will promote confidence of the shareholders, regulators and general public.

**An independent director shall:**

(1) uphold ethical standards of integrity

(2) act objectively while exercising his duties;

(3) for the interest of the company;

(4) devote sufficient time and attention to his professional obligations for informed and balanced decision making;

(5) not allow any extraneous considerations that will influence his exercise of objective independent judgment in the while concurring in or dissenting from the collective judgment of the Board in its decision making;

(6) not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;

(7) refrain from any activity that would lead to loss of his independence;

(8) where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;

(9) assist the company in implementing the best corporate governance practices. II.

**Role and functions:**

The independent directors shall:

(1) bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;

(2) bring an objective view in the evaluation of the performance of board and management;

(3) scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;

(4) look into the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;

(5) be concerned about the interests of all stakeholders, particularly the minority shareholders;

(6) balance the conflicting interest of the stakeholders;

(7) determine remuneration of executive directors, key managerial personnel and senior management and have

a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;

(8) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholdes' interest.

**Duties of Independent Directors:**

The independent directors shall:

(1) regularly update and refresh their skills, knowledge and familiarity with the company; 278

(2) seek information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;

(3) attend all meetings of the Board of Directors and of the Board committees of which he is a member;

(4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;

(5) attend the general meetings of the company;

(6) keep themselves well informed about the company and the external environment in which it operates;

(7) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;

(8) report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;

(9) acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees;

(10) not to disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans etc.

(11) not to share unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

**Manner of Appointment:**

(1) while selecting independent directors the Board shall ensure that there is appropriate balance of skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively.

(2) The appointment of independent director(s) of the company shall be approved at the meeting of the shareholders.

(3) The explanatory statement attached to the notice ensures appointed fulfils the conditions specified in the Act and the rules made thereunder and that the proposed director is independent of the management.

(4) The appointment of independent directors shall be formalised through a letter of appointment, which shall set out :

(a) the term of appointment;

(b) the expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks;

(c) the fiduciary duties that come with such an appointment along with accompanying liabilities;

(d) provision for Directors and Officers (D and O) insurance, if any;

(e) the Code of Business Ethics that the company expects its director

**Corporate Governance Ratings**

A question may come how do outsiders or even the company itself is able to know to what extent the company follows CG principles and where does it stand compared to other similar companies. This has given rise an independent evaluation of CG practices by companies. Therefore, Corporate Governance Rating is an important component in the overall governance system. Corporate Governance Rating is defined as an opinion on a company's corporate governance system, its compliance with the various parameters deployed for assessment and the rating differentiates companies in accordance with their corporate governance quality.

- The rating provides vital information to various stakeholders about the extent of corporate governance practices implemented.
- The rating determines the relative standing of an entity vis-à-vis other entities in respect of the best practices followed on corporate governance principles.
- CG Rating as an opinion on relative standing of an entity with regard to adoption of corporate governance practices. It may be justified using ratings on five parameters.
- Firstly it provides information to various stakeholders about the level of corporate governance practices of the organization.
- Secondly it enables corporates to obtain an independent and credible assessment of the quality and extent of their adherence to governance standards.
- Thirdly the rating process determines the relative standing of the organisation vis-à-vis the best practices followed in the domestic as well as international arena.
- Fourthly, organisations can deploy the CG ratings as reference and set benchmark for further improvements.
- Fifthly investors get benefited as they are able to differentiate companies based on the adherence to corporate governance principles.

**Assessment Criteria**

There are various methods of rating a company' governance parties. However, one has to keep the few of the following issues while assessing the Governing practices

(i) Board Structure and balancing

(ii) Share holder Rights and Compensation'

(iii) Accounting

(iv) Ownership and Control

(v) Professionalism

(vi) Disclosures

(vii)Market price of shares

(viii)Compliance of law

(ix) Earnings Dividend pay-out

(x) Dealing with conflict of interest

(xi) Related party transactions

(xii)Risk management

(xiii)Investor grievances

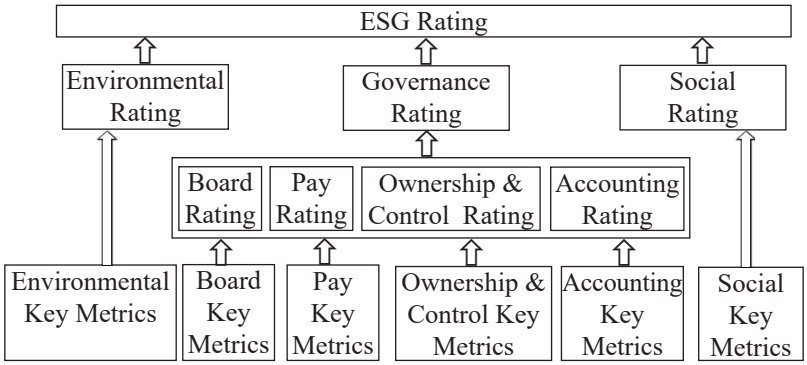
(xiv)Customer grievances

(xv) Vendor grievances

(xvi) CSR initiatives

**Environmental, Social and Governance (ESG)**

ESG RATINGS COMPONENT STRUCTURE




**Format of compliance report on Corporate Governance by Listed Entities**

1. As per the provisions of Regulation 27(2) of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations"), a listed entity is required to submit a quarterly compliance report on corporate governance in the format specified by the Board from time to time to recognised Stock Exchange(s).
2. The format for compliance report on Corporate Governance by listed entities has been specified, as per the following annexures,

   I. Annex - I - on quarterly basis;

   II. Annex - II - at the end of a financial year

   III. Annex - III - at the end of 6 months from the close of financial year.
3. In order to bring about transparency and to strengthen the disclosures around loans/ guarantees/comfort letters/ security provided by the listed entity, directly or indirectly to promoter/ promoter group entities or any other entity controlled by them, it has been decided to mandate such disclosures on a half yearly basis, in the Compliance Report on Corporate Governance. The format of disclosure in this regard is specified vide Annex - IV of the said report and shall be effective from financial year 2021-22.
4. Accordingly the format for compliance report on Corporate Governance shall be as under:

   I. Annex - I - on quarterly basis;

   II. Annex - II - at the end of a financial year

   III. Annex - III - at the end of 6 months from the close of financial year.

   IV. Annex - IV - on a half yearly basis (w.e.f. first half year of the FY 21-22)

# Corporate Governance in Family Business

# 3.3

The International Finance Cooperation defines a family business as follows:

"A family business refers to a company where the voting majority is in the hands of the controlling family; including the founder(s) who intend to pass the business on to their descendants. The terms "family business", "family firm", "family company", "family-owned business", "family-owned company", and "family-controlled company" will be used interchangeably through- out the Handbook to refer to family businesses." (IFC, 2008)

The Family Business Governance Handbook drafted by the International Finance Corporation, one of the institutions of the World Bank Group, is a useful document that gathers important facts and elements on how to develop a family business. This Handbook determines that:

"Family businesses constitute the world's oldest and most dominant form of business organizations. In many countries, family businesses represent more than 70 percent of the overall businesses and play a key role in the economy growth and workforce employment. In Spain, for example, about 75 percent of the businesses are family-owned and contribute to 65 percent of the country's GNP on average. Similarly, family businesses contribute to about 60 percent of the aggregate GNP in Latin America." (IFC, 2008)

As examples of well- known family businesses we can find: 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; and finally Ford Motors Co, and Wal-Mart Stores in the United States of America.

Family owned companies have specific problems due to its nature, their constitution, and their managerial systems. As the company grows, more members, children, grandchildren and so on are incorporated into the family and different types of interests and relationships are generated within the company. The larger the company, the greater the conflict of interest are. Problems arise when the sentimental value collides with the entrepreneurial values. This is why conflicts in family Companies must be handled properly with the help of a consultant or lawyer. These conflicts may bring bad consequences to these kind companies, that may end up destroying the family, the company or both.

It must be understood that the same corporate governance norms that is commonly used for other companies might not apply to these ones. The family factor brings along a different way of looking the company, its strengths and also its weaknesses. A balance between the emotional factor of family with the profitable factor of business.

**Features of Corporate Governance in a Family Owned Companies in India**

In India, business was traditionally a family business. Even now 99% of the corporate houses are owned by individuals or families. Nothing wrong in that. In fact growth of family business is quite substantial.

1. full time directors/other directors and senior management personnel are either from the family or related to the family members.
2. Formation of coterie is common.

3. Control and ownership is diluted with shareholding being diluted on passing of generation.
4. Conflict of interest is very common where personal interest of the promoter conflicts with the company interest. However, proper procedures are followed as per the Act to avoid legal complication.
5. Emotions are attached and therefore, some decision are taken which may not be managerially correct.
6. Where the family members are united, the non family directors/managers are defunct in decision making process. Where family is divided, there are more problems like confusion in leadership, delay in decision making, distrust of outside stakeholders etc. The stability, reputation and performance is effected.
7. Some families have clear cut roles of the family members in business with structured succession planning, allotment of each company to each member to avoid conflict.
8. Personal image of the chairman/MD? Directors is very important which determines the reputation.
9. Many hard-core professional avoid working in family business for obvious reasons.
10. Death/disability of senior member in the family results to leadership management crisis.

**CG in listed family managed companies.**

There are many companies, few big, listed in stock exchange which are owner/prompter managed. However, CG, being highly regulated in India, do not effect such ownership issue as the compliances are codified and the company has to follow the same. Hence, CG in listed family managed company cannot be isolated from the CG in non family business.

**Emerging issues in CG in family managed companies in India.**

(i) Separation of ownership and management: In few companies in India, the main promoter or owner have chosen to be investor and not to a part of management even as part time chairman. The whole Board of directors are non owners and are hard core professionals.

(ii) Family members acquiring professional courses from reputed institutes.

(iii) Promoters are encouraging professionals in the organisation.

(iv) Promoters are more focused on compliances to avoid loss of reputation which may result to price fall in the share market.

(v) Role and leadership clarity decided at board level

(vi) Owners are accepting and honouring opinion of managers.

(vii) Family's social and emotional issues are being satisfied by forming trusts/foundations which are separate from the business entity, without any conflict of interest.

# Corporate Social Responsibility – Nature of Activities, Evaluation of CSR Projects

# 3.4

### 3.4.1. Introduction, Definitions and Concept

CSR is the commitment of any business enterprise to do responsive business and contribute directly and indirectly to make positive and well being of the society, particularly the less privileged people of the country.

CSR rests on the principle of Concern, Care and Share (CCS). Unless you are concerned, you don't care and when you care, you share your resources.

### 3.4.2. Business Society Interface

Philip Kotler had said "we sell goods and services in the society in the market". This implies that unless society demands, there cannot be any production, sale or services. Production employs various factors or resources into economic value addition. Employment creates earning and earning creates demand and demand creates production, and the cycle continues.

Business, therefore, is essential to any social development. The ideal situation would be vibrant corporates working hand in hand with society and contributing to the welfare of people. Therefore, social responsibility is an attempt to meet the economic, ethical, legal demands of the society, without, of course, compromising the sustainability of business. Business is an extension of the Society and no business can sustain in the long run ignoring social values.

Corporate Social Responsibility is the responsibility which the corporate enterprises accept for the social, economic and environmental impact their activities have on the stakeholders. The stakeholders include employees, consumers, investors, shareholders, civil society groups, Government, non-government organisations, communities and the society at large.

It is the responsibility of the companies to not only shield the diverse stakeholders from any possible adverse impact that their business operations and activities may have, but also entails affirmative action by the companies in the social, economic and environmental spheres as expected of them by the stakeholders, to the extent of their organisational resource capabilities.

This is besides corporate legal obligation to comply with statutory rules and regulations regarding the conduct of business operations, and the duty to compensate the stakeholders in the event of any harm or collateral damage.

It is now universally accepted that corporate social responsibility is not a stand-alone, one time, ad hoc philanthropic activity. Rather, it is closely integrated and aligned with the business goals, strategies and operations of the companies. There is a close integration of social and business goals of companies.

### 3.4.3. International Scenario

The UN Human Rights Council established the UN Working Group (UNWG) and tasked it with facilitating the global dissemination and implementation of the UNGPs. The UNWG has strongly encouraged all States to develop a National Action Plan (NAP) as part of the States' responsibility to disseminate and implement the UNGPs.

**UN Sustainable Development Goals (SDGs):**

In September 2015, the UN General Assembly adopted the 2030 Agenda for Sustainable Development which established seventeen

Sustainable Development Goals (SDGs), comprising targets and indicators, as well as follow-up and review mechanisms. Significantly, the SDGs recognize the role of business as a major driver for economic growth and infrastructure, whilst explicitly calling for businesses to act in accordance with the UNGPs.

**Paris Agreement on Climate Change (2015):**

This is an agreement under the United Nations Framework for Climate Change (UNFCC) reached in December 2015, in which countries have committed to take steps to combat climate change and adapt to its effects. India ratified the agreement on 2nd October 2016,and its commitments are called the National Determined Contributions (NDCs).

### 3.4.4. CSR in India- background

Corporates doing something for the society is not new. There are many companies used to run school, medical units, roads, sanitation etc. They used to do these voluntarily, since there was no law for mandatory CSR.

The Ministry of Corporate Affairs (MCA), Government of India, released a set of guidelines in 2011 called the National Voluntary Guidelines on the Social, Environmental and Economic Responsibilities of Business (NVGs).

This was expected to provide guidance to businesses on what constitutes responsible business conduct. In order to align the NVGs with the Sustainable Development Goals (SDGs) and the United Nations Guiding Principles (UNGP) the process of revision of NVGs was started in 2015.

After, revision and updation, the new principles are called the National Guidelines on Responsible Business Conduct (NGRBC). As with the NVGs, the NGRBC has been designed to assist businesses to perform above and beyond the requirements of regulatory compliance.

The primary rationale for the update is to capture key national and international developments in the sustainable development agenda and business responsibility field that have occurred since the release of the NVGs in 2011.

Some of the key drivers of the NGRBC are given below:

1) The UN Guiding Principles for Business and Human Rights (UNGPs): Through its resolution 17/4 of 16 June 2011, the UN Human Rights Council endorsed the Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework. The UNGPs are grounded in recognition of,

   a) the State's existing obligations to respect, protect and fulfil human rights and fundamental freedoms;

   b) the requirement of business enterprises to respect human rights, and

   c) the need for access to effective remedy for those who are affected by adverse business related human rights impacts or abuse. Since their release, the UNGPs have become the authoritative global standard for Business and Human Rights.

   In 2012, the Securities Exchange Board of India (SEBI) amended the Listing Agreement for companies listed in the stock exchanges in India, and mandated the submission of an ABBRs by the top 100 listed companies.

   The ABRR is based on the Business Reporting Framework of the NVGs, and SEBI has since extended this requirement to the top 500 listed companies.

2) Requires companies to undertake Corporate Social Responsibility (CSR) initiatives in communities, and has since, provided additional rules and guidance on the areas and target groups of such interventions in consistency

with national socio-economic priorities.

Applicability The NGRBC are designed to be used by all businesses, irrespective of their ownership, size, sector, structure or location. It is expected that all businesses investing or operating in India, including foreign multinational corporations (MNCs) will follow these guidelines.

Correspondingly, the NGRBC also provide a useful 12 National Guidelines on Responsible Business Conduct framework for guiding Indian MNCs. The NGRBC reiterate the need to encourage businesses to ensure that not only do they follow these guidelines in business contexts directly within their control or influence, but that they also encourage and support their suppliers, vendors, distributors, partners and other collaborators to follow them.

the NGRBC has taken this requirement a step further by identifying specific aspects of each Principle as part of the duty and responsibility of the highest governance structure of the business to oversee the implementation and adherence to these guidelines in their business.

Content and Structure: The NGRBC consist of two chapters and an expanded set of annexures. The connected Core Elements enhance the operationalization of each Principle. The details in the annexures provide practical guidance to businesses on the adoption and implementation of these guidelines.

Keeping the importance of Micro, Small and Medium Enterprises (MSMEs) in view, the business case for adoption of NGRBC by the MSMEs is also given. An updated Business Responsibility Reporting Framework (BRRF) has been included for reporting of actions taken by businesses vis-à-vis the Principles and Core Elements.

The BRRF is meant to serve as an internal tool for companies to assess where they are in their journey of responsible business conduct and identify opportunities for improvement.

Guidance on how this framework may be used by businesses is included as an annexure. Additionally, the BRRF can serve as a framework for regulators to develop disclosure formats

### 3.4.5. Sustainability Reporting

Annual Business Responsibility Report (ABRR) has been made compulsory by the Securities and Exchange Bureau of India (SEBI) based on NVGs. It contains a set of useful references and resources which businesses may consult as part of their implementation efforts.

National Guidelines on Responsible Business There are nine thematic pillars of business responsibility which are called Principles.

Each Principle is introduced as a statement and followed by a narration of the essential aspects of the Principle, referred to as the brief description. A reading of each Principle and brief description should provide a clear idea of the essential spirit and intent of the Principle.

Each Principle is accompanied by Core Elements.

The information sought in Annexure 3 of the Guidelines (Business Responsibility Reporting Framework) is derived from the Core Elements. The Principles are interdependent, interrelated and non-divisible, and businesses are urged to address them holistically.

Annexure 1 of the Guidelines provides guidance to all businesses on the adoption and implementation of the Principles. Furthermore, businesses impact different stakeholders in different ways.

Therefore, while applying these principles, businesses need to be sensitive to characteristics, such as caste, creed, sex, race, ethnicity, age, colour, religion, disability, socio-economic status or sexual orientation. Though this has not been specifically mentioned in the Principles and Core Elements, businesses are expected to keep this in mind. Most importantly, the ultimate responsibility for adoption of the Principles rests with the highest governance structure of the business.

### 3.4.6. The National Guidelines on Responsible Business Conduct

The NGRBC is designed for all businesses, not taking into consideration their ownership, size, sector, structure or location. It is expected that all companies that are invested or operating in India, including foreign multinational corporation (MNCs), has to abide by these guidelines. The NGRBC also provides a useful framework for guiding the Indian MNCs in their overseas operation, by aligning with the applicable local, national standards and norms that are governing the responsible business conduct.

The National Guidelines on Responsible Business Conduct comprises nine thematic pillars of business responsibility that are known Principles. These principles are interdependent, interrelated and non-divisible and all business are urged to address them holistically. Annexure 1 of the guidelines guide all companies on the adoption and implementation of the Principles.

**Principle 1: Businesses should conduct and govern themselves with integrity and in a manner that is ethical, transparent and accountable.**

The principle ensures ethical behaviour in all operation, functions and processes, is the basic of businesses that are guiding their governance of economic, social and environmental responsibilities. It considers that businesses are an integral part of society and they will hold themselves accountable for the effective adoption, the implementation and the making of disclosures on their performance.

**Principle 2: Businesses should provide goods and service in a manner that is sustainable and safe.**

The principle emphasises that businesses have to focus on safety and resource-efficiency in the design and manufacture of their products. These products have to be manufactured in such a way, by which it creates value by minimising and mitigating its adverse impacts in the environment and society through all stages of its life cycle, from design to final disposal. This principle encourages businesses to understand every material sustainability issues across their product life cycle and value chain.

**Principle 3: Businesses should respect and promote the well-being of all employees, including those in their value chains.**

The principle encloses all policies and practises that are about the equity, dignity and well-being and the provision of decent work, for every employee that who are engaged within a business or in its value chain, without any discrimination and in a way that contributes to the diversity. The principle identifies the well-being of an employee and the welfare of his/ her family.

**Principle 4: Businesses should respect the interests of and be responsive to all its stakeholders.**

This principle recognises the businesses operate in an eco-system that consists of some stakeholders, being shareholders and investors and their activities affect natural resources, habitats, communities and the environment. The principle brings into light that businesses have a responsibility to maximise the positive effects and minimise and mitigate the negative impacts of the products, operations and practises on their stakeholders.

**Principle 5: Businesses should respect and promote human rights.**

This principle identifies the human rights are rights that have to be inherent to all human beings and these guidelines are applied without discrimination. These human rights are considered to be inherent, inalienable, interrelated, interdependent and indivisible. This principle is inspired, informed and guided by the Constitution of India and the International Bill of Rights, and recognises the primacy of the State's duty to protect and fulfil human rights.

**Principle 6: Businesses should respect and make efforts to protect and restore the environment.**

This principle gives preference to environmental issues that are interconnected at the local, regional and global levels doing businesses to address the problems like pollution, biodiversity conservation, sustainable use of natural

resources and climate change in a comprehensive and systematic manner. The principle encourages firms to adopt environmental practises and processes that minimise or eliminates the harmful effects of their operations across the value chain. Moreover, it also persuades businesses to follow the Precautionary Principle in all its actions.

**Principle 7: Businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent.**

This principle concedes that businesses operate within a specified national and international legislative and policy frameworks that guide their growth and also provides specific restrictions and boundaries. The principle recognises the legitimacy of businesses to engage with governments for redressal of a grievance or for influencing public policy. In addition to this, the law demands that public policy advocacy has to expand public good.

**Principle 8: Businesses should promote inclusive growth and equitable development.**

The principle rests the challenges of the social and economic development that are faced by the country and enhances the national and development agenda according to the government policies and priorities. The principle mentioned the need for collaboration amongst businesses, government agencies and civil society in this development agenda. This principle reiterates that business success, inclusive growth and equitable development are interdependent.

**Principle 9: Businesses should engage with and provide value to their consumers in a responsible manner.**

The principle is based on the fact consumers that are safe to use, creating value for both. It recognises consumers having freedom of choice for the usage of goods and services, and the enterprises strive to provide the products that are safe.

Competitively priced, easy to use and safe to dispose of, for the benefit of their consumers. The businesses play a significant role with other relevant stakeholders, in mitigating the adverse effects from excessive consumption of its products that have overall well-being of individuals and society.

### 3.4.7. Activities / expenditure which shall be considered as CSR

CSR touch upon social issues such as welfare of employees, empowerment of the weaker sections, holistic development of backward regions, improvement of the working conditions of labour, etc. Activities undertaken by companies to address basic issues pertaining to health, nutrition, sanitation and education needs of the impoverished communities, for the promotion of skill development, capacity building and inclusive growth of society, are all sustainability activities.

CSR already discussed in 1.4.1.16, CSR activities which can be taken up have specifically mentioned in schedule VII of the Companies Act, 2013. The schedule contains all philanthropic, social welfare activities which are possible under the sun. It is an exhaustive list. However, Govt. has clarified that the activities should be broadly interpreted, i. e. when it says education, it can be interpreted as education, training , skill development of any kind.

However, wide interpretation has given a chance to the companies to do something which may not directly affect the poor, downtrodden, needy and under privileged.

Companies therefore should have an holistic approach while selecting projects , particularly the beneficiary profile should be clear. Even where the funds are going to an institution , it should ultimately benefit the kind of beneficiaries referred above. Instances are there where funds spent have not made any impact as there was no immediate need. We also have many cash rich NGOs.

### 3.4.8. Activities/ expenditure which shall be not considered as CSR

(a) Publicity activities with only intention to advertise product/services.

(b) Compliance of regulation, Govt. order.

(c) Employee benefits, employees' family benefit, direct or indirect.

(d) Anything done in physical environment to facilitate production, distribution of goods.

(e) Contribution to political parties or for political purpose.

### 3.4.9. Steps in CSR Implementation Process

The steps in CSR implementation is discussed in brief.

**(a) Determining thrust area:** an area has to be selected out of a broad list so that the domain experience by the company which will help in better service. Thrust area is not a pre requisite and company can spend money in diverse areas but this will narrow down the targets. A company may decide that it will, for a particular year, focus on primary education for the poor children.

**(b) Identification of project:** once the company has decided an area of work, it has to identify the project. Keeping the thrust area as above, the company has to find out which primary school and what is to be done. It may be construction/ repair of school building, distributing books/ dresses, pay for meals, give cash scholarships etc.

The following issues are discussed in detail in elsewhere in this chapter

**(c) Evaluation of CSR projects**

**(d) Implementation of the CSR projects:**

**(e) Monitoring**

**(f) Impact Assessment**

### 3.4.10. Collaborative Projects

When companies decide to do something for the society under CSR, it may not be possible to do with stand alone infrastructure unless the company is very big. Therefore, they need to collaborate, partner or supplement with external agencies which can be a GOVT. agency, academic institution or NGO.

(a) With other companies: sometimes, one company may not be able to implement the project on its own mad may decide to go with other similar companies.

(b) With Govt. under PPP model: Govt. may not be able to reach out t to every corner due to lack of resources. NGOs and voluntary organizations may be roped in to do the job with Govt. Support.

(c) With specialized agencies: companies sometime implement project through specialized agencies funded by them.

### 3.4.11. Specialized Implementing Agencies

1. Community based organizations whether formal or informal;
2. Elected local bodies such as Panchayats;
3. Voluntary Agencies (NGOs);
4. Institutes/Academic Organisations;
5. Trusts, Missions, etc. (NGOs)
6. Self-help Groups;
7. Government, Semi-Government and autonomous Organisations;
8. Mahila Mandals/Samitis and the like;

### 3.4.12. Evaluation of the CSR Projects

Evaluation of CSR projects can be in two phases;

1. Evaluation before making the expenditure :
2. Evaluation after making the expenditure

Let us elaborate on two issues.

**Evaluation before making the expenditure :**

This is also called due diligence of CSR projects after s shortlisting have been made. Normally companies make a shortlisting on the basis of the projects proposals available to the company. The purpose of due diligence is to decide whether the company is ultimately taking up the project or making the expenditure.

1. nature of project
2. cost of the project
3. independent or linked to some other project
4. collaborative project
5. beneficiaries
6. technical feasibility
7. financial feasibility
8 implementation time
9. Whether impact can be measurable
10. Monitoring mechanism

**How evaluation is done?**

Normally, the company spending on CSR will make a team with 2/3 officers who will inspect the documents submitted or while visiting the site/office of the implementing agency. They will have to make checklist of issues relent to the project and the agency. This committee will make a structured report.

Normally a project report is prepared on the CSR project which contains all the information about the project, right from the concept to implementation mechanism. This is sometimes prepared by independent professionals having domain knowledge.

In case of implementing agency, the project repot is prepared by them, or by consultant appointed by them, which needs to be evaluated by the company's evaluation team.

These evaluation report s along with recommendation of the team/ dealing officer is placed before the CSR committee with recommendation. Once CSR committee agrees, the project is recommended to the Board for approval. Many companies have delegated the authority, up to certain amount to the committee or to the CMD. In such case, it need not go to the Board for approval.

Once approved, an agreement/ MOU is made between the company and the implementing agency for execution of the project. Payment is normally released on instalment basis to the agency. Companies can go for monitoring during implementation. Once completed, the agency will inform the company with completion certificate from an independent chartered accountant or chartered engineer . If company wants, it can also inspect the final completion.

### 3.4.13. Implementation of CSR projects

**Direct implementation by the company**

There are some large companies and their budget for CSR is also very high. These companies have adequate manpower and execute the CSR project. They have separate well organized CSR department in the company.

Evaluation of the project in such companies is limited to the project itself, but when the company decides to implement through implementing agency, it has to evaluate the agency also in addition to the project.

To understand CSR evaluation we will discuss the issues to be checked for the project and also the implementing agency.

**Advantages of direct implementation by the company**

(a) Flexible: small decisions also are taken by the company

(b) Better supervision: since it is being directly implemented

(c) Quick decision making

(d) Less coordination and no coordination with third parties, i.e. implementing agency or actual contractor.

(e) Less cost

**Disadvantages of direct implementation by the company**

(a) Manpower involvement

(b) Lack of domain knowledge

(c) No 80 G benefit

(d) Biased

(e) Corrective action not clearly defined

(f) Negative points remain undocumented.

(g) Lack of local area knowledge and language

(h) Lack of adequate monitoring due to other issues

**Third party implementation:**

Third party implementation means implementation by specialised agencies as mentioned above.

When the project is being implemented by implementing agencies, apart from the evaluation of projection parameters mentioned above, the organisation needs to evaluated, which can be done with following checks.

(a) Documentation

(b) Inspection of project site

(c) Track record of the organisation

(d) Beneficiary feedback

(e) Sponsors' feedback

(f) Interview of the persons responsible for implementation.

**Advantages of third party implementation:**

(a) expertise

(b) Better supervision at site

(c) unbiased

(d) Single point coordination

(e) Negotiate cost

**Disadvantages third party implementation:**

(a) May be more supervision

(b) Lack of domain knowledge of the agency

(c) No 80 G benefit

(d) Biased, if also beneficiary

(e) No proper accounting

(f) Negative points remains undocumented.

(g) Dominance in local area

(h) Lack of adequate monitoring by the company

### 3.4.14. Problems in implementation

**Internal**

(a) deciding preferences of projects:

(b) Financial Mismatch

(c) Lack of seriousness by management.

(d) Right people to work.

(e) Internal references

(f) Indecisiveness / difference in opinion of the team/ committee

**External**

(a) Political pressure.

(b) Social pressure.

(c) Projects' road block due to uncontrollable reasons.

(d) Inefficient implementing agency.

(e) Diverting money

(f) Siphoning money

(g) Fraud

### 3.4.15. Evaluation after making the expenditure

Diligence of CSR initiatives is important to ensure effective implementation of planned strategy and to determine

future action plans. Each company can design measuring strategies based on their selected CSR focus areas. Some basic indicators to measure different CSR areas are elucidated as follows:

**Monitoring**

Should be done periodically

Collecting data of the performance

(a) Assess the progress

(b) Corrective action, in case of deviation/ delay

(c) Concurrent/final

### 3.4.16. Impact assessment

Any CSR project/activity should have some impact, big or small. Impact refers to success of the activity with relation to the target.it is confined to the target beneficiaries. In order to know the impact, an impact analysis study is supposed to be made, which would compare the achieved results with the desired result. In order to get real picture, it is the following issues needs consideration.

(a) Should preferably done by an independent agency

(b) Focused on the impact only

(c) Done immediately after the benefit given

(d) Should be data based

Impact assessment helps in formulating future action plan, review of the policy and suggest corrective action.

# Sustainability Management

# 3.5

Sustainability Development (SD) is the development of a processes by which needs of the future is fulfilled without harming the future. SD was defined in the report "our common future" commonly known as Brundtland Report released by Brundtland Commission (1987). The concept of need means needs of the poor and limitation of technology and society to environment ability to meet present needs and future needs.

Therefore, sustainable management would mean managing the public policy and affairs, and management of affairs of corporates (business houses) in a manner which would protect resources for the future and would continue to sustain as an economically and socially responsible organisation.

There are three approaches to sustainable development, commonly known as triple bottom-line approach.

1. **Economic approach:** The current decision should not impair the prospects of maintaining or improving future living standards. This also called "Profit" approach.
2. **Ecological/Environment Approach:** Scarce natural resources should be preserved for the future, which would include preservation of genetic diversity, water, mines, forests etc. Industries should use minimum natural resources. Any industry damaging the environment through affluent discharge should be avoided or minimised. This also called "Planet" approach
3. **Social approach:** The industry is for the society and shall not damage social security, values and welfare of the people. This also called "People" approach

The above approach is called 3 P approach also.

Sustainable management can be the job of the Govt. machinery who control and manage public affairs. They have administrative powers to issue restrictive orders and can take action against the offenders.

Other manager is the manager in business/corporate houses who run business primarily for profit. However, the process and steps of both the above type of manager is same. Let us try to understand the steps.

1. Identify problem areas
2. Set thrust areas for solution
3. Set targets/goals
4. Evaluate projects
5. Select project
6. Planning the action
7. Use tools and technology
8. Innovating ideas/processes:

9. Schedule of actions
10. Organising
11. Staffing
12. Directing
13. Monitoring:
14. Corrective cation
15. Review action.

Few of the areas where actions can be taken

1. Change present process to alternate process which would reduce use of natural resources;
2. Convince and make the community to reduce waste, use alternate source, protect the environment, adopt recycling, use bio degradable packaging;
3. Control deforestation and encourage of forestation;
4. Reduce discharge of affluent in the environment; install affluent treatment pants etc.;
5. Sustainable agriculture;
6. Carbon emission management. etc.

### 3.5.1. Benefits of Sustainable Management

Sustainable management takes the concepts from sustainability and synthesizes them with the concepts of management. Sustainability has three branches: the environment, the needs of present and future generations, and the economy. Using these branches, it creates the ability of a system to thrive by maintaining economic viability and also nourishing the needs of the present and future generations by limiting resource depletion. From this definition, sustainable management has been created to be defined as the application of sustainable practices in the categories of businesses, agriculture, society, environment, and personal life by managing them in a way that will benefit current generations and future generations.

Sustainable management is needed because it is an important part of the ability to successfully maintain the quality of life on our planet. Sustainable management can be applied to all aspects of our lives. For example, the practices of a business should be sustainable if they wish to stay in businesses, because if the business is unsustainable, then by the definition of sustainability they will cease to be able to be in competition. Communities are in a need of sustainable management, because if the community is to prosper, then the management must be sustainable. Forest and natural resources need to have sustainable management if they are to be able to be continually used by our generation and future generations. Our personal lives also need to be managed sustainably. This can be by making decisions that will help sustain our immediate surroundings and environment, or it can be by managing our emotional and physical well-being. Sustainable management can be applied to many things, as it can be applied as a literal and an abstract concept. Meaning, depending on what they are applied to the meaning of what it is can change.

A manager is a person that is held responsible for the planning of things that will benefit the situation that they are controlling. To be a manager of sustainability, one needs to be a manager that can control issues and plan solutions that will be sustainable, so that what they put into place will be able to continue for future generations.

The job of a sustainable manager is like other management positions, but additionally they have to manage systems so that they are able to support and sustain themselves.

The trend towards sustainable management means that organizations are beginning to implement a systems wide

approach that links in the various parts of the business with the greater environment at large.

As sustainable management institutions adapt, it becomes imperative that they include an image of sustainable responsibility that is projected for the public to see.

Additionally, companies must make the connection between sustainability as a vision and sustainability as a practice. Managers need to think systematically and realistically about the application of traditional business principles to environmental problems.

By focusing on the big picture, a company can generate more savings and better performance by using planning, design, and construction based on sustainable values, etc.

Managers need to understand that their values are critical factors in their decisions.

The strategic vision that is based on core values of the firm guides the firm's decision-making processes at all levels. Thus, the sustainable management requires finding out what business activities fit into the Earth's carrying capacity and also defining the optimal levels of those activities.

Sustainability values form the basis of the strategic management, process the costs and benefits of the firm's operations, and are measured against the survival needs of the planets stakeholders.

### 3.5.2. Sustainability Reporting

UNO supports principles of Responsible Investment (PRI). These principles have subscribed by 3500 signatories who are investors. They have committed to integrate ESG factors into investment decision making.

Most of the large companies in the world are already reporting their ESG profile in line with globally recognized parameters.

Studies have made by one rating agency on ESG ratings which shows variance in rating in different sectors. Though not mandatory ESG rating would give the message to the outsiders, stakeholders about the ESG approach of the entity. More and more companies are coming under ESG philosophy and practice.

In view of the above, it has become important to reporting of company's performance on sustainability related factors and its importance is as relevant operational performance.

SEBI had in November 2015, prescribed format in reporting ESG parameters listed entities. SEBI has raised the format in May,2021 for reporting ESG parameters called Burins Responsibility and Sustainability Report (BRSR). It seeks disclosure from listed entities on their performance against the principles of National Guidelines on Responsible Business Conduct (NGBRC). Each parameter is divided into leadership and essential indicators, whereas the formal is voluntary and latter is mandatory.

**Purpose of Disclosure**

1. The disclosure, are in nature of quantity and standards so that it can be easily compared with other similar entities by third parties, particularly a prospective investor.
2. Engaging with stakeholders in most proper way beneficial to both.
3. The corporates need to look beyond financial figures for effective ecosystem between corporate, society and environment.

**Application of mandatory reporting**

With effect from financial year 2022-23, the filing shall be mandatory for top 1000 companies listed in any of the exchange, based on market capitalization.

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. Three Ps of triple bottom line are:
   a) planet, people and purpose
   b) planet, people and profit
   c) planet, profit and purpose
   d) planet, profit and period
2. At which level corporate governance is more relevant in a company?
   a) top level
   b) middle level
   c) lower level
   d) all levels
3. which among the following would amount to undesirable practice by a senior executive of a company
   a) using published information of the competitor for his company's benefit
   b) using unpublished information of the competitor for his company's benefit
   c) using un published and secret information of the competitor obtained from undisclosed and unfair source for his company's benefit
   d) lure the executives of the competitor to join his company.
4. Which , out of the following would not amount to Sustainable Development activity.
   a) rain water harvesting
   b) paddy cultivation
   c) solar energy
   d) plantation of sapling for forestation
5. corporate governance practices are almost…….by companies in India.
   a) formalised
   b) regulated
   c) accepted
   d) rejected

6. The latest committee on Corporate governance was:
   a) Narayan Murthy committee
   b) Kotak committee
   c) Kumar Mangalam Birla committee
   d) Rahul Bajaj Committee
7. The ideal implementing agency of CSR projects, should be:
   a) section 8 company
   b) trust
   c) society
   d) one of the above
8. Economic approach to sustainability relates to:
   a) planet
   b) profit
   c) people
   d) none of the above
9. Corporate governance is more about:
   a) achieving results
   b) managing things
   c) method of managing a company
   d) fair method of managing a company
10. The items under Schedule VII of the Act, should be:
   a) strictly interpreted
   b) liberally interpreted
   c) depends on the company
   d) only a guideline
11. CG practises should target to keep balance amongst:
   a) all shareholders
   b) all employees
   c) employees and shareholders
   d) All stakeholders

12. When a company evaluates an implementing agency, first step is to :

    a) local feedback

    b) interviewing the officials

    c) inspection of site

    d) examining documents

13. Every CSR activity is ultimately for the:

    a) company

    b) govt.

    c) implementing agency

    d) beneficiary

14. The CSR fund earmarked for on going project, needs to be spent within:

    (a) one year

    (b) two years

    (c) three years

    (d) Four years

15. Clause 49A which was the first major compliance of corporate governance by listed companies was on the basis of recommendation of:

    (a) Narayan Murthy committee

    (b) Kotak committee

    (c) Kumar Mangalam Birla committee

    (d) Rahul Bajaj Committee

16. Corpoarate governance is close to:

    (a) ethical conduct of business

    (b) managerial conduct of business

    (c) target oriented business

    (d) none of the above

17. A foreign entity cannot be:

    (a) implementing agency of CSR project in India

    (b) advisor

    (c) trainer

    (d) consultant

18. Some of the reasons for which companies cannot practice good governance may be:

    (a) narrow mind-set of the promoters

    (b) financial problem in the company

    (c) unhealthy completion in the market

    (d) all or any of the above.

19. A company sponsors the expenditure of a primary school of physically disabled students having 200 students. Three employees' children, being physical disabled, have also been admitted in that school:

    (a) the school will qualify as CSR project as admission of the employees' children is incidental

    (b) not qualify as CSR project as there are students who are employees' children

    (c) depends on how the company represents the same to the auditors

    (d) depends on Board of Directors

20. Which will not qualify as CSR expenditure

    (a) direct donation to a unrecognised charitable organisation

    (b) contribution to fund under schedule VII of the Act

    (c) any activity under schedule VII

    b) Direct implementation of a CSR project by the company

21. Advantages of direct implementation of CSR activity by the company are:

    a) Flexible, since, even small decisions also are taken by the company

    b) Better supervision, since it is being directly implemented

    c) Quick decision making

    d) All of the above

22. Advantages of third party implementation of CSR projects, are:

    a) expertise

    b) Better supervision at site

    c) unbiased

    d) all of the above

23. CG ratings are done by :

    a) commercial banks

    b) RBI

    c) Credit Rating Agencies

    d) SEBI

24. Audit committee can:

    a) interact with statutory auditors only

    b) interact with internal auditors only

    c) interact with both statutory and internal auditors

    d) none if the above

25. The recommendation of the Audit Committee:

    a) may not be accepted by Board of Directors

    b) has to be accepted by Board

    c) In case not accepted, Board has to records the reasons

    d) Recommendation need not go to Board meetings

26. Which of the following is the advantage of the family business over non-family business?

    a) Staff recruitment

    b) Raising funds for growth

    c) Ownership vs. Management

    d) Deep industry insight

**State True or False**

1. Most of the provisions relating to corporate governance of a listed company is stipulated under LODR.
2. Stakeholders means shareholders only.
3. The chairman of CSR committee has to be an independent director
4. The signing of code of conduct by directors is optional
5. Companies having budget up to ₹ 90 lakhs in a year, need have a CSR committee

**Fill in the blanks**

1. Corporate governance is to be practiced at……level of management.
2. CSR provisions apply to companies with a turnover of ₹…….crores
3. The recommendation of ……..committee was incorporated in listing agreement.
4. The CEO certification under CG relates to……..
5. ABRR relates to annual ……..responsibility report.
6. A director can be member of maximum……..committees taking all companies into consideration.
7. Managerial remuneration appears under schedule …….. ……of the companies Act.
8. PRI stands for ……
9. SDG, in parlance to sustainability means……..
10. The Voluntary guidelines on CSR was issued in the year…….
11. ABRR stands for……
12. The areas of CSR is mentioned under schedule…..to Companies Act. 2013.
13. No CSR Committee is required, If the CSR Committee budget is up to ₹……..

**Short Essay Type Questions:**

**1.** Mention at least two differences between:

(a) law and ethics

(b) ethics and Corporate Governance

(c) Business Responsibility and CSR

(f) environment sustainability and corporate sustainability

**2.** Write short notes on:

(a) CSR project implementation by a company

(b) Role of NGOs in implementation of CSR projects

(c) need for sustainable management by Indian corporate sector

**Essay Type Questions:**

1. How would the company satisfy itself about successful evaluation of the project?
2. Is it wise for the company to practice good governance which comes with additional cost?

**Case Study 1: (Solved)**

1. M/s ABC Tyres Ltd., manufactures of tyres of all types of vehicles, is a public limited company has three manufacturing units, one at Durgapur, West Bengal, Palej, Gujarat and Munnar in Kerala with corporate office at Kolkata. The company is professionally managed, the promoter being the chairman, only comes in Board meetings and does not interfere in day to day management. The other directors are independent professionals. The company has sales offices and dealers pan India.

   The financial performance of the company is as follows: (₹ in Crores)

| Parameters | 2020-2021 | 2021-22 | 2022-2023 | 2023-24 |
|---|---|---|---|---|
| Turnover | 700 | 650 | 920 | 1010 |
| Net worth | 402 | 423 | 480 | 530 |
| Net profit | 14.5 | 15.7 | 16.8 | 18 |

**Queries:**

1. Do the company comes under CSR obligation?
2. What would be minimum budget for 2024-25.
3. Is CSR committee required?

**Solution:**

1. Section 135 of the Act provides for the applicability of the CSR provisions on corporates. Sub-section (1) of section lays down that every company having
   - net worth of ₹ 500 Crores or more; or
   - turnover of ₹ 1000 Crores or more;
   - net profit of ₹ 5 Crores

   Therefore, ABC Tyres Ltd. Comes under CSR obligation.
2. Minimum budget will be ₹ 3.37 lakhs for 2024-25. This 2% of average profit of last 3 financial years.
3. Yes, CSR committee is required to be formed as it comes under the purview of section 135 of the Act.

**Answer:**

**Multiple Choice Questions (MCQs)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | 18 | 19 | 20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| b | a | c | b | b | b | d | b | d | b | d | d | d | c | c | a | a | d | a | a |
| 21 | 22 | 23 | 24 | 25 | 26 | | | | | | | | | | | | | | |
| d | d | c | c | c | d | | | | | | | | | | | | | | |

**True/False**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| T | F | F | F | T |

**Fill in the blanks**

| | | | |
|---|---|---|---|
| 1 | Top/ higher | 2 | 1000 |
| 3 | Kumar Mangalam Birla | 4 | Code of conduct |
| 5 | Business | 6 | 10 |
| 7 | V | 8 | Principles of Responsible Investment |
| 9 | Sustainability Development Goals | 10 | 2011 |
| 11 | Annual Business Responsibility Reporting) | 12 | VII |
| 13 | 50 lakhs | | |

# SECTION B
# ECONOMIC LAWS AND REGULATIONS

# SEBI Laws and Regulations 4

**This Module Includes:**


**4.1 Raising Finance from Capital Markets-IPO**

**4.2 Insider Trading**

**4.3 Takeover Code**

# SEBI Laws and Regulations

**SLOB Mapped against the Module**

To have an overview of important SEBI regulations relating to the fund mobilisation through capital market, trading in securities market and takeover of target companies;

**Module Learning Objectives:**

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

- Few important SEBI regulation, though there are many regulations;
- The role and compliance requirement by the Capital market regulator
- Importance of disclosure of financial information in public domain.

# Raising Finance from Capital Markets - IPO 4.1

### 4.1.1. Eligibility of the issuer

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 selling shareholders are debarred from accessing the capital market by SEBI, or of any other company which is debarred from accessing the capital market under the order or directions made by SEBI.

(b) Unless an application is made to one or more stock exchanges for "in principle" approval of listing of equity shares and convertible securities on such stock exchanges and has chosen one of them as a designated stock exchange. In case of an initial public offer, the issuer should make an application for listing in at least one recognised stock exchange having nationwide trading terminals.

(c) 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.

(d) Unless all existing partly paid-up equity shares of the issuer have either been fully paid up or forfeited.

(e) 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.

(f) Promoter's holding is in dematerialised form prior to filing of offer document.

(g) The amount for general corporate purposes as mentioned in the objects of the issue in the draft offer document shall not exceeds 25% of the amount raised by the issuer.

(h) A public issue of equity securities, if the issuer or any of its promoters or directors is a wilful defaulter; or

(i) Issue shall be open for at least 3 days and not more than 10 days.

(j) Minimum subscription shall be 90% of the issuer size failing which the application money has to be refunded within 15 days of closure of the issue.

### 4.1.2. Appointment of Merchant banker and other intermediaries

The issuer shall appoint one or more merchant bankers, and at least one of whom should be a lead merchant banker. The issuer should also appoint SEBI registered intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue. 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.

(1) The issuer shall, in case of an issue made through the book building process, appoint syndicate member(s) and

in the case of any other issue, appoint bankers to issue, at various centres.

(2) The issuer shall appoint a Registrar to the issue, registered with the Board, which has connectivity with all the depositories:

(3) The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors

### 4.1.3. Other conditions for Initial Public Offer

(a) An issuer may make an initial public offer only in following cases

(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. The 50% criteria will not apply in case of IPO entirely through offer for sale.

(2) It has a minimum average pre-tax operating profit of ₹15 crores, calculated on a restated and consolidated basis, during the 3 most profitable years out of the immediately preceding 5 years.

(3) The issuer company has a net worth of at least ₹1 crore in each of the preceding 3 full years (of 12 months each).

(4) In case of change of name by the issuer company within last one year, at least 50% of the revenue for the preceding 1 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:

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 do so.

(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, provided company has not defaulted payment of principal/ interest for a period of 6 months.

(d) An issuer cannot make an allotment pursuant to a public issue if the number of prospective allottees are 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.

(f) If the issue size is more than ₹100 crores, a Bank/PFI shall monitor and report on quarterly basis till 95% utilisation of the proceeds.

(g) the issuer may obtain grading for its IPO from one or more Credit Rating Agencies (CRA)s registered with SEBI.

### 4.1.4. Pricing of shares 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. The issuer may mention a price or price band in offer document and a floor price in red running prospectus. The issue price shall not be less than the face value.

#### 4.1.4.1. 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 may be offered equity shares at a price which is not lower than 10% the price at which net offer is made 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 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.

(d) 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.

### 4.1.5. Promoters' Contribution

(a) In case of an initial public offer, the minimum contribution should not be less than 20% of the post issue capital.

### 4.1.5.1. Lock-in of specified securities held by promoters.

(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.

### 4.1.6. Book Building process

Book Building means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities.

(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 5% 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 6, the allocation in the net offer to public category shall be as follows:

(1) not more than 10% to retail individual investors;

(2) not more than 15% to non-institutional investors;

(3) not less than 75% to qualified institutional buyers, 5% of which shall be allocated to mutual funds:

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.

(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 30% 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.

# Insider Trading

# 4.2

The insider trading is being regulated by SEBI through Securities and Exchange Board of India (prohibition of insider trading) Regulations, 2015

### 4.2.1. Few important Definitions

(a) "compliance officer" means any senior officer, designated so and reporting to the board of directors or head of the organization in case board is not there, who is financially literate and is capable of appreciating requirements for legal and regulatory compliance under these regulations and who shall be responsible for compliance of policies, procedures, maintenance of records, monitoring adherence to the rules for the preservation of unpublished price sensitive information, monitoring of trades and the implementation of the codes specified in these regulations under the overall supervision of the board of directors of the listed company or the head of an organization, as the case may be.

(b) "connected person" means,-

(i) any person who is or has during the 6 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.The following persons shall be considered 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 ; 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

(c) "generally available information" means information that is accessible to the public on a non-discriminatory basis;

(d) "immediate relative" means a spouse of a person, and includes parent, sibling, and child of such person or

of the spouse, any of whom is either dependent financially on such person, or consults such person in taking decisions relating to trading in securities;

(e) "insider" means any person who is:

i) a connected person; or

ii) in possession of or having access to unpublished price sensitive information;

(f) "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.

### 4.2.2. Restrictions on communication and trading by insiders

(i) No insider shall communicate, procure, provide, or allow access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, except where such communication is in furtherance of legitimate purposes. The board of directors of a listed company shall make a policy for determination of "legitimate purposes" as a part of "Codes of Fair Disclosure and Conduct" .

(ii) Due notice shall be given to " insiders" to maintain confidentiality of such unpublished price sensitive information in compliance with these regulations.

(iii) An unpublished price sensitive information may be communicated, procured provided, allowed access to or procured, in connection with a transaction that would:–

(a) entail an obligation to make an open offer;

(b) The board of directors of the that sharing of such information is in the best interests of the company and the information that constitute unpublished price sensitive information is disseminated to be made generally available at least 2 trading days prior to the proposed transaction being effected in such form as the board of directors may determine. The parties may be to execute agreements to contract confidentiality and non-disclosure obligations on the part of such parties and such parties shall keep information so received confidential, except for the purpose of sub-regulation (3), and shall not otherwise trade in securities of the company when in possession of unpublished price sensitive information.

(iv) The organization shall ensure that a structured digital database containing the nature of unpublished price sensitive information to be maintained internally with adequate internal controls and preserved for a period of not less than eight years (more in case of nay investigation)

(v) No insider shall trade in securities that are listed or proposed to be listed on a stock exchange when in possession of unpublished price sensitive information. The insider may prove his innocence by few defenses.

(vi) In the case of connected persons the onus of establishing, that they were not in possession of unpublished price sensitive information, shall be on such connected persons and in other ases, the onus would be on the Board. The Board may specify such standards and requirements, from time to time, as it may deem necessary for the purpose of these regulations.

### 4.2.3. Trading Plans

An insider shall formulate a trading plan and present it to the compliance officer for approval and public disclosure. Such trading plan shall not entail commencement of trading on behalf of the insider earlier than 6 months from the public disclosure of the plan. Which cannot be deviated. Upon approval of the trading plan, the compliance officer shall notify the plan to the stock exchanges on which the securities are listed.

### 4.2.4. Disclosures of trading by insiders

**(i) General provisions.**

The disclosures to be made by any insider including those relating to trading by such person's immediate relatives, and by any other person for whom such person takes trading decisions. These regulations are to prevent abuse by trading when in possession of unpublished price sensitive information.

**(ii) Disclosures by certain persons.**

**Initial Disclosures.**

a key managerial personnel or a director of the company shall disclose his holding of securities of the company as on the date of appointment

Continual Disclosures to be made within two trading days of such transaction if the value of the securities traded, over any calendar quarter, aggregates to a traded value in excess of ₹10 lakhs. Disclosures by other connected persons are also to be given as detailed in the Regulations..

### 4.2.5. Code of Fair Disclosure.

The board of directors of every listed company, shall formulate and publish on its official website, a code of practices and procedures for fair disclosure of unpublished price sensitive information that it would follow the principles set out in Schedule A and shall be promptly intimated to the stock exchanges. Schedule A to the Rules provides for Principles of Fair Disclosure for purposes of Code of Practices and Procedures for Fair Disclosure of Unpublished Price Sensitive Information, which are as follows.

1. Prompt public disclosure of unpublished price sensitive information that would impact price discovery no sooner than credible and concrete information comes into being in order to make such information generally available.

   Dissemination of unpublished price sensitive unpublished price sensitive information to avoid selective disclosure.
2. Designation of a senior officer as a chief investor relations officer to deal with dissemination of information.
3. Appropriate and fair response to queries on news reports and requests for verification of market rumors by regulatory authorities.
4. Ensuring that information shared with analysts and research personnel is not unpublished price sensitive information.
5. Developing best practices to make transcripts or records of proceedings of meetings with analysts and other investor relations conferences on the official website to ensure official confirmation and documentation of disclosures made.

### 4.2.6. Code of Conduct

The chief executive officer or managing director shall formulate a code of conduct 3 to regulate, monitor and report trading by its designated persons and their immediate relatives of designated persons towards achieving compliance with these regulations. A senior officer with the responsibility to administer the code of conduct and monitor compliance with these regulations.

The board of directors or such other analogous authority shall in consultation with the compliance officer specify

the designated persons to be covered by the code of conduct on the basis of their role and function in the organisation and the access that such role and function would provide to unpublished price sensitive information in addition to seniority and professional designation. Schedule B contains the minimum Standards for Code of Conduct for Listed Companies to Regulate, Monitor and Report Trading by Designated Persons, some of which are reproduced below.

1. The compliance officer shall report to the board of directors and in particular, shall provide reports to the Audit Committee, if any, or to the board of directors.
2. Designated Persons and immediate relatives shall be governed by an internal code of conduct governing dealing in securities.

   Transactions which are undertaken in accordance with respective regulations made by the Board may be specified by the Board.
3. The timing for re-opening of the trading window shall be determined by the compliance officer taking into account various factors including the unpublished price sensitive information in question becoming generally available and being capable of assimilation by the market, which in any event shall not be earlier than forty-eight hours after the information becomes generally available.
4. When the trading window is open, trading by designated persons shall be subject to pre-clearance by the compliance officer, if the value of the proposed trades is above such thresholds as the board of directors may stipulate.
5. Prior to approving any trades, the compliance officer shall be entitled to seek declarations to the effect that the applicant for pre-clearance is not in possession of any unpublished price sensitive information.
6. The code of conduct shall specify any reasonable timeframe, which in any event shall not be more than seven trading days, within which trades that have been pre-cleared have to be executed by the designated person, failing which fresh pre-clearance would be needed for the trades to be executed.
7. The code of conduct shall stipulate such formats as the board of directors deems necessary for making applications for pre-clearance, reporting of trades executed. The code of conduct shall stipulate the sanctions and disciplinary actions.

Designated persons shall be required to disclose names and Permanent Account Number or any other identifier authorized by law of the following persons to the company on an annual basis and as and when the information changes.

Listed entities shall have a process for how and when people are brought 'inside' on sensitive transactions. Individuals should be made aware of the duties and responsibilities attached to the receipt of Inside Information, and the liability that attaches to misuse or unwarranted use of such information.

### 4.2.7. Institutional Mechanism for Prevention of Insider trading

(1) The Chief Executive Officer shall put in place adequate and effective system of internal controls for compliance

(2) The Audit Committee shall review compliance with the provisions of these regulations at least once in a financial year and shall verify that the systems for internal control are adequate and are operating effectively.

(3) Every listed company shall formulate policies and procedures for inquiry in case of leak or suspected leak of unpublished price sensitive information, which shall be approved by board of directors of the company and accordingly initiate appropriate inquiries on time and inform the Board promptly of the status.

(4) he listed company shall have a whistle-blower policy and make employees aware of such policy to enable employees to report instances of leak of unpublished price sensitive information.

(5) If an inquiry has been initiated by a listed company in case of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information, the relevant intermediaries and fiduciaries shall co-operate with the listed company in connection with such inquiry conducted by listed company.

# Takeover Code

# 4.3

Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 is commonly called as takeover regulation or takeover code. It applies to direct and indirect acquisition of shares or voting rights in, or control over target company. these regulations shall not apply to direct and indirect acquisition of shares or voting rights in, or control over a company listed without making a public issue, on the Innovators Growth Platform of a recognised stock exchange. We need to know few terminologies.

**Takeover:** When an "Acquirer" takes over the control of the "Target Company", it is termed as Takeover.

**Substantial acquisition of shares:** When an acquirer acquires "substantial quantity of shares or voting rights" of the Target Company, it results into substantial acquisition of shares.

**Acquirer** means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company.

**Control:** the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

**Frequently traded shares:** shares of a target company, in which the traded turnover on any stock exchange during the 12 calendar months preceding the calendar month in which the public announcement is made is at least 10% of the total number of shares of such class of the target company.

**Tendering period**: means 10 working days period to take within the offer period.

**Offer Price:** Price at which the acquirer announce to acquire the share from the public revision can be made upto 3 days prior to opening of the offer. It may be noted that the promoter shall not be entitled for any share.

**Identified date:** means 10 working days after closer of the offer, the acquiree shall make payment to the shareholder for offer shares have been acquired.

**Offer period:** the period between the date of entering into an agreement, formal or informal, to acquire shares, voting rights in, or control over a target company requiring a public announcement, or the date of the public announcement, as the case may be, and the date on which the payment of consideration to shareholders who have accepted the open offer is made, or the date on which open offer is withdrawn, as the case may be.

**Persons Acting in Concert(PAC):** persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.

**Deemed Persons Acting in Concert:**

i) a company, its holding company, subsidiary company and any company under the same management or control;

ii) a company, its directors, and any person entrusted with t he management of the company;

iii) promoters and members of the promoter group;

iv) immediate relatives;

v) a mutual fund, its sponsor, trustees, trustee company, and asset management company;

vi) a collective investment scheme and its collective investment management company, trustees and trustee company ;

vii) a venture capital fund and its sponsor, trustees, trustee company and asset management Company;

viii)an alternate investment fund and its sponsor, trustees, trustee company and manager;

ix) a merchant banker and its client, who is an acquirer;

x) a portfolio manager and its client, who is an acquirer;

**Target Company:** a company and includes a body corporate or corporation established under a Central legislation, State legislation or Provincial legislation for the time being in force, whose shares are listed on a stock exchange.

**Tendering period:** the period within which shareholders may tender their shares in acceptance of an open offer to acquire shares made under these regulations.

**Volume weighted average market price:** the product of the number of equity shares traded on a stock exchange and the price of each equity share divided by the total number of equity shares traded on the stock exchange.

**Volume weighted average price:** the product of the number of equity shares bought and price of each such equity share divided by the total number of equity shares bought.

### 4.3.1. Kinds of takeover

**Friendly takeover :** Promoter of the target company voluntarily sell off shares to the acquirer at an attractive price offered by acquirer.

**Hostile takeover:** Promoter of the target company don't want to give away the ownership /control of their company and fight back to defend their ownership/control.

**Horizontal takeover :** Takeover of one company by another in same industry.

**Vertical takeover :** Takeover of one Co. of its suppliers or customers i.e. Backward or Forward integration.

**Conglomerate takeover :** Takeover of one company by another company operating in totally different industries.

**Disclosure norms under the regulation**

**Event based disclosure**

No obligation on the target company to give any disclosure;

Obligation is only on acquirer, promoter & their PACs

Acquisition includes shares acquired by way of encumbrance (not applicable on Scheduled Commercial Banks or PFI acquiring shares by way of pledge).

Disposal includes shares given upon release of encumbrance(not applicable on Scheduled Commercial Banks or PFI acquiring shares by way of pledge).

**Continual disclosures (reg. 30):**

Disclosure of shareholding as on 31st March i.e. at the end of financial year Within 7 working days from the end of each financial year to be given to Every Stock exchange where the shares of the Target Company are listed & Registered Office of the target company to be made by-

**Promoters :** Irrespective of the shareholding.

**Non Promoters:** Any person along with PAC holding more than 25% shares

**encumbrance disclosure (reg. 31)**

A claim against a property by another party;

Encumbrance usually impacts the transferability of the property and can restrict its free use until the encumbrance is removed. For takeover regulation, it includes a pledge, lien, or any transaction which creates a risk on the ownership of shares of the promoters. Promoter of every target company shall disclose details of shares in such target company relating to creation of encumbrance of shares of target company and invocation or release of the encumbrance of shares. Disclosure is to be made within 7 working days from the date of creation/invocation of pledge to-

I. Every stock exchange where the shares of the target company are listed;

II. Registered office of the target company;

### 4.3.2. Requirement of open offer process & compliance

Any acquirer, along with PAC, if any, while acquiring shares of the Target Company, where by pursuant to such acquisition their post acquisition holding in the Target company reaches or exceeds 25% of the voting rights in such target company then initial trigger is said to be touched by such acquirer. It casts an obligation on the acquirer to make public announcement of an open offer for acquisition of additional 26% shares of target company, entitling him to exercise 25% or more voting rights in such Target Company).

An acquirer can, who has reached at a level of 25% but less than maximum permissible non public shareholding or more and wants to acquire five percent or more share within the financial year, has to again make public offer to receive 26% (or)more shares subject to delisting level.

As per Reg. 3(2): any acquirer, along with PAC (if any).who has already acquired 25% or more shares of the Target Company, shall not acquire more than 5% shares of such Target company within any financial year (starting April 1st) without making prior public announcement of an open offer for acquiring additional 26% shares of Target Company.

Provided that:

Post acquisition holding of such acquirer together with its PAC must not exceed the maximum permissible non – public shareholding, thus maintaining the minimum public float of 25% in such Target company

### 4.3.3. Pre conditions to voluntary open offer

(a) Prior holding of at least 25% or more of voting rights in the Target Company

(b) No acquisition was made in the preceding 52 weeks without attracting the obligation to make an public announcement to make an open offer i.e. no creeping acquisition.

(c) No acquisition of shares during the offer period except under the open offer

(d) No further acquisition of shares for a period of 6 months after the completion of open offer except by way of another voluntary open offer or competing offer.

(e) An acquirer may make on offer conditional by prescribing minimum level of acceptance

### 4.3.4. Withdrawal of Offer (Reg.23)

**Permitted conditions:**

i) Statutory approvals required have been refused, ii) Acquirer being a natural person has died. iii) Any condition stipulated in the agreement for acquisition, iv) Any such circumstances as in the opinion SEBI merits withdrawal.

ii) Within 2 working days merchant banker (manager to open offer) make an announcement in Newspapers

Providing reasons & grounds for withdrawal of offer simultaneously inform –i)SEBI; ii)Stock Exchanges; iii) Registered Office of the Target Company.

### 4.3.5. Open offer process.

The following process has to be taken by the acquirer.

**(i) submission of draft letter of offer:** The acquirer shall submit a draft letter of offer to SEBI within 5 working days from the date of detailed public announcement along with a non-refundable fee as applicable. simultaneously, a copy of the draft letter of offer shall be send to the target company at its registered office and to all the stock exchanges where the shares of the company are listed.

**(ii) dispatch of letter of offer:** Within maximum 7 working days from the date of receipt of communication of comments from SEBI or where no comments are offered, within 7 working days from the expiry of 15 working days from the date of receipt of draft letter of offer by SEBI.

**(iii) opening of the offer**: the tendering period shall start within maximum 12 working days from date of receipt of comments from sebi and shall remain open for 10 working days.

**(iv) completion of requirements**: within 10 working days from the last date of the tendering period.

### 4.3.6. Mode of payment

The payment of shareholders can be made by the acquirer by:

(i) cash issue, exchange or transfer of listed shares in the equity share capital of the acquirer or of any PAC;

(ii) issue, exchange or transfer of listed secured debt instruments issued by the acquirer or any person acting in concert with a rating not inferior to investment grade as rated by a credit rating agency registered with the SEBI.

(iii) issue, exchange or transfer of convertible debt securities entitling the holder thereof to acquire listed shares in the equity share capital of the acquirer or of any person acting in concert.

#### 4.3.6.1. Escrow account

An escrow account has to be opened at least 2 working days prior to detailed Public Statement with an object of payment and security against Performance of his obligations under Takeover Regulations which may be in any of the following forms.

(a) cash deposited with Scheduled Commercial Bank

(b) bank Guarantee issued in favour of the manager of the Open Offer

(c) Deposit of Frequently Traded & Free transferable equity shares or other freely transferable securities with appropriate margin.

(d) Bank Guarantee / Deposit of Securities

The manager to the open offer shall not release the escrow account until the expiry of 30 days from the completion of payment of consideration to shareholders or on fulfilling other compliances under the regulations.

### 4.3.7. Obligations of the target company

(i) the board of directors of such target company shall ensure that during the offer period, the business of the target company is conducted in the ordinary course consistent with past practice.

(ii) the target company shall be prohibited from fixing any record date for a corporate action on or after the third working day prior to the commencement of the tendering period and until the expiry of the tendering period.

(iii) furnish to the acquirer within two working days from the identified date, a list of shareholders as per the register of members of the target company containing names, addresses, shareholding and folio number, in electronic form, wherever available, and a list of persons whose applications, if any for registration of transfer of shares are pending with the target company

(iv) during the offer period:

(a) unless the approval of shareholders of the target company by way of a special resolution by postal ballot is obtained, the board of directors of either the target company or any of its subsidiaries shall not —

(b) alienate any material assets whether by way of sale, lease, encumbrance or otherwise or enter into any agreement therefor outside the ordinary course of business.

### 4.3.8. Independent directors' recommendation:

Such recommendations shall be published in such form as may be specified, at least two working days before the commencement of the tendering period, in the same newspapers where the public announcement of the open offer was published, and simultaneously, a copy of the same shall be sent to —

a) SEBI

b) all stock exchanges;

c) merchant banker (manager to open offer)

### 4.3.9. Obligations of the acquirer

The acquirer has the following obligations.

(a) To ensure that firm financial arrangements have been made for fulfilling the payment obligations under the open offer.

(b) to ensure able to implement the open offer, subject to any statutory approvals for the open offer that may be necessary.

(c) acquirer shall not alienate any material assets of the target company or of any of its subsidiaries ,whether by way of sale, lease, encumbrance or otherwise outside the ordinary course of business, unless the acquirer the acquirer has not declared an intention in the detailed public statement and the letter of offer .If such intention wasn't declared then for alienation - special resolution via postal ballot is required and notice must mention the reasons for such alienation.

(d) the acquirer and persons acting in concert with him shall not sell shares of the target company held by them, during the offer period.

(e) the acquirer and persons acting in concert with him shall be jointly and severally responsible for fulfillment of applicable obligations under takeover code.

### 4.3.10. Exemptions

The following types of acquisition shall not come under the purview of this regulation

(a) acquisition in the ordinary course of business by

(i) Underwriter registered with SEBI

(ii) Stock Broker registered with SEBI on behalf of client in exercise of lien over the shares purchased on behalf of the client

(iii) merchant banker registered with the Board or a nominated investor in the process of market making

(b) any person acquiring shares pursuant to a scheme of safety net

(c) a merchant banker registered with the Board acting as a stabilizing agent.

(d) acquiring shares pursuant to an agreement of disinvestment

to Reconstruction / Merger / Amalgamation / Demerger under order of Court to provisions of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 to provisions of Delisting of shares Upon Share Forfeiture of Equity Shares by a Company.

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. Maximum days for keeping an issue open is;
   a) 7
   b) 8
   c) 9
   d) 10
2. At the time of IPO, the issuer has to have a:
   a) CFO
   d) MD
   c) designated Compliance officer
   d) at least one independent director
3. Which of the flowing do not require prospects
   a) Rights issue
   b) Bonus issue
   c) IPO
   d) FPO
4. Minimum face value of shares, can be:
   a) ₹ 10
   b) ₹ 5
   c) ₹ 1
   d) ₹ 15
5. Takeover means
   a) buying few shares
   b) acquiring 10%
   c) acquiring shares which will give control over the management.
   d) none of the above
6. The purpose of the SEBI Act is to provide for the establishment of a Board called Securities and Exchange Board of India (SEBI). The Preamble to the Act provides for the establishment of a Board to:
   a) Protect the interests of investors in securities
   b) Promote the development of the securities market
   c) To regulate the securities market

d) All of the above

7. SEBI has three functions rolled into one body. Which of the following is not the function of SEBI?

   a) Quasi-legislative

   b) Quasi-judicial

   c) Quasi-executive

   d) Quasi-official

8. For the appointment, reappointment, remuneration and removal of the director of a banking company, prior approval of ..... should be obtained.

   a) Chairman

   b) RBI

   c) Managing Director

   d) Finance Secretary

**State True or False**

1. SEBI regulations normally apply to public issues.
2. Promoters contribution is locked in for 3 years
3. Only Company secretary can be compliance officer.
4. Information relating to change in capital structure comes under "unpublished price sensitive information" under Insider Trading Regulation
5. SEBI (SAST) regulation and takeover code is same.

**Fill in blanks**

1. In case of IPO, the minimum promoters contribution shall be……percent of the post issue capital
2. When promoters of the target company voluntarily transfers shares, it is called…..……..takeover
3. In case of open offer, the account where payable amount to shareholders are kept is called……..……
4. Identified date means …… .working days after closure of the offer.
5. Minimum subscription is ….. percentage of the issue size.

**Short Essay Type Question**

1. Write a small note on differential pricing.
2. What do mean by "lock in period"?
3. Define "unpublished price sensitive information".

**Essay Type Questions**

1. Discuss in detail, the book building process.
2. What are three requirements of a company which wants to make public issue for the first time?
3. Discuss "connected person" in context of insider trading.

**Answer:**

**Multiple Choice Questions (MCQs)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|
| d | b | c | c | c | d | d | b |

**True/False**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| T | T | F | T | T |

**Fill in the blanks**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| 20 | Friendly | Escrow account | 10 | 90 |

# The Competition Act, 2002 5

**This Module Includes:**


**5.1 Competition – Meaning, Objectives, Extent and Applicability**

**5.2 Competition Commission of India**

# The Competition Act, 2002

**SLOB Mapped against the Module**

To acquire fair knowledge of laws regulating the competitive landscape of businesses in India.

**Module Learning Objectives:**

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

- The stipulations under the Competition Act;
- The precautions and procedure to be followed in case merger, and joint ventures.

# Competition – Meaning, Objectives, Extent and Applicability

# 5.1

The Monopolies & Restrictive Trade Practices Act, 1969 is the first enactment to deal with competition issues and came into effect on 1st June 1970. The Government appointed a committee in October 1999 to examine the existing MRTP Act for shifting the focus of the law from curbing monopolies to promoting competition and to suggest a modern competition law. Pursuant to the recommendations of this committee, the Competition Act, 2002, was enacted on 13th January 2003. It was subsequently amended in 2007.It provides for different notifications for making different provisions of the Act effective including repeal of MRTP Act and dissolution of the MRTP Commission.

Under the Act, Competition Commission of India and the Competition Appellate Tribunal have been established in October 2003. In accordance with the provisions of the Amendment Act, the Competition Commission of India and the Competition Appellate Tribunal have been established. The Competition Commission of India is now fully functional with a Chairperson and six members. The provisions of the Competition Act relating to anti-competitive agreements and abuse of dominant position were notified on May 20, 2009.

**(a) Objectives of the Act**

The objectives of the Competition Act are to:

(i) prevent anti-competitive practices,

(ii) promote and sustain competition,

(iii) protect the interests of the consumers and

(iv) ensure freedom of trade.

(v) competition advocacy by creating awareness among various levels at Government, industry and consumers.

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.

**(b) Few important Definitions**

(i) "acquisition" means, directly or indirectly, acquiring or agreeing to acquire shares, voting rights or assets of any enterprise; or control over management or control over assets of any enterprise;

(ii) "agreement" includes any arrangement or understanding or action in concert, whether or not, such arrangement, understanding or action is formal or in writing; or whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

(iii) Appellate Tribunal" means the National Company Law Appellate Tribunal referred to in sub-section (1) of section 53A

(iv) "cartel" includes an association of producers, sellers, distributors, traders or service providers who, by

agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services;

(v) "consumer" means any person who—

buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, whether such purchase of goods is for resale or for any commercial purpose or for personal use; or

hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services when such services are availed of with the approval of the first-mentioned person whether such hiring or availing of services is for any commercial purpose or for personal use;

(vi) "enterprise" means a person or a department of the Government, 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 divisions or subsidiaries, 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.

(vii) "goods" means goods as defined in the Sale of Goods Act, and includes—

(A) products manufactured, processed or mined;

(B) debentures, stocks and shares after allotment;

(C) in relation to goods supplied, distributed or controlled in India, goods imported into India;

(viii)"person" includes—

(a) an individual;

(b) a Hindu undivided family;

(c) a company;

(d) a firm;

(e) an association of persons or a body of individuals, whether incorporated or not, in India or outside India;

(f) any corporation established by or under any Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956);

(g) any body corporate incorporated by or under the laws of a country outside India;

(h) a co-operative society registered under any law relating to co-operative societies;

(i) a local authority;

(j) every artificial juridical person, not falling within any of the preceding sub-clauses;

(ix) "price", in relation to the sale of any goods or to the performance of any services, includes every valuable consideration, whether direct or indirect, or deferred, and includes any consideration which in effect relates

to the sale of any goods or to the performance of any services although ostensibly relating to any other matter or thing;

(x) "relevant market" means the market which may be determined by the commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets;

(xi) "relevant geographic market" means the area in which the competition for supply of goods or provision of services are of same type or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighboring areas;

(xii)"relevant product market" means a market comprising products or services which are interchangeable or substitutable by the consumer, by reason of characteristics of the product or services, their prices and intended use;

### 5.1.1. Anti Competitive Agreement

The purpose of Competition act is to encourage competition both for the benefit of consumers and regulating the industry. Therefore, law defines few types of trade, commerce or business agreements as anti-competitive.

Agreement is defined under Section 2(b) of the Competition Act. It includes any written/ oral agreement/ arrangement relating to production, supply, distribution, storage, acquisition or control of goods or services which causes or may cause an appreciable adverse effect on competition in India shall be void. Agreement widely defined and include any kind of arrangement whether express or implied, to be decided from facts and circumstantial evidence.

**There can be two types of agreement under the Act-**

1. Vertical
2. Horizontal

**The difference between Horizontal and Vertical Agreements** is that in Horizontal Agreements there is same level of competition whereas in Vertical Agreement there is different level of competition.

Section 3(3) of the Act states that any agreement entered into between enterprises or associations of business entities or persons or associations of persons or between any person and enterprise or practice carried on, or concerted decision taken by, any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods Services. There are few recognized trade associations in India. There are informal association and arrangement by which similar business entities. Mostly competitors join hands and exploit the market in concerted manner.

Vertical agreements are agreements that are entered amongst enterprise or persons at different stages of the production and distribution chain. Under the Act, such agreements are:

(a) **Tie-in arrangement:** sale of one product is tied up with taking of other product which may not be useful or commercially not viable;

(i) anticompetitive agreements and assist the competition authorities in lieu of immunity or lenient treatment.

A Leniency programme is a protection to those who come forward and submit information honestly, who would otherwise have to face stringent action by the Commission if existence of a cartel is detected by the Commission on its own. It is based on the principle of fair competition for greater good.

A. Anti-competitive agreement shall be presumed to have appreciable adverse effect on competition and thereby deemed to be restrictive. Some type of agreements are discussed below.

(i) Any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India. Any such agreement shall be void.

(ii) Any agreement entered into between enterprises or associations of enterprises including cartels, engaged in identical or similar trade of goods or provision of services, which—

a. directly or indirectly determines purchase or sale prices;

b. limits or controls production, supply, markets, technical development, investment ;

c. shares the market or source of production by way of allocation of geographical area of market;

d. directly or indirectly go for bid rigging or collusive bidding; "bid rigging" means any agreement, eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding, other than joint ventures business agreements are excepted .

(iii) Any agreement amongst enterprises or persons in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including, tie-in arrangement: includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;

(iv) exclusive supply agreement: includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person.

**Example:** ABC Ltd. has appointed Soni Brothers as a supplier of raw materials with a restriction that they can not do business with other parties.

(v) exclusive distribution agreement: includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods

(vi) refusal to deal: includes any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought.

**Example:** ABC Ltd. appoints a dealer for domestic fans and restricts him to take dealership of other product.

(vii) resale price maintenance: includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged. In other words the " maximum retail price" shall have to de disclosed and nobody can take more than that. Therefore, we find the MRP in most of the product on the package.

**Above restriction shall not apply to**

(a) the right to restrain any infringement of Intellectual property rights under the Copyright, Patents Act, Trade Marks , Geographical Indications , Designs and Semi-conductor Integrated Circuits Layout-Design as provided in the respective Acts.

(b) the right of any person to export goods from India to the extent to which the agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export.

### 5.1.2. Abuse of Dominant Position

(a) if an enterprise or a group directly or indirectly, imposes unfair or discriminatory—

(i) condition in purchase or sale of goods or service; or

(ii) price in purchase or sale (including predatory price) of goods or service; or

(b) limits or restricts—

(i) production of goods or provision of services or market therefor; or

(ii) technical or scientific development relating to goods or services to the prejudice of consumers; or

(c) indulges in practice or practices resulting in denial of market access in any manner; or

(d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or

(e) uses its dominant position in one relevant market to enter into, or protect, other relevant market.

"dominant position" means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to—

(i) operate independently of competitive forces prevailing in the relevant market; or

(ii) affect its competitors or consumers or the relevant market in its favour.

"predatory price" means the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors.

"group" shall have the same meaning as assigned to it in clause (b) of the Explanation to section 5

### 5.1.3. Combinations and its Regulation

#### 5.1.3.1. Combination defined

1. The acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises and persons or enterprises, if

2. 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. 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. The thresholds 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 value of assets shall be determined by taking the book value of the assets as shown, in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date

of proposed merger falls, as reduced by any depreciation, and the value of assets shall include the brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, homonymous geographical indication, geographical indications, design or layout design or similar other commercial rights, if any.

### 5.1.3.2. Regulation of combinations

No person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void. Any person or enterprise, who or which proposes to enter into a combination, shall give notice to the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination, within 30 days:—

(a) approval of the proposal relating to merger or amalgamation, by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be;

(b) execution of any agreement or other document for acquisition

(c) No combination shall come into effect until two hundred and ten days have passed from the day on which the notice has been given to the Commission under sub-section (2) or the Commission has passed orders, whichever is earlier.

The provisions of this section shall not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement. They shall, within seven days from the date of the acquisition, file, with the Commission the details of the acquisition including the details of such acquisition and control.

### 5.1.3.3. Inquiry into combination by Commission

(1) The Commission may, upon its own knowledge or information relating to acquisition or acquiring of control or merger or amalgamation referred to in clause (c) of that section, inquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India. The Commission shall not initiate any inquiry under this subsection after the expiry of one year from the date on which such combination has taken effect.

(2) The Commission shall, on receipt of a notice, Inquire whether a combination referred to in that notice or reference has caused or is likely to cause an appreciable adverse effect on competition in India.

(3) Not with standing anything contained in section 5, the Central Government shall, on the expiry of a period of two years from the date of commencement of this Act and thereafter every two years, in consultation with the Commission, by notification, enhance or reduce, on the basis of the wholesale price index or fluctuations in exchange rate of rupee or foreign currencies, the value of assets or the value of turnover, for the purposes of that section.

(4) For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission shall have due regard to all or any of the following factors, namely:—

(a) actual and potential level of competition through imports in the market

(b) extent of barriers to entry into the market;

(c) level of combination in the market;

(d) degree of countervailing power in the market;

(e) likelihood that the combination would result in the parties to the combination being able to increase prices or profit margins;

(f) extent of effective competition likely to sustain in a market;

(g) extent to which substitutes are available ;

(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;

(I) nature and extent of innovation;

(m) relative advantage, by way of the contribution to the economic development;

(n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

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. 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/ the Member presiding, shall have a second or/casting vote. The quorum for such meeting shall be three Members.

### 5.1.3.4. Procedure for investigation of combination

Where the Commission is of the primary opinion that a combination is likely to cause, or has caused an appreciable adverse effect on competition, it shall issue a notice to show cause to the parties to combination calling upon them to respond within thirty days.The Commission may call for a report from the Director General and such report shall be submitted by the Director General. if it is forms prima facie opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall, within seven working days direct the parties to publish details of the combination within ten working days of such direction, the knowledge or information of the public and persons affected or likely to be affected by such combination, who can file his objections, if any, before the Commission within fifteen working days.

The Commission may, within fifteen working days from the expiry of the period specified in sub-section (3), call for such additional or other information as it may deem fit from the parties to the said combination.

The additional or other information called for by the Commission shall be furnished by the parties referred to in sub-section (4) within fifteen days from the expiry of the period specified in sub-section (4).

After receipt of all information and within a period of forty-five working days from the expiry of the period specified in sub-section (5), the Commission shall proceed to deal with the case in accordance with the provisions contained in section 31

### 5.1.3.5. Orders of Commission on certain combinations

(i) Where the Commission is of the opinion that any combination does not, or is not likely to, have an appreciable adverse effect on competition, it shall, by order, approve that combination including the combination in respect of which a notice has been given under sub-section (2) of section 6.

(ii) 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.

(iii) 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.

(iv) The parties, who accept the modification proposed by the Commission under, shall carry out such modification within the period specified by the Commission but those fail within the period specified by the Commission, such combination shall be deemed to have an appreciable adverse effect on competition.

(v) If the parties to the combination do not accept the modification proposed by the Commission under, 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.

(vi) If the Commission agrees with the amendment submitted by the parties under subsection (6), it shall, by order, approve the combination.If the Commission does not accept the amendment submitted , 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 .

(vii)If the parties fail to accept the modification proposed by the Commission within thirty working days or within a further period of thirty working days 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.

(viii)Where the Commission has directed that the combination shall not take effect or the combination is deemed to have an appreciable adverse effect on competition , 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 such combination shall not be effective. If the Commission does not, on the expiry of a period of 210 days from the date of notice given to the Commission, pass an order or issue direction in accordance with the provisions of sub-section (1) or sub-section (2) or sub- section (7), the combination shall be deemed to have been approved by the Commission.

**Explanation.—**For the purposes of determining the period of 210 days specified in this subsection, the period of thirty working days specified in sub-section (6) and a further period of 30 working days specified in sub-section (8) shall be excluded.

(ix) 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 statutory or judicial authorities under any other law for the as if such acquisition or acquiring of control or merger or amalgamation had not taken place. Any proceeding initiated or which may be initiated under any other law shall be valid.

# Competition Commission of India

# 5.2

The Central Government has already established, the "Competition Commission of India", which is a body corporate, headquartered at New Delhi.

### 5.2.1. Constitution of the Commission

The Commission shall consist of a Chairperson and not less than two and not more than six other Members, who will be whole time, shall be appointed by the Central Government. Such persons shall be a person of ability, integrity and standing and who has special knowledge of, and such professional experience of not less than fifteen years in, international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs or competition matters, including competition law and policy.

The Chairperson and other Members shall be whole-time Members.

The Chairperson and every other Member shall hold office as such for a term of 5 years from the date on which he enters upon his office and shall be eligible for re-appointment. The age of retirement is 65 years.

The Central Government may 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. Secretary, experts, professionals and officers shall also be appointed.

### 5.2.2. Duties and Powers of the Commission

The Commission shall take such actions and issue such direction to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade carried on by other participants, in markets in India. It can initiate inquiry into certain agreements and dominant position of enterprise.

1) The Commission may inquire into any alleged contravention of the provisions on its own motion or on receipt of any information, from any person, consumer or their association or trade association; or a reference made to it by the Central Government or a State Government or a statutory authority.

(2) The Commission shall, while determining whether an agreement has an appreciable adverse effect on competition under section 3, have due regard to all or any of the following factors, namely:—

(a) creation of barriers to new entrants ;

(b) driving existing competitors out of the specified market;

(c) foreclosure of competition by blocking entry into the market;

(d) accrual of benefits to consumers;

(e) improvements in production or distribution of goods or provision of services; or

(f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

(3) The Commission shall, while inquiring whether an enterprise enjoys a dominant position or not under section 4, shall take into consideration any of the following factors, namely:—

(a) market share of the enterprise;

(b) size and resources of the enterprise;

(c) size and importance of the competitors;

(d) economic power of the enterprise;

(e) vertical integration of the enterprises;

(f) dependence of consumers on the particular enterprise;

(g) monopoly or dominant position;

(h) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;

(i) countervailing buying power;

(j) market size;

(k) social obligations and social costs;

(l) relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;

(m) any other factor which the Commission may consider relevant for the inquiry.

(4) 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".

(5) The Commission shall, while determining the "relevant geographic market", have due regard to all or any of the following factors, namely:—

(a) regulatory trade barriers;

(b) local specification requirements;

(c) national procurement policies;

(d) adequate distribution facilities;

(e) transport costs;

(f) language;

(g) consumer preferences;

(h) need for secure or regular supplies or rapid after-sales services.

(6) The Commission shall determine the "relevant product market", based on:

(a) physical characteristics or end-use of goods;

(b) price of goods or service

(c) consumer preferences;

(d) exclusion of in-house production;

(e) existence of specialised producers;

(f) classification of industrial products.

### 5.2.3. Orders by Commission after inquiry into agreements or abuse of dominant position

Where after inquiry the Commission finds that any agreement referred to in section 3 or action of an enterprise in a dominant position, it may pass all or any of the following orders, namely:

(a) direct any enterprise or association of enterprises involved in such agreement, or abuse of dominant position, to discontinue and not to re-enter such agreement or discontinue;

(b) impose such penalty, as it may deem fit: However, 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 percent. of its turnover for each year of the continuance of such agreement, whichever is higher.

Provided that in case any agreement referred to in section 3 has been entered into by a cartel, the Commission may impose upon each producer, seller, distributor, trader or service provider included in that cartel, a penalty of up to three times of its profit for each year of the continuance of such agreement or ten per cent. of its turnover for each year of the continuance of such agreement, whichever is higher

(c) direct that the agreements shall stand modified to the extent and in the manner as may be specified in the order

by the Commission;

(d) 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;

(e) 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 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.

### 5.2.4. Division of enterprise enjoying dominant position

The Commission may, direct division of an enterprise to ensure that such enterprise does not abuse its dominant position because of its size. 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;

(c) the creation, allotment, surrender or cancellation of any shares, stocks or securities;

(d) the formation or winding up of an enterprise

(e) amendment of the memorandum of association or articles of association

### 5.2.5. Power of Commission to regulate its own procedure

(1) the Commission shall be guided by the principles of natural justice and subject to the Act and Rules, shall have the powers to regulate its own procedure. The Commission shall have, powers as are vested in a Civil Court. Commission may issue interim orders.

(2) The Commission may call upon such experts, to assist the Commission in the conduct of any inquiry by it.

(3) The Commission may direct any person—

(a) to produce before the Director General or the Secretary or an officer authorised by it, such books or other documents in the custody or under the control of such person so directed as may be specified or described in the direction, being documents relating to any trade, the examination of which may be required for the purposes of this Act;

(b) to furnish to the Director General or the Secretary or any other officer authorised by it, as respects the trade or such other information as may be in his possession in relation to the trade carried on by such person as may be required for the purposes of this Act.

### 5.2.6. Orders of Commission imposing monetary penalty

If a person fails to pay any monetary penalty imposed the Commission shall proceed to recover such penalty, in such manner as may be specified by the regulations. Including procedure of recovery of income tax.

### 5.2.7. Acts taking place outside India but having an effect on competition in India

The Commission shall pass orders 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,

### 5.2.8. Contravention of orders of Commission

(1) The Commission may cause an inquiry to be made into compliance of its orders or directions made in exercise of its powers under the Act.

(2) If any person, without reasonable clause, fails to comply with the orders or directions of the Commission, he shall be punishable with fine which may extend to rupees one lakh for each day during which such non-compliance occurs, subject to a maximum of rupees ten crore, as the Commission may determine.

(3) If any person does not comply with the orders or directions issued, or fails to pay the fine imposed under sub-section (2), he shall, be punishable with imprisonment.

### 5.2.9. Penalty for failure to comply with directions of Commission and Director General

If any person fails to comply, without reasonable cause, with a direction given by—

(a) the Commission under sub-sections (2) and (4) of section 36; or

(b) the Director General while exercising powers referred to in sub-section (2) of section 41,

such person shall be punishable with fine which may extend to rupees one lakh for each day during which such failure continues subject to a maximum of rupees one crore, as may be determined by the Commission

### 5.2.10.Penalty for making false statement or omission to furnish material information

If any person, being a party to a combination,—

(a) makes a statement which is false in any material particular, or knowing it to be false; or

(b) omits to state any material particular knowing it to be material,

such person shall be liable to a penalty which shall not be less than ₹50 lakhs but which may extend to rupees one crore, as may be determined by the Commission.

### 5.2.11. Penalty for offences in relation to furnishing of information

Without prejudice to the provisions of section 44, if a person, who furnishes or is required to furnish under this Act any particulars, documents or any information,—

(a) makes any statement or furnishes any document which he knows or has reason to believe to be false in any material particular; or

(b) omits to state any material fact knowing it to be material; or

(c) willfully alters, suppresses or destroys any document which is required to be furnished as aforesaid, such person shall be punishable with fine which may extend to ₹1 crore as may be determined by the Commission.

The Commission may, if it is satisfied impose lesser penalty that any person has made a full and true disclosure in respect of the alleged violations, a lesser penalty. However, lesser penalty shall not be imposed by the Commission in cases where the report of investigation directed under section 26 has been received before making of such disclosure.

Lesser penalty shall not be imposed by the Commission if the person making the disclosure does not continue to cooperate with the Commission till the completion of the proceedings before the Commission. The Commission may, if it is satisfied that such producer, seller, distributor, trader or service provider included in the cartel had in the course of proceedings,—

(a) not complied with the condition on which the lesser penalty was imposed by the Commission; or

(b) had given false evidence; or

(c) the disclosure made is not vital,

and thereupon such producer, seller, distributor, trader or service provider may be tried for the offence with respect to which the lesser penalty was imposed and shall also be liable to the imposition of penalty to which such person has been liable, had lesser penalty not been imposed.

### 5.2.12. Contravention by companies

Where a person committing contravention of any of the provisions of this Act or of any rule, regulation, order made or direction issued thereunder is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly:

Nothing contained in this sub-section shall render any such person liable to any punishment if he proves that the contravention was committed without his knowledge or that he had exercised all efforts to stop such contravention.

Where a contravention of any of the provisions of this Act or of any rule, regulation, order made or direction issued thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that contravention and shall be liable to be proceeded against and punished accordingly.

### 5.2.13. Establishment of Appellate Tribunal

The National Company Law Appellate Tribunal constituted under section 410 of the companies Act, 2013 shall be the Appellate Tribunal for the purpose of this Act and the said appellate Tribunal shall –

(a) to hear and dispose of appeals against any direction issued or decision made or order passed by the Commission under sub-sections (2) and (6) of section 26, section 27, section 28, section 31, section 32, section 33, section 38, section 39, section 43, section 43A, section 44, section 45 or section 46 of this Act

(b) to adjudicate on claim for compensation that may arise from the findings of the Commission or the orders of the Appellate Tribunal in an appeal against any finding of the Commission or under section 42A or under sub-section (2) of section 53Q of this Act, and pass orders for the recovery of compensation under section 53N of this Act.

Any person, aggrieved by any direction, decision or order may prefer an appeal to the Appellate Tribunal within a period of 60 days from the date on which a copy of the direction or decision or order made by the Commission is received by the aggrieved party.

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.

### 5.2.14. Procedures and powers of Appellate Tribunal

The Appellate Tribunal, though having powers of civil court, shall not be bound by the procedure laid down in the Code of Civil Procedure, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules made by the Central Government, the Appellate Tribunal shall have power to regulate its own procedure including the places at which they shall have their sittings.

### 5.2.15.Execution of orders of Appellate Tribunal

Every order made by the Appellate Tribunal shall be enforced by it in t h e same manner as if it were a decree made by a court in a suit pending therein, and it shall be lawful for the Appellate Tribunal to send, in case of its inabilityto execute such order, to the court within the local limits of whose jurisdiction,-

a) in the case of an order against a company, the registered office of the company is situated; or

b) in the case of an order against any other person, place where the person concerned voluntarily resides or carries on business or personally works for gain, is situated.

(2) The Appellate Tribunal may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the order as if it were a decree made by that court.

If any person contravenes, without any reasonable ground, any order of the Appellate Tribunal, he shall be liable for a penalty of not exceeding rupees one crore or imprisonment for a term up to three years or with both.

### 5.2.16.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.

### 5.2.17. Powers of Central Government (CG) to issue directions

(i) The Central Government may, by notification, make rules to carry out the provisions of this Act;

(ii) CG shall have power to decide the staff and officers and decide on their salaries

(iii) The Central Government may, by notification, exempt from the application of this Act, or any provision thereof, and for such period

(iv) Power of Central Government to issue directions

(iv) The Central Government may, under emergent situation supersede the Commission for such period, not exceeding 6 months, as may be specified in the notification:

### 5.2.18. Application of other laws not barred

The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force. Therefore, all other laws are applicable in spite of proceedings under this Act.

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. The Competition Act has replaced-
   a) Companies Act, 1956
   b) Consumer Protection Act
   c) MRTP Act, 1969
   d) None
2. The turnover threshold for individual company, operating in India, in combination is _____ crores.
   a) ₹ 4,000
   b) ₹ 6,000
   c) ₹ 8,000
   d) ₹ 10,000
3. Which is not the objective of CCI.
   a) To promote start-up company
   b) promote and sustain competition,
   c) protect the interests of the consumers and
   d) prevent anti-competitive practices,
4. Selling products/services below the cost is called _____.
   a) Undercut pricing
   b) Under invoicing
   c) Predatory pricing
   d) Introductory pricing
5. The asset bases up to US $..... in case of a group having presence out of India shall not be required to take CCI approval in case of merger.
   a) 2 billion
   b) 3 billion
   c) 4 billion
   d) 10 billion
6. Which of the following is not the type of unfair competition?
   a) Collusive price fixing
   b) Creation of barriers to entry

c) Tie in purchase A

d) Predatory pricing

7. Which of the following is not the objective of Competition Act, 2002?

   a) To prevent practices having adverse effect on competition.

   b) To prevent competition in market A

   c) To protect the interest of the consumers

   d) To ensure freedom of trade carried on by the other participant in marketing India and for matter connected there with or incidental thereto.

8. Unfair competition under the Competition Act, 2002 means adoption of practices viz. -

   a) collusive price fixing.

   b) allocation of markets.

   c) discriminatory pricing etc.

   d) All of the above

9. 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 is known as

   a) Acquisition

   b) Agreement

   c) Cartel

   d) Pool

10. Which of the following is not the benefits of CSR Programme?

    a) Mutual trust

    b) Attracting and retaining employees

    (c) Communities as suppliers

    d) Enhancing corporate reputation

11. Any person aggrieved by any order of Competition Appellate Tribunal (COMPAT), may file an appeal to the Hon'ble Supreme Court within…… days, from the date of receipt of the order of Appellate Tribunal.

    a) 30 days

    b) 45 days

    c) 60 days

    d) 90 days

12. The Chairperson and every other Member shall hold office for a term of …… years from the date on which he enters upon his office.

    a) 2

    b) 3

    c) 5

    d) 10

13. The Commission also has the power to impose a fine which may extend up to of the total turnover or the assets of the combination, whichever is higher, for failure to give notice to the Commission of the combination

    a) 2%

    b) 1%

    c) 0.5%

    d) 3%

14. 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 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) all the above

15. If the Commission does not, on the expiry of a period of …….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

    a) 210

    b) 180

    c) 260

    d) 300

**State True or False**

1. The objective the Competition Act is to ensure freedom of trade
2. The Competition Act is replacement of Consumer Protection Act.
3. Exclusive distribution agreement shall be presumed to have appreciable adverse effect.
4. Combinations are based on threshold limits of paid up capital of the companies
5. Companies can go for merger beyond the threshold limit by intimated the CCI.

**Fill in the blanks**

1. The Competition Act is regulated by……..
2. Anti competitive agreements shall have presumed to have…….
3. If no approval for any merger is received, after…… days after application, it would amount to deemed approval.
4. The main office of CCI is located at ……..
5. One of the basis of determination of combination, is ……

**Short Essay Type Questions**

1. Discuss objects of the Act.
2. How do you define combination of domestic companies.
3. Discuss in brief, the role of Director General of Investigation of CCI.

**Essay Type Questions**

1. Discuss the meaning of abuse of dominance under Competition Act.
2. What is "combination" under Competition Act? How they are regulated?
3. Write a note on Competition Commission of India.

**Case Study (Solved)**

You are CFO of ABC India Limited, a large steel parts manufacturing company in India with turnover of more than 1 billion and turnover of more than 2 billion. Negotiation for take over of a foreign company is going on, whose turnover for last financial year was US$ 3.5 billion and assets of 1.5 billion US$. Company wants to know the steps to be taken in case the negotiation succeeds. Please advise your company.

**Solution:**

In the given case, ABC India Ltd is to acquire a foreign company whose turnover for last financial year was US$3.5 billion and assets of 1.5 billion US$. The combined assets of both the companies, shall exceed the threshold limit of combination which require CCI nod and therefore, will come under the purview of Competition Act. The threshold limit is asset of US$ 1 billion and turnover of US$ 3 billion for the combined entity.

Here, the procedure is as follows;

1. The binding documents are to be signed, which will be done with the approval of Board or shareholders, whatever may be the case. Here binding documents means agreement to invest or any other undertakings.
2. Within 30 days of signing the binding documents, the company shall give a notice to CCI in a prescribed format.
3. CCI may go for primary inquiry and form an opinion on the notice.

4. CCI may communicate acceptance or ask for clarification thereafter.
5. If no communication is received within 210 days, the proposal shall be deemed to have been approved and the company may proceed forward.

**Answer:**

**Multiple Choice Questions (MCQs)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| c | b | c | c | c | c | b | d | c | a | c | c | b | d | a |

**State True or False**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| T | F | T | F | F |

**Fill in the blanks**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| Competition Commission of India | Appreciable adverse effect | 210 | New Delhi | Turnover |

# Foreign Exchange Management Act, 1999

6

**This Module Includes**

**6.1 Salient features of Foreign Exchange Management Act (FEMA)**

**6.2 Foreign Direct Investment in India (FDI) - Master Directions on FDI**

**6.3 External Commercial Borrowings, Trade Credit and Structured Obligations - Master Directions**

**6.4 Liberalized Remittance scheme (LRS) - Master Directions**

# Foreign Exchange Management Act, 1999

**SLOB Mapped against the Module**

To develop detailed understanding of provisions relating to management of foreign exchanges.

**Module Learning Objectives:**

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

- Understand the basis provisions of the Act;
- Foreign transaction is common and students working in finance, after apposing out, should know the procedure, limits and implication so of foreign remittances; this will be clear from the module.
- Concept of fighting direct and indirect investment is expected to be clear after study of the module.

# Salient features of Foreign Exchange Management Act (FEMA)

# 6.1

**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 order to facilitate external trade and payments as well as to preserve Foreign Exchange reserves, FEMA was formulated with a total of 49 Sections divided into 7 chapters.

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.

### 6.1.1. Objective and Applicability

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, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency. Under FEMA, rules and regulations are very transparent, easy to access and understandable.

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. RBI has been 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 being a economic legislation, is civil law and provisions of arrest and non monetary punishment is normally given in extreme cases.

**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).

(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.

Rules and Regulations have been issued along with main Act. They are understandable and are available under public domain.

**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,

**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. In other words the stringent stipulations under FERA have been relaxed in FEMA.

### 6.1.2. Few important definitions

**(a) Authorized Dealer**

'Authorized Dealer' means a person authorized as an authorized dealer under sub-section (1) of section 10 of FEMA.

**(b 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 by an Indian Company in accordance to provisions of the Companies Act, as applicable.

**(c) 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.

**(d) Currency -Section 2(h)**

"currency" includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank;

**(e) 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.

**(f) 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.

**(g) 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. In case of FDI, the investor directly invests in the company and not through any intermediary. Investment like means investment in shares and convertible debentures.

**(h) Foreign exchange - Section 2(n)**

'foreign exchange' means foreign currency and includes,-

(1) deposits, credits and balances payable in any foreign currency.

(2) drafts, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency.

(3) drafts, travellers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency.

**(i) 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.

**(j) 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.

**(k) 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.

**(l) 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.

**(m) 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.

**(n) 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 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, or the person is a spouse of an Indian citizen or a person referred to in sub-clause (i) or (ii).

**(o) Person -Section (u)**

includes— (i) an individual, (ii) a Hindu undivided family, (iii) a company, (iv) a firm, (v) an association of persons or a body of individuals, whether incorporated or not, (vi) every artificial juridical person, not falling within any of the preceding sub-clauses, and (vii) any agency, office or branch owned or controlled by such person;

**(p) Person resident in India- Section (v)**

(a) a person residing in India for more than 182 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:

(i) for or on taking up employment outside India, or

(ii) for carrying on outside India a business or vocation outside India, or

(iii) 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:

(i) for or on taking up employment in India, or

(ii) for carrying on in India a business or vocation in India, or

(iii) 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.

### 6.1.3. Salient provisions of FEMA

(a) Restriction on dealing in foreign exchange, etc. (Section 3)

Section 3 prohibits the following transactions, No person shall-

(i) deal in or transfer any foreign exchange or foreign securities by any person not being an authorized person.

(ii) making any payment to or for the credit of any person resident outside India in any manner.

(iii) receiving otherwise than through an authorized person, any payment by order or on behalf of any person resident outside India in any manner.

(iv) 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.

**(b) Restriction on holding of foreign exchange (Section 4)**

No person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India, other than those provided under the relevant Rules. Rules provide exemption as under.

(i) Property held outside India by a foreign citizen resident in India.

(ii) Property acquired by a person on or before 8th July, 1947 and held with the permission of Reserve Bank.

(iii) Property acquired by way of gift or inheritance from persons referred to in above.

(iv) Property purchased out of funds held in RFC account.

**(c) Current account transactions (Section 5)**

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 specifying the levels and types of prohibition in transactions. Schedule I specifies the transactions which are altogether prohibited. 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, freight vessels etc. in foreign print media by a State Government and Public Sector Undertakings. 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 restriction.

**(d) Capital Account Transactions (Section 6)**

(i) 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.

(ii) 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) 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.

(d) 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.

(e) 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.

(f) 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.

**Case Study:**

Mr. Goel is an NRI based at London. He has shared in five Indian Companies. He decides to sell 5000 shares of Larsen and Toubro to Mr Rakesh based at Kolkata.

Mr Goel has a business and imports mica from India on regular basis from a mica mines from Bihar. The payment is made through letter of credit within 6 months.

What kind of transaction are the above transaction and why:

**Solution:**

Transfer of shares , being a capital asset is capital account transaction as per RBI regulations, as it is effecting change in the asset position of a person resident outside India, so far the assets of India. However, general permission has been given by RBI and there is a relaxation of taking specific approval from RBI.

So far import from India is concerned, it is a current account transaction where the payment has to be ,made within twelve months. No specific approval is required.

**(d) 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:

(i) Authorised Persons in accordance with the limits advised by the Reserve Bank.

(ii) Any person may possess foreign coins without no restriction.

(iii) Any person resident in India is permitted to retain in aggregate foreign currency not exceeding a limit notified from time to time.

(iv) 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.

(e) **Forms of business may be conducted by a Foreign Company in India**.

A foreign company planning to set up business operations in India may:

(i) Incorporate a company under the Companies Act, 1956 (now Companies Act 2013), as a Joint Venture or a Wholly Owned Subsidiary.

(ii) 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.

# Foreign Direct Investment in India (FDI) – Master Directions on FDI

# 6.2

Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI Policy which is formulated and announced by the Government of India, Department for Promotion of Industry & International Trade, 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. Consolidated FDI Policy is governed by the provisions of the Foreign Exchange Management Act (FEMA), 1999. FEMA Regulations 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.

### 6.2.1. Few stipulations of foreign investment in India as per Master Directions'

(i) Foreign Direct Investment' (FDI) is the investment through capital instruments by a person resident outside India (a) in an unlisted Indian company; or (b) in 10% or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company.

If an existing investment by a person resident outside India in capital instruments of a listed Indian company falls to a level below 10% of the post issue paid-up equity capital on a fully diluted basis, the investment will continue to be treated as FDI.

(ii) 'Foreign Portfolio Investment' is any investment made by a person resident outside India in capital instruments where such investment is (a) less than 10% of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company or (b) less than 10% of the paid up value of each series of capital instruments of a listed Indian company.

(iii) A person resident outside India may hold foreign investment either as Foreign Direct Investment or as Foreign Portfolio Investment in any particular Indian company,issued outside India, the underlying of which is a security issued by a person resident in India.

(iv) 'Investment Vehicle' is an entity registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose and will be Real Estate Investment Trusts (REITs) governed by the SEBI (REITs) Regulations, 2014, Infrastructure Investment Trusts (InvIts) governed by the SEBI (InvIts) Regulations, 2014 and Alternative Investment Funds (AIFs) governed by the SEBI (AIFs) Regulations, 2012.A Venture Capital Fund (VCF) registered under the Securities and Exchange Board of India will not be considered as an Investment Vehicle.

(v) Any equity held by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned under the sectoral cap.

### 6.2.2. Prohibited sectors/ persons

FDI is prohibited in the following sectors:

(1) Lottery Business including Government/ private lottery, online lotteries.

(2) Gambling and betting including casinos.

(3) Chit funds (except for investment made by NRIs and OCIs on a non- repatriation basis).

(4) Nidhi company.

(5) Trading in Transferable Development Rights (TDRs).

(6) Real Estate Business or Construction of Farm Houses.

(7) '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.

(8) Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes..

(9) Activities/ sectors not open to private sector investment viz., (i) Atomic energy and(ii) Railway operations (other than permitted activities).

(10) Any investment by a person who is a citizen of Bangladesh or Pakistan or is an entity incorporated in Bangladesh or Pakistan requires prior Government approval.

(11) A person who is a citizen of Pakistan or an entity incorporated in Pakistan can, only with the prior Government approval, invest in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.

### 6.2.3. Capital Instruments

The capital instruments are equity shares, debentures, preference shares and share warrants issued by the Indian company. Twenty five percent of the total consideration amount (including share premium, if any), has to be received upfront and the balance consideration towards fully-paid equity shares should be received within a period of twelve months from the date of issue of partly-paid shares.Other instruments are fully convertible debentures and fully convertible preference shares.

### 6.2.4. Entry Routes

Automatic Route not require the prior Reserve Bank approval or Government approval.

Government Route is the entry route which requires prior Government approval. Concerned ministry shall give the approval.

### 6.2.5. Sectoral caps

Foreign investment in the sectors/activities is permitted up to the limit indicated against each sector/ activity, subject to applicable laws/ regulations, security and other conditions.

Foreign investment is permitted up to 100% on the automatic route, subject to applicable laws/ regulations, security and other conditionality, in sectors/activities not listed in Regulation 16 of FEMA 20(R) and not prohibited under Regulation.

Wherever there is a requirement of minimum capitalization, it will include premium received along with the face value of the capital instrument, only when it is received by the company upon issue of such instruments to a person resident outside India. Amount paid by the transferee during post-issue transfer beyond the issue price of the capital

instrument, cannot be taken into account while calculating minimum capitalization requirement.

Foreign Investment in investing companies not registered as Non-Banking Financial Companies core investment companies (CICs), will require prior Government approval. Foreign investment in investing companies registered as Non-Banking Financial Companies (NBFCs) with the Reserve Bank, will be under 100% automatic route.

### 6.2.6. Permitted Investments by persons resident outside India

Any investment made by a person resident outside India shall be subject to the entry routes, sectoral caps or the investment limits, may make investment as stated hereinafter. For details, one has to see the relevant annexure, out of various annexures which relate to each kind of investment.

(i) Subscribe/ purchase/ sale of capital instruments of an Indian company is permitted as per the directions laid down in Annex 1.

(ii) Purchase/ sale of capital instruments of a listed Indian company on a recognised stock exchange in India by Foreign Portfolio Investors is permitted as per the directions laid down in Annex 2.

(iii) Purchase/ sale of Capital Instruments of a listed Indian company on a recognised stock exchange in India by Non-Resident Indian (NRI) or Overseas Citizen of India (OCI) on repatriation basis is permitted as per the directions laid down in Annex 3.

(iv) Purchase/ sale of Capital Instruments of an Indian company or Units or contribution to capital of a LLP or a firm or a proprietary concern by Non-Resident Indian (NRI) or Overseas Citizen of India (OCI) on a Non-Repatriation basis is permitted as per the directions laid down in Annex 4.

(v) Purchase/ sale of securities other than capital instruments by a person resident outside India is permitted as per the directions laid down in Annex 5.

(vi) Investment in a Limited Liability Partnership (LLP) is permitted as per the directions laid down in Annex 6.

(vii) Investment by a Foreign Venture Capital Investor (FVCI) is permitted as per the directions laid down in Annex 7.

(viii) Investment in an Investment Vehicle is permitted as per the directions laid down in Annex 8.

(ix) Issue/ transfer of eligible instruments to a foreign depository for the purpose of issuance of depository receipts by eligible person(s) is permitted as per the directions laid down in Annex 9.

(x) Purchase/ sale of Indian Depository Receipts (IDRs) issued by Companies Resident outside India is permitted as per directions laid down in Annex 10.

### 6.2.7. Acquisition through rights issue or bonus issue

Investment in rights issue or a bonus issue subject to fulfilment of applicable regulations applicable to an Indian company is permitted to issue "employees' stock option" and/ or "sweat equity shares" to its employees/ directors or employees/ directors of its holding company or joint venture or wholly owned overseas subsidiary/ subsidiaries who are resident outside India, subject to the compliance of other provisions of this regulations.

### 6.2.8. Issue of Convertible Notes by an Indian startup company

A person resident outside India is permitted to invest in convertible notes issued by an Indian startup company for an amount of ₹25 lakh subject to the compliance of other provisions of this regulations.

### 6.2.9. Merger or demerger or amalgamation of Indian companies

The new (amalgamated) company, can issue capital instruments to the existing holders of the transferor company who are resident outside India, subject to compliance of other provisions of this regulations. Prior Government approval is required to be obtained for any transfer in case the company is engaged in a sector which requires Government approval.

### 6.2.10. Pricing guidelines

The price of capital instruments of an Indian company issued by it to a person resident outside India should not be less than:

(a) the price worked out in accordance with the relevant SEBI guidelines in case of a listed Indian company or in case of a company going through a delisting process as per the SEBI (Delisting of Equity Shares) Regulations, 2009; or

(b) the valuation of capital instruments done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a SEBI registered Merchant Banker or a practicing Cost Accountant, in case of an unlisted Indian Company.

In case of convertible capital instruments, the price/ conversion formula of the instrument is required to be determined upfront at the time of issue of the instrument. 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.

### 6.2.11. Subscription to Memorandum of Association

Where shares in an Indian company are issued to a person resident outside India in compliance with the provisions of the Companies Act, 2013, by way of subscription to Memorandum of Association, such investments shall be made at face value subject to entry route and sectoral caps.

### 6.2.12. Investment in an LLP

Investment in an LLP either by way of capital contribution or by way of acquisition/ transfer of profit shares, should not be less than the fair price worked out as per any valuation norm which is internationally accepted/ adopted as per market practice and a valuation certificate to that effect should be issued by a Chartered Accountant or by a practicing Cost Accountant or by an approved valuer from the panel maintained by the Central Government.

### 6.2.13. Guidelines for calculation of total foreign investment in Indian companies

Any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned for total foreign investment.

FCCBs and DRs having underlying of instruments in the nature of debt will not be reckoned for total foreign investment.

The methodology for calculating total foreign investment would apply at every stage of investment in Indian companies and thus in each and every Indian company.

For the purpose of downstream investment, the portfolio investment held as on March 31 of the previous financial year in the Indian company making the downstream investment will be considered for computing the total foreign investment of the investee Indian entity.

The foreign investment received by a wholly owned subsidiary of an Indian company will be limited to the total foreign investment received by the company making the downstream investment

### 6.2.14. Conditions for exit

Exiting out of invest in India is nothing new. There are many instances where the foreign entity has divested the stake for various reasons. In case of exit of foreign joint venture, the right to first refusal rests with the Indian partner. If it refuses to take the shares, it can be sold to third party. However, here, the problem comes when the pricing of shares are to be decided. This is big problem in case of unlisted companies where share price cannot be easily determined and you need independent valuation to be made by reliable agencies. Valuation is also subject RBI guidelines and payment of Income tax under capital gains.

Capital instrument of an Indian company held by another Indian company which has received foreign investment and is not owned and not controlled by resident Indian citizens or is owned or controlled by persons resident outside India may be transferred to:

a person resident outside India, subject to reporting requirements in Form FCTRS. However, pricing guidelines will not apply for such a transfer.

a person resident in India subject to adherence to pricing guidelines.

In case of an Indian company with foreign investment and not owned and not controlled by resident Indian citizens or owned or controlled by persons resident outside India. Pricing and reporting guidelines will not apply.

**Case Study:**

Amit, Rohit and Mahesh are three friends passed out engineers, They want to form start up company by contributing ₹ 10 lakhs each, Mahesh gets a job in USA and has left for USA. The company will be manufacturing a spare for computer which is very much in demand. Mahesh wants to be a shareholder and a director of the company, which others have agreed. Others also will be directors.

The proposed company will be a private company and the product in delicensed sector. The holding Mahesh in the company will be around 35%. The team of the above entrepreneurs want to clarify the following. Please advise them.

1. Can Mahesh hold 35% shares in the company?
2. Can he attend the Board meetings in India?
3. Can they be allotted convertible note or any security other than equity shares?
4. Which route is to be taken and why?
5. Shall Mahesh get dividend on the shares if he is non resident.

**Solution:**

1. Yes Mahesh can hold 355 shares in the company. Being a technological company, there is no bar on limit of foreign investment.
2. He can be director and attend Board meeting in India, whenever held.
3. Yes he can be allotted convertible note. A convertible note is an instrument issued by a start-up company evidencing receipt of money initially as debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of such start up company, within a period not exceeding five years from the date of issue of the convertible note, on occurrence of nay event.

   **The following capital instruments are permitted to be issued to a NRI.:** 'Capital Instruments' means equity shares, debentures, preference shares and share warrants issued by the Indian company.

   **Equity shares:** Equity shares are those issued in accordance with the provisions of the Companies Act, 2013 and will include partly paid equity shares issued on or after July 8, 2014.

**Share warrants:** Share warrants issued on or after July 8, 2014 will be considered as capital instruments.

**Debentures:** 'Debentures' means fully, compulsorily and mandatorily convertible debentures.

**Preference shares:** 'Preference' shares means fully, compulsorily and mandatorily convertible preference shares.

Non-convertible/ optionally convertible/ partially convertible/ optionally convertible/ partially convertible debentures.

**4. The routes under which foreign investment can be made is as under:**

**a) Automatic Route:** Foreign Investment is allowed under the automatic route without prior approval of the Government or the Reserve Bank of India, in all activities/ sectors as specified in the Regulation 16 of FEMA 20 (R).

**b) Government Route:** Foreign investment in activities not covered under the automatic route requires prior approval of the Government. Procedure for applying for Government approval is given.

Here, since the investment is permitted under Regulation, no Govt. approval would be required.

**5. Mahesh will get dividend which will be repayable.**

# External Commercial Borrowings, Trade Credit and Structured Obligations – Master Directions

# 6.3

Transactions on account of External Commercial Borrowings (ECB) and Trade Credit (TC) are governed section 6 of the Foreign Exchange Management Act, 1999 (FEMA).

**6.3.1.External Commercial Borrowings** are commercial loans raised by resident entities from recognized 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 given below apply in totality and not on a standalone basis. Corporate borrowers who have availed Rupee loans domestically for capital expenditure classified as SMA-2 or NPA can avail ECB for repayment of these loans under any one time settlement with lenders. Lender banks are also permitted to sell, through assignment, such loans to eligible ECB lenders, provided, the resultant external commercial borrowing complies with all-in-cost, minimum average maturity period and other relevant norms of the ECB framework. Foreign branches/ overseas subsidiaries of Indian banks are not eligible to lend for the above purposes. The applicable MAMP will have to be strictly complied with under all circumstances.

Eligible borrowers under the ECB framework, who are participating in the Corporate Insolvency Resolution Process under Insolvency and Bankruptcy Code, 2016 as resolution applicants, can raise ECB from all recognised lenders, except foreign branches/subsidiaries of Indian banks, for repayment of Rupee term loans of the target company. Such ECB will be considered under the approval route.

| Currency of borrowing | FCY denominated ECB | INR dominated ECB |
|---|---|---|
| Forms of ECB | Loans including bank loans; floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; FCCBs; FCEBs and Financial Lease. | Loans including bank loans; floating/ fixed rate notes/bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; and Financial Lease. plain vanilla Rupee denominated bonds issued overseas, which can be either placed privately or listed on exchanges as per host country regulations. |
| Eligible borrower | All entities eligible to receive FDI. | a) All entities eligible to raise FCY ECB; and micro-finance, non profit organizations. |

| | | |
|---|---|---|
| Lender | The lender should be resident of FATF or IOSCO compliant country, including on transfer of ECB. However,<br>a) Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognised lenders;<br>b) b) Individuals lenders; Foreign branches/ subsidiaries of Indian banks.<br>c) Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for Foreign Currency ECB (except FCCBs and FCEBs). Foreign branches / subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers/underwriters/ market-makers/traders for Rupee denominated Bonds issued overseas. However, underwriting by foreign branches/subsidiaries of Indian banks for issuances by Indian banks will not be allowed. | |
| Minimum average maturity period | 3 yrs | |
| End uses (negative list) | | The negative list, for which the ECB proceeds cannot be utilised, would include the following:<br>a) Real estate activities.<br>b) Investment in capital market.<br>c) Equity investment.<br>d) 6 Working capital purposes, except in case of ECB mentioned at v(b) and v(c) above.<br>e) General corporate purposes, except in case of ECB mentioned at v(b) and v(c) above.<br>f) Repayment of Rupee loans, except in case of ECB mentioned at v(d) and v(e) above.<br>On-lending to entities for the above activities, except in case of ECB raised by NBFCs as given at v(c), v(d) and v(e) above |

**6.3.2. Limit and leverage:** Under the aforesaid framework, all eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under the automatic route. Further, in case of FCY denominated ECB raised from direct foreign equity holder, ECB liability-equity ratio for ECB raised under the automatic route cannot exceed 7:1.

However, this ratio will not be applicable if the outstanding amount of all ECB, including the proposed one, is up to USD 5 million or its equivalent. Further, the borrowing entities will also be governed by the guidelines on debt equity ratio, issued, if any, by the sectoral or prudential regulator concerned.

**6.3.3. Parking of ECB proceeds:** ECB proceeds are permitted to be parked abroad as well as domestically in the manner given below:

**Parking of ECB proceeds abroad:** ECB proceeds meant only for foreign currency expenditure can be parked abroad pending utilisation. Till utilisation, these funds can be invested in few specified liquid assets.

**Parking of ECB proceeds domestically:** ECB proceeds meant for ₹ expenditure should be repatriated immediately for credit to their Rupee accounts with AD Category I banks in India. Can also be to park ECB proceeds in term deposits with AD Category I banks in India for a maximum period of 12 months cumulatively.

**6.3.4. Procedure of raising ECB:** All ECB can be raised under the automatic route if they conform to the parameters prescribed under this framework. For approval route cases, the borrowers may approach the RBI

**6.3.5. Reporting Requirements:** Borrowings under ECB Framework are subject to following monthly reporting requirements.

Any borrower who has raised ECB will be treated as 'untraceable entity', if entity/auditor(s)/director(s)/ promoter(s) of entity are not reachable/responsive/reply in negative over email/letters/phone for a period of not less than two quarters with documented communication/ reminders.

a) Entity not found to be operative at the registered office address as per records available with the AD Bank or not found to be operative during the visit by the officials of the AD Bank or any other agencies authorised by the AD bank for the purpose;

b) Entities have not submitted Statutory Auditor's Certificate for last 2 years or more; File Revised Form ECB, if required, and last Form ECB 2 Return without certification from company with 'UNTRACEABLE ENTITY' written in bold on top. The outstanding amount will be treated as written-off from external debt liability of the country but may be retained by the lender in its books for recovery through judicial/ non-judicial means;

c) No fresh ECB application by the entity should be examined/processed by the AD bank;

d) Directorate of Enforcement should be informed whenever any entity is designated 'UNTRACEABLE ENTITY'; and

e) No inward remittance or debt servicing will be permitted under auto route.

The designated AD Category I banks can approve any requests from the borrowers for changes subject to ECB norms ECB norms and are with the consent of lender(s). Further, the following can also be undertaken under the automatic route:

**6.3.6. Refinancing of existing ECB:** Refinancing of existing ECB by fresh ECB provided the outstanding maturity of the original borrowing (weighted outstanding maturity in case of multiple borrowings) is not reduced and all-in-cost of fresh ECB is lower than the all-in-cost (weighted average cost in case of multiple borrowings) of existing ECB. Further, refinancing of ECB raised under the previous ECB frameworks may also be permitted, subject to additionally ensuring that the borrower is eligible to raise ECB under the extant framework. Raising of fresh ECB to part refinance the existing ECB is also permitted subject to same conditions. Indian banks are permitted to participate in refinancing of existing ECB, only for highly rated corporates (AAA) and for Maharatna/Navratna public sector undertakings.

**6.3.7. Conversion of ECB into equity:** Conversion of ECB, including those which are matured but unpaid, into equity is permitted subject to the following conditions:

The activity of the borrowing company is covered under the automatic route for FDI or

i. Government approval is received, wherever applicable, for foreign equity participation as per extant FDI policy.

ii. The conversion, which should be with the lender's consent and without any additional cost, should not result in contravention of eligibility and breach of applicable sector cap on the foreign equity holding under FDI policy;

iii. Applicable pricing guidelines for shares are complied with.

iv. In case of partial or full conversion of ECB into equity, the reporting to the Reserve Bank will be as under:

- For partial conversion, the converted portion is to be reported in Form FC-GPR prescribed for reporting of FDI flows, while monthly reporting to DSIM in Form ECB 2 Return will be with suitable remarks, viz., "ECB partially converted to equity".
- For full conversion, the entire portion is to be reported in Form FC-GPR, while reporting to DSIM in Form ECB 2 Return should be done with remarks "ECB fully converted to equity". Subsequent filing of Form ECB 2 Return is not required.
- For conversion of ECB into equity in phases, reporting through Form FC-GPR and Form ECB 2 Return will also be in phases.

v. If the borrower concerned has availed of other credit facilities from the Indian banking system, including foreign branches/subsidiaries of Indian banks, the applicable prudential guidelines issued by the Department of Banking Regulation of Reserve Bank, including guidelines on restructuring are complied with;

vi. Consent of other lenders, if any, to the same borrower is available or atleast information regarding conversions is exchanged with other lenders of the borrower;

vii. For conversion of ECB dues into equity, the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion or any lesser rate can be applied with a mutual agreement with the ECB lender. It may be noted that the fair value of the equity shares to be issued shall be worked out with reference to the date of conversion only.

**6.3.8. Security for raising ECB:** AD Category I banks are permitted to allow creation/cancellation of charge on immovable assets, movable assets, financial securities and issue of corporate and/or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised/ raised by the borrower, An entity which is under a restructuring scheme/ corporate insolvency resolution process can raise ECB only if specifically permitted under the resolution plan. Special Dispensations under the ECB framework: is available for Public Sector Oil Marketing Companies (OMCs), startups.

**6.3.9. Borrowing by Entities under Investigation:** All entities against which investigation / adjudication / appeal by the law enforcing agencies for violation of any of the provisions of the Regulations under FEMA pending, may raise ECB as per the applicable norms, if they are otherwise eligible..

### 6.3.10. Trade Credits Framework

**Introduction:** Trade Credits (TC) refer to the credits extended by the overseas supplier, bank, financial institution and other permitted recognised lenders for maturity, as prescribed in this framework, for imports of capital/non-capital goods permissible under the Foreign Trade Policy of the Government of India. Depending on the source of finance, such TCs include suppliers' credit and buyers' credit from recognised lenders.

TC for imports into India can be raised in any freely convertible foreign currency (FCY denominated TC) or Indian Rupee (INR denominated TC), as per the framework given in the table below:

| Sr. No. | Parameters | FCY denominated TC | INR denominated TC |
|---|---|---|---|
| I | Forms of TC | Buyers' Credit and Suppliers' Credit. | |
| II | Eligible borrower | Person resident in India acting as an importer. | |
| III | Amount under automatic route | Up to USD 150 million or equivalent per import transaction for oil/gas refining & marketing, airline and shipping companies. For others, up to USD 50 million or equivalent per import transaction. | |
| IV | Recognised lenders | 1. For suppliers' credit: Supplier of goods located outside India.<br>2. For buyers' credit: Banks, financial institutions, foreign equity holder(s) located outside India and financial institutions in IFSCs located in India.<br>Note: Participation of Indian banks and non-banking financial companies (operating from IFSCs) as lenders will be subject to the prudential guidelines issued by the concerned regulatory departments of the Reserve Bank. Further, foreign branches/subsidiaries of Indian banks are permitted as recognised lenders only for FCY TC. | |
| V | Period of TC | The period of TC, reckoned from the date of shipment, shall be up to three years for import of capital goods. For non-capital goods, this period shall be up to one year or the operating cycle whichever is less. For shipyards/shipbuilders, the period of TC for import of non-capital goods can be up to three years. | |
| VI | All-in-cost ceiling per annum | 10 Benchmark Rate plus 350 bps spread: For existing TCs linked to LIBOR whose benchmarks are changed to ARR. Benchmark rate plus 300 bps spread: For new TCs. | Benchmark rate plus 250 bps spread. |
| VII | Exchange rate | Change of currency of FCY TC into INR TC can be at the exchange rate prevailing on the date of the agreement between the parties concerned for such change or at an exchange rate, which is less than the rate prevailing on the date of agreement, if consented to by the TC lender. | For conversion to Rupee, exchange rate shall be the rate prevailing on the date of settlement. |
| VIII | Hedging provision | The entities raising TC are required to follow the guidelines for hedging, if any, issued by the concerned sectoral or prudential regulator in respect of foreign currency exposure. Such entities shall have a board approved risk management policy. | The overseas investors are eligible to hedge their exposure in Rupee through permitted derivative products with AD Category I banks in India. The investors can also access the domestic market through branches / subsidiaries of Indian banks abroad or branches of foreign banks with Indian presence on a back to back basis. |
| IX | Change of currency of borrowing | Change of currency of TC from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted. | Change of currency from INR to any freely convertible foreign currency is not permitted. |

### 6.3.11. Trade Credits (TC) in SEZ/FTWZ/DTA:

TC can be raised by a unit or a developer in a SEZ including FTWZ for purchase of non- capital and capital goods within an SEZ including FTWZ or from a different SEZ including FTWZ subject to compliance with parameters given at paragraph 14 above. Further, an entity in DTA is also allowed to raise TC for purchase of capital / non-capital goods from a unit or a developer of a SEZ including FTWZ.

TC transactions in respect of SEZs and DTAs as permitted above should also be in compliance with applicable provisions of SEZ Act, 2005 as amended from time to time. For TC transactions related to SEZ, date of transfer of ownership of goods will be treated as TC date. As there will be no bill of entry for sale transactions within SEZ, the inter unit receipt generated through NSDL can be treated as an import

### 6.3.12.Security for Trade Credit:

The provisions regarding security for raising TC are as under:

Bank guarantees may be given by the ADs, on behalf of the importer, in favour of overseas lender of TC not exceeding the amount of TC. Period of such guarantee cannot be beyond the maximum permissible period for TC. TC may also be secured by overseas guarantee issued by foreign banks/overseas branches of Indian banks. Issuance of such guarantees i.e. guarantees by Indian banks and their branches/subsidiaries located outside India.

For the purpose of raising TC, the importer may also offer security of movable assets (including financial assets)/ immovable assets (excluding land in SEZs) / corporate or personal guarantee for raising trade credit. ADs may permit creation of charge on security offered / accept corporate or personal guarantee, duly ensuring that:

i. there exists a security clause in the loan agreement requiring the importer to create charge, in favour of overseas lender / security trustee on immovable assets / movable assets / financial securities/ issuance of corporate and/ or personal guarantee;

ii. No objection certificate, wherever necessary, from the existing lenders in India has been obtained;

iii. such arrangement is co-terminus with underlying TC;

iv. In case of invocation, the total payments towards guarantee should not exceed the dues towards trade credit; and

v. Creation/ enforcement / invocation of charge shall be as per the provisions contained in Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018 and Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017, as amended from time to time, or any other relative Regulations framed under the Foreign Exchange Management Act, 1999 and should also comply with applicable FDI/FII/SEZ policy/ rules/ guidelines.

**Note:** The directions on issuance of corporate or personal guarantee mentioned under this provision shall come into force from the date of publication, in the Official Gazette, of the relative Regulations issued under FEMA.

### 6.3.13. Reporting requirements

**Monthly reporting:** AD Category I banks are required to furnish details of TCs like drawal, utilisation, and repayment of TC approved by all its branches, in a consolidated statement, during a month, in Form TC to the Director, Division of International Trade and Finance, Department of Economic Policy and Research, each month.

**Quarterly reporting:** AD Category I banks are also required to furnish data on issuance of bank guarantees for TCs by all its branches, in a consolidated statement, at quarterly intervals on the XBRL platform.

**Role of ADs:** ADs are also expected to ensure compliance with applicable parameters of the trade credit policy / provisions of Foreign Exchange Management Act, 1999 by their constituents. As the Reserve Bank has not prescribed any format or manner in which TC arrangements / loan agreements are to be documented, ADs may consider any document to satisfy themselves with the underlying TC arrangement. ADs should ensure that there is no double financing on account of these transactions between a unit or a developer in a SEZ including FTWZ for purchase of non-capital and capital goods within an SEZ including FTWZ or from a different SEZ including FTWZ. ADs should also ensure that for import of non-capital goods, the period of TC, as applicable, is lower of operating cycle or one year.

### 6.3.14. Non-resident guarantee for domestic fund based and non-fund based facilities

Borrowing and lending in Indian Rupees between two residents does not attract any provisions of the Foreign Exchange Management Act, 1999. In cases where a Rupee facility which is either fund based or non-fund based (such as letter of credit/ guarantee / letter of undertaking / letter of comfort) or is in the form of derivative contract by residents that are subsidiaries of multinational companies, is guaranteed by a non-resident (non-resident group entity in case of derivative contracts), there is no transaction involving foreign exchange until the guarantee is invoked and the non-resident guarantor is required to meet the liability under the guarantee.

### 6.3.15. Facility of Credit Enhancement

The facility of credit enhancement by eligible non- resident entities (viz. Multilateral financial institutions (such as, IFC, ADB, etc.) / regional financial institutions and Government owned (either wholly or partially) financial institutions, direct/ indirect equity holder) to domestic debt raised through issue of capital market instruments, such as Rupee denominated bonds and debentures, is available to all borrowers eligible to raise ECB under automatic route subject to the certain conditions.

# Liberalized Remittance Scheme (LRS) – Master Directions

# 6.4

Under the Liberalised Remittance Scheme, all resident individuals, including minors, are allowed to freely remit up to USD 2,50,000 per financial year (April – March) for any permissible current or capital account transaction or a combination of both. The Scheme was introduced on February 4, 2004, with a limit of USD 25,000. The LRS limit has been revised in stages consistent with prevailing macro and micro economic conditions. The Scheme is not available to corporates, partnership firms, HUF, Trusts etc.

### 6.4.1. Prohibited items under the Scheme

i. Remittance for any purpose specifically prohibited under Schedule-I (like purchase of lottery tickets/sweep stakes, proscribed magazines, etc.) or any item restricted under Schedule II of Foreign Exchange Management (Current Account Transactions) Rules, 2000.

ii. Remittance from India for margins or margin calls to overseas exchanges / overseas counterparty.

iii. Remittances for purchase of FCCBs issued by Indian companies in the overseas secondary market.

iv. Remittance for trading in foreign exchange abroad.

v. Capital account remittances, directly or indirectly, to countries identified by the Financial Action Task Force (FATF) as "non- cooperative countries and territories", from time to time.

vi. Remittances directly or indirectly to those individuals and entities identified as posing significant risk of committing acts of terrorism as advised separately by the Reserve Bank to the banks.

### 6.4.2. Facility to resident individual

Individuals can avail foreign exchange facility for the following purposes within the LRS limit of USD 2,50,000 on financial year basis:

i. Private visits to any country (except Nepal and Bhutan)

ii. Gift or donation Going abroad for employment

iii. Emigration

iv. Maintenance of close relatives abroad

v. Travel for business, or attending a conference or specialised training or for meeting expenses for meeting medical expenses, or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/ check-up

vi. Expenses in connection with medical treatment abroad

vii. Studies abroad

viii. Any other current account transaction which is not covered under the definition of current account in FEMA 1999.

The AD bank may undertake the remittance transaction without RBI's permission for all residual current account

transactions which are not prohibited/ restricted transactions under Schedule I, II or III of FEM (CAT) Rules, 2000, as amended or are defined in FEMA 1999. It is for the AD to satisfy themselves about the genuineness of the transaction, as hitherto.

LRS does not envisage extension of fund and non-fund based facilities by the AD banks to their resident individual customers to facilitate remittances for capital account transactions under LRS.

However, AD banks may extend fund and non-fund based facilities to resident individuals to facilitate current account remittances under the Scheme.

### 6.4.3. Consolidation of remittances under the LRS facility be in respect of family members

Remittances under the facility can be consolidated in respect of close family members subject to the individual family members complying with the terms and conditions of the Scheme. However, clubbing is not permitted by other family members for capital account transactions such as opening a bank account/investment/purchase of property, if they are not the co-owners/co-partners of the investment/property/overseas bank account. Further, a resident cannot gift to another resident, in foreign currency, for the credit of the latter's foreign currency account held abroad under LRS.

There are no restrictions on the frequency of remittances under LRS. However, the total amount of foreign exchange purchased from or remitted through, all sources in India during a financial year should be within the cumulative limit of USD 2,50,000.

Once a remittance is made for an amount up to USD 2,50,000 during the financial year, a resident individual would not be eligible to make any further remittances under this scheme, even if the proceeds of the investments have been brought back into the country.

Resident individuals (but not permanently resident in India) who have remitted their entire earnings and salary and wish to further remit 'other income' may approach RBI with documents through their AD bank for consideration.

Remittances directly or indirectly to countries identified by the Financial Action Task Force (FATF) as "non-cooperative countries and territories", from time to time; and remittances directly or indirectly to those individuals and entities identified as posing significant risk of committing acts of terrorism as advised separately by the Reserve Bank to the banks are not permissible.

### 6.4.4. Requirements to be complied with by the remitter

The individual will have to designate a branch of an AD through which all the capital account remittances under the Scheme will be made. The applicants should have maintained the bank account with the bank for a minimum period of one year prior to the remittance.

For remittances pertaining to permissible capital account transactions, Authorised Dealers should carry out due diligence on the opening, operation and maintenance of the account. Further, the AD should satisfy themselves regarding the source of funds.

The remittances can be made in any freely convertible foreign currency.

A. Banks including those not having operational presence in India are required to obtain prior approval from Reserve Bank for soliciting deposits for their foreign/overseas branches or for acting as agents for overseas mutual funds or any other foreign financial services company

### 6.4.5. Rating of debts

No ratings or guidelines have been prescribed under LRS of USD 2,50,000 on the quality of the investment an individual can make. However, the individual investor is expected to exercise due diligence while taking a decision regarding the investments which he or she proposes to make.

### 6.4.6. Remittance by sole proprietor under LRS

In a sole proprietorship business, there is no legal distinction between the individual / owner and as such the owner of the business can remit USD up to the permissible limit under LRS. If a sole proprietorship firm intends

to remit the money under LRS by debiting its current account then the eligibility of the proprietor in his individual capacity has to be reckoned. Hence, if an individual in his own capacity remits USD 250,000 in a financial year under LRS, he cannot remit another USD 250,000 in the capacity of owner of the sole proprietorship business as there is no legal distinction.

The following facilities are available to persons other than individuals:

a. Donations up-to one per cent of their foreign exchange earnings during the previous three financial years or USD 5,000,000, whichever is less, for- (a) creation of Chairs in reputed educational institutes, (b) contribution to funds (not being an investment fund) promoted by educational institutes; and (c) contribution to a technical institution or body or association in the field of activity of the donor Company.

b. Commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India up to USD 25,000 or five percent of the inward remittance whichever is less.

c. Remittances up to USD 10,000,000 per project for any consultancy services in respect of infrastructure projects and USD 1,000,000 per project, for other consultancy services procured from outside India.

d. Remittances up to five per cent of investment brought into India or USD 100,000 whichever is less, by an entity in India by way of reimbursement of pre-incorporation expenses.

e. Remittances up to USD 250,000 per financial year for purposes stipulated under Para 1 of Schedule III to FEM (CAT) Amendment Rules, 2015. However, all residual current account transactions undertaken by such entities are otherwise permissible without any specified limit and are to be disposed off at the level of AD, as hitherto. It is for the AD to satisfy themselves about the genuineness of the transaction.

Anything in excess of above limits requires prior approval of the Reserve Bank of India.

A resident individual is permitted to make a rupee loan to a NRI/PIO who is a close relative of the resident individual ('relative' as defined in Section 2(77) of the Companies Act, 2013) by way of crossed cheque/ electronic transfer subject to the following conditions:

(i) The loan is free of interest and the minimum maturity of the loan is one year.

(ii) The loan amount should be within the overall LRS limit of USD 2,50,000, per financial year, available to the resident individual. It would be the responsibility of the lender to ensure that the amount of loan is within the LRS limit of USD 2,50,000 during the financial year.

(iii) The loan shall be utilised for meeting the borrower's personal requirements or for his own business purposes in India.

(iv) The loan shall not be utilised, either singly or in association with other person, for any of the activities in which investment by persons resident outside India is prohibited.

(v) The loan amount should be credited to the NRO A/c of the NRI /PIO. Credit of such loan amount may be treated as an eligible credit to NRO A/c.

(vi) The loan amount shall not be remitted outside India.

(vii)Repayment of loan shall be made by way of inward remittances through normal banking channels

A resident individual can make a rupee gift to a NRI/PIO who is a close relative of the resident individual.The gift amount would be within the overall limit of USD 250,000 per financial year as permitted under the LRS for a resident individual. It would be the responsibility of the resident donor to ensure that the gift amount being remitted is under the LRS and all the remittances made by the donor during the financial year including the gift amount have not exceeded the limit prescribed under the LRS.

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. Automatic route in FDI means.
   a) Prior permission of RBI not required
   b) Prior permission of Central Govt. not required
   c) Prior permission of neither RBI nor Central Govt.is required
   d) None of the above
2. For investment in market securities, FIIs are to be registered with:
   a) Ministry of Corporate Affairs
   b) RBI
   c) SEBI
   d) none of the above
3. DPIIT comes under :
   a) Industry and Commerce
   b) Finance
   c) Corporate affairs
   d) none of the above.
4. Sale of shares from a resident to non resident is:
   a) current account transaction
   b) capital account transaction
   c) any of the above
   d) None of the above.
5. FDI is prohibited in the which of the following sectors:
   a) Lottery Business including Government/ private lottery, online lotteries.
   b) Gambling and betting including casinos.
   c) Chit funds
   d) All of the above.
6. Individuals can avail of foreign exchange facility for the following purposes within the LRS limit on financial year basis for the following:
   a) Private visits to any country (except Nepal and Bhutan)
   b) Gift or donation Going abroad for employment
   c) Emigration
   d) all of the above
7. Eligible borrower can raise up to ……..million US$ through ECB in automatic route.
   a) 500
   b) 750
   c) 1000
   d) 1250

8. Total maximum remittance during a financial year under LRS scheme is:
   a) US $ 1,00,000
   b) US $ 1.25.000
   c) US $ 1,50,000
   d) US $ 2,50,000
9. The following remittance is prohibited.
   a) Remittance for any purpose specifically prohibited under Schedule-I (like purchase of lottery tickets/ sweep stakes, proscribed magazines, etc.) or any item restricted under Schedule II of Foreign Exchange Management (Current Account Transactions) Rules, 2000.
   b) Remittance from India for margins or margin calls to overseas exchanges/overseas counterparty.
   c) Remittances for purchase of FCCBs issued by Indian companies in the overseas secondary market.
   d) All of the above
10. Zenith Ltd. is accompany registered in UK, issues shares to citizen of UK. Under the Indian law, the shares are;
   a) foreign security
   b) Indian security
   c) any of the above
   d) none of the above
11. FEMA……foreign currency transaction.
   a) encourages
   b) prohibits
   c) restricts
   d) none

**Fill in the blanks**

1. FEMA has replaced……
2. Security issued by any foreign entity is a……...security.
3. A resident Indian purchasing a house in London is a……account transaction.
4. FEMA is regulated by……
5. WOS stands for……..
6. In case of FEMA, Master directors are issued by…….
7. Any foreign exchange transaction which is not categorized as capital accounts is a…… account transaction.
8. In Case of FCCB, the bond is converted into equity shares of the……..company.
9. FPI stands for……
10. RFC account denotes……

**Short Essay Type Questions**

1. Differentiate between current account and capital account transaction.
2. Discuss in brief foreign direct investment
3. Write a note on authorised dealer.

**Essay Type Questions**

1. Differentiate between:
   (i) Foreign security and Indian security
   (ii) Automatic route and Govt. route in FDI
2. Discuss provisions for parking of ECB till cattail utilisation.
3. What is the vote of authorised dealers in case of trade credits?
4. What are the remittances which are prohibited?
5. Discuss few important stipulation of liberalised Remittance Scheme.

**Case Study (Solved)**

Modern Technologies, an unlisted Indian company, having a capital of Rs. 23 crores are negotiating with foreign investor for 20 % stake in the company by issue of fresh shares at a price to be negotiated. The Company is in high tech area where there no limit on foreign investment. You are the CFO of the company. Please prepare a note for directors, whether the issue is possible and if so, the steps to be taken.

**Solution**

Note for Directors.

Our Company, Modern Technologies, is an unlisted company and SEBI regulations do not apply. However, Company has to comply with FEMA regulations.

As per present FDI regulation, no Govt. approval is required. Neither one requires prior approval of RBI.

2. The investment is within limit. Once the remittance is received, RBI has to be given intimation.
3. The shares certificates have to be issued in dematerialised mode. There is no restriction on repatriation of dividend, subject to tax, as per Indian laws.
4. The shares shall have same voting and other rights.

## Answers

**Multiple Choice Questions (MCQs)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|---|---|---|---|---|---|---|---|---|---|
| c | c | a | b | d | d | b | d | d | d | c |

**Fill in the blanks**

| | | | |
|---|---|---|---|
| 1 | FERA | 2 | Foreign |
| 3 | capital | 4 | RBI |
| 5 | Wholly owned subsidiary | 6 | RBI |
| 7 | current | 8 | Indian |
| 9 | Foreign Portfolio Investment | 10 | Resident Foreign Currency Account |

# Laws and Regulations Related to Banking Sector

7

**This Module Includes:**


**7.1 The Banking Regulation Act, 1949**

**7.2 Role of Reserve Bank of India**

**7.3 The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002**

# Laws and Regulations Related to Banking Sector

**SLOB Mapped against the Module**

To obtain an overview of multiple specialised laws and regulations governing banking sectors in India.

**Module Learning Objectives:**

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

- Understand function of banks under the Banking Regulation Act;
- The role of RBI in supervision and control of other banks;

# The Banking Regulation Act, 1949

# 7.1

## 7.1.1. Overview

Parliament has the power to legislate on banking through entry 45 of Union List. 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. There are two other legislations which effect banking regulations.

The Act gives the Reserve Bank of India (RBI) the 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.

The important provisions under Banking Regulation Act, 1949 are as follows:

## 7.1.2. Forms of business in which banking companies may engage [Section 6]

'Banking' means accepting, for the purpose of landing and investment of deposit of money from the parties, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise.

This section provides that a Banking Company may engage in addition to the business of banking, a list of activities as detailed below:

Banking company means any company which transacts the business of banking.

(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

### 7.1.3. Board of Directors to include persons with professional and other experience

Every company to ensure 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. They may 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.

Directors shall not face any conflict of interest with any connected parties. RBI may order for reconstitution of Board of any bank. Removal of any director is appealable to Central Govt. shall fill up vacancies , if any, in nay bank, omits own. There shall be not be nay common director in banks.

### 7.1.4. 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. Where chairman is appointed on part time basis, management of whole affairs shall be entrusted to MD, both to be appointed with RBI approval. Such approval shall be for 5 years tenure at a time.

### 7.1.5. 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 5 years.

### 7.1.6. Requirements regarding minimum paid up capital and reserves [Sections 11 & 12]

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 not exceeding two years or as per RBI guidelines from the date of increase. The shares can be equity or preference.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 more than 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.

### 7.1.7. 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.

Banking Company may pay dividend, 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.

### 7.1.8. 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 unless specific exemption is made by Central Govt. on recommendation of RBI.

Any appropriation of reserves shall have to be intimated to RBI within 21 days with reasons.

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.

### 7.1.9. 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 and shall report within 20th of each month.

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.

### 7.1.10. Restrictions on nature of 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 any activities by acquiring a controlling interest in any 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.

### 7.1.11. 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.

### 7.1.12. Licensing of banking companies [Section 22]

a) 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 may, within thirty appeal to the Central Government where 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. 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.

### 7.1.13. Control on the opening of new business [Section 23]

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 1 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.

### 7.1.14. 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 such percentage not exceeding 40% of the total of its time and demand liabilities as on the last Friday of the second proceeding fortnight as the Reserve Bank of India may, by notification in the official gazette, specify from time to time and such assets shall be maintained, as may be specified in such notification. The liquid assets include cash, gold or unencumbered approved securities and they are valued at a price not exceeding the current market price.

### 7.1.15. 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.

### 7.1.16. 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).

### 7.1.17. Submission of Return, Forms, etc., to RBI [Section 27]

Under this section, every banking company shall before the close of the month succeeding that to which it relates,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,

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.

### 7.1.18. Audit of the Balance Sheet and Profit & Loss Account [Section 30]

Annual accounts of the banking company shall be prepared on as per the format and shall be audited. Under this section RBI is entrusted with wide powers to cause an inspection of any banking company and its books and accounts. Every banking company shall, before appointing, re-appointing or removing any auditor or auditors, obtain the previous approval of the Reserve Bank. The accounts and balance sheet together with the auditor's report shall be published in the prescribe manner and three copies thereof shall be furnished to the Reserve Bank within three months from the end of the period to which it refer.

### 7.1.19. 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.

### 7.1.20. Power of Central Government

The Central Government may, by order, authorise the Reserve Bank to issue directions to any banking company or banking companies to initiate insolvency resolution process in respect of a default, under the provisions of the Insolvency and Bankruptcy Code, 2016 (31 of 2016).

### 7.1.21. Power of RBI

**1) Power to issue direction in respect of stressed assets (35AB)**

RBI may issue direction to bank for resolution of stressed assets and may from authorities/committees for the same.

**2) 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 maximum permissible number of directors or appointment, re-appointment, remuneration and removal of the chairman or a director of a banking company and also for the amendments of provisions in the Memorandum or Articles or Resolutions of a General Meeting or Board of Directors.

**3) 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.

**4) Suspension of Board of Directors in certain cases.**

RBI/Central Government may in consultation of RBI on satisfaction 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) 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.

### 7.1.22. 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. Notwithstanding anything contained in the Companies Act, the High Court shall order for the winding up of the banking company , if it is not able to pay its debt or an application has been made by the RBI under section 37 or 38 of this act. 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.

### 7.1.23. Power of CG to acquire a banking business.

CG may acquire a banking company by compulsorily transferring shares or otherwise.

### 7.1.24. 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 in value of the shareholders of each of the said companies, present either in person or by proxy called for the purpose..

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.

As per the amendment in October, 2020, RBI may initiate a scheme for reconstruction and amalgamation without imposing moratorium.

# Role of Reserve Bank of India

# 7.2

Since its inception Reserve Bank has been playing key role in the formulation of monetary, banking and financial policies. To facilitate the transition process and in order to effectively perform its varying roles in the changing banking scenario, from 'regulator' to 'facilitator' over the period, Department has undergone various organizational changes and so also in its activities, approach and functioning.

**(i) Inspection of banks**

Reserve Bank of India has been empowered under Banking Regulation Act, 1949 to conduct the inspection of banks and regulate them in the interest of banking system, banking policy and depositors/public.

**(ii) Regulatory role of commercial banks**

Department of Banking Operations and Development exercises regulatory powers in respect of commercial banks and Local Area Banks (LABs).The Department of Banking Operations and Development is entrusted with the responsibility of regulation of commercial banks and LABs under the regulatory provisions contained in the Banking Regulation Act, 1949 and the Reserve Bank of India Act, 1934 and other related statutes besides enunciation of banking polices. It's functions broadly relate to prescription of regulations for compliance with various provisions of Banking Regulation Act on establishment of banks such as licensing and branch expansion, maintenance of statutory liquidity reserves, management and operations, amalgamation, reconstruction and liquidation of banking companies.

**(iii) Anti - money laundering under PMLA**

RBI has a role in PMLA by creating an anti money laundering Cell(AML Cell) for combating Financing of Terrorism (CFT) and tracking domestic and global developments in AML and CFT.

**(iv) Approval/ monitoring of Board level appointments of commercial banks.**

The key activity of the section, appropriately named as Appointments Section, relate

- Approval of proposals from the domestic private sector banks for appointment/ removal of part-time Chairman/Managing Director/ whole-time Chairman and Chief Executive Officers. Ensuring compliance with the provisions of the Banking Regulation Act, 1949 with regard to the composition of the Board of Directors of commercial banks in the private sector.
- Making recommendations to Government regarding appointment of Executive Directors/Chairmen & Managing Directors of public sector banks, fixation of their salaries, payment of superannuation benefits and other allied matters.
- Making recommendations to Government regarding appointment of non-official directors, non-workmen directors and RBI Nominee Directors on the Boards of Nationalised banks.

**(v) licensing of branches**

(a) issue of authorisations to Indian commercial banks including Local Area Banks for opening of branches in pursuance to regulatory powers vested with Reserve Bank under the provisions of Banking Regulation Act, 1949.

(b) To consider representations/complaints from institutions/VIPs and members of public for opening /shifting/

closure of bank offices.

(c) Review of branch licensing policy periodically

(d) Maintenance and updation of database on opening/substitution/closure/shifting of branches, Extension Counters, ATMs, etc.

**(vi) Banking policy**

It undertakes various new policy initiatives and reviews existing guidelines for progressive upgradation of prudential norms to move towards best practices. The major activities of the Section are as follows:

- Formulation of policy and issue of prudential guidelines pertaining to Capital adequacy; Income recognition; asset classification and provisioning pertaining to advances portfolio; Classification, valuation and operation of investment portfolio; and Credit exposure limits
- Formulation of policy and issues regarding capital structure of public sector banks, including raising of fresh equity, return of capital, recapitalisation.
- Formulation of policy and issuance of regulatory guidelines for implementation of the Basel II framework.
- Policy guidelines / clarifications on integrated risk management systems including Asset Liability Management and issue of guidance notes on various aspects.
- Policy issues/ guidelines pertaining to compromise settlement of NPAs of banks.
- Matters regarding Foreign Contributions Regulations Act – donations received by organizations from abroad..

**(vii)Issue of directives to banks**

Various directions are issued by RBI from time to time, on payment of Interest rates on various types of deposit accounts (including NRI deposit), maintenance of deposit accounts, prohibitions in respect of S.B. Accounts, matters relating to payment of additional interest and brokerage on deposits, appointment of agents for soliciting deposits, giving gifts/incentives to depositors/staff members, freezing of accounts, Resurgent India Bonds, Development Bonds, etc. RBI may also direct Capital Market Exposure of banks.

**(viii)Collection and dissemination of information**

Collection and dissemination of information from/to banks and notified All-India financial institutions (FIs) regarding defaulting borrowers with outstanding aggregating ₹1 crore and above, which have been classified by them as 'doubtful' or 'loss' (non-suit filed accounts) on half-yearly basis viz., as on March 31 and September 30.

**(ix)Overseeing/ monitoring Indian banks operations abroad**

- Policy formulation and issue of guidelines regarding overseas operations of Indian banks, examination of proposals and grant of approvals for opening their Joint Ventures / Representative Offices / branches and review of their overseas operations including closure of branches / joint ventures / representative offices.
- Approval of Indian banks' proposals for entering into Management Agreements and correspondent banking arrangements with foreign entities.
- Preparation of proposals for submission before IDC of GOI regarding opening of branches / representatives offices of Indian banks abroad.

**(x) Authorisation for dealing in precious metals**

Policy matters relating to Gold Deposit and Gold Import Schemes and dealing with references received from banks in this regard, issue and renewal of authorization for banks for import of gold / silver / platinum and acceptance of gold under Gold Deposit Scheme and collection of data relating to import of gold and Gold Deposit Scheme and collection of data relating to import of gold and gold deposits by banks in India.

**(xi) Overseeing and monitoring offshore banking units**

- Approvals for setting up of Offshore Banking Units (OBUs) and issue of policy guidelines for the operation

of OBUs in Special Economic Zones (SEZs).

- Correspondence with Government and other agencies relating to setting up of Special Economic Zones, International Financial Services Centres.

**(xii) Monitoring and policy making industrial and export credit**

The industrial credit segment has been considerably liberalized / deregulated over the period. At present, various items of work currently undertaken by IECS are distributed amongst three desks viz. (i) Policy Desk (ii) Export Credit Desk and (iii) Industrial Rehabilitation Desk.

**(xiii)Interpretation of regulations**

- RBI is involved in interpretation of the various provisions of the Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, etc. Examining and framing of rules/regulations and amendments thereto.

**(xiv) Granting exemptions**

- Dealing with applications received from banks for exemptions from the various provisions of the Banking Regulation Act, 1949, and Rules framed thereunder.

**(xv) Role in management of foreign exchange.:**

a) Controlling dealings in foreign exchange by giving general or special permission for dealing in foreign exchange, excluding those cases where specific provisions have been made in Act, Rules or Regulations.

b) RBI cannot impose any restrictions on current account transactions. These can be imposed only by Central Government in consultation with RB. In certain cases, prior approval of RBI is required for current account transactions as provided in Foreign Exchange Management (Current Account Transactions) Rules, 2000.

c) Specifying conditions for payment in respect of capital account transaction – Section 6(2).

d) Regulate/prohibit/restrict the following, by issuing Regulations:

- Transfer or issue of foreign security to resident and Indian security to non-resident;
- Borrowing and lending in foreign exchange or to a foreign person;
- Export/import of currency or currency notes;
- Transfer of immovable property outside India;
- Giving guarantee or surety where foreign exchange transaction is involved – Section 6(3)

e) Specify (by regulation) period and manner in which foreign exchange due from export of goods and services should be received – Section 8.

f) To grant exemption from realisation and repatriation in cases specified under Section 9.

g) Granting authorisation to 'Authorised Person' to deal in foreign exchange, to give directions to them and to inspect the authorised person – Sections 10, 11 & 12.

This post was last modified on June 25, 2021 12:38 pm

**(xvi)Bankers bank**

It extends loans and advances to commercial banks.

**(xvii)Bankers to Central Govt./State Govt.**

RBI is the banker to Central/ State Govt. where it also extends loan and keeps account. It also issues bonds on behalf of the Govt.

**(xviii)Oversee payment and settlement system**

RBI oversees payment and settlement system of commercial banks.

# The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

# 7.3

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.

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.

**Important Definitions**

**Asset Reconstruction**

"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**

"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**

"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**

(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**

"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**

"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 buyer**

"Qualified institutional buyer" means a financial institution, insurance company, bank, state financial corporation,state industrial development corporation, trustee or asset reconstruction 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.

**Securitisation**

"Securitisation" means acquisition of financial assets by any asset reconstruction company from any originator, whether by raising of funds by such asset reconstruction company from qualified buyers by issue of security receipts representing undivided interest in such financial assets or otherwise.

### 7.3.1. Registration of Asset 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 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 asset reconstruction companies.

(a) The requirement for registration of AMC is as under-

(1) that the asset reconstruction company has not incurred losses in any of the three preceding financial years.

(2) that such asset 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 asset reconstruction company have adequate professional experience in matters related to finance, securitisation and reconstruction.

(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 the asset reconstruction company has complied with or is in a position to comply with prudential norms specified by the Reserve Bank.

(8) that the asset reconstruction company has complied with one or more conditions specified in the guidelines issued by the Reserve Bank for the said purpose.

(b) RBI may impose restrictions/conditions as deemed fit.

Reserve Bank approval is further required for-

(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 an asset 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.

### 7.3.2. 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 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.

### 7.3.3. 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 asset 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.

### 7.3.4. Measures for assets reconstruction (Section 9)

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.

### 7.3.5. Other functions of asset reconstruction company (Section 10)

Any asset 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 asset 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 asset 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 an asset 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. RBI may call for information, carry out audit and inspection of ARCs. RBI may determine policy and issue directions to ARCs.

### 7.3.6. 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 asset 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.

### 7.3.7. Enforcement of security interest (Section 13)

(a) 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 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. 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.

(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, to bid for the immovable property on behalf of the secured creditor at any subsequent sale.

(2) Where the secured creditor, 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.

(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 60% 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 may retain the sale proceeds of his secured assets after depositing the workmen's dues with the liquidator .

(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.

### 7.3.8. 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 an asset reconstruction company 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 is taken over by the secured creditor, then, the shareholders shall not nominate or appoint any person to be director of the company unless approved by secured creditor

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.

### 7.3.9. No compensation to directors for loss of office (Section 16)

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.

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).

### 7.3.10. 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.

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.

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. NPA stands for:
   a) Non Productive asset
   b) Non Performance Asset
   c) National Productivity asset
   d) none of the above
2. Banking Regulation Act was enacted in the year:
   a) 1940
   b) 1942
   c) 1947
   d) 1949
3. Cash reserve ratio should be ……percent of the total time and demand liabilities
   a) 1
   b) 2
   c) 3
   d) 4
4. SLR stands for:
   a) Special Liquidity Ratio
   b) Statutory Liquidity Reserve
   c) Special Liquidity Reserve
   d) None of the above
5. Banking companies cannot pay dividend unless following are completely written off.
   a) preliminary expenses
   b) brokerage
   c) commission
   d) all of the above
6. Asset Reconstruction Companies are to be registered with:
   a) SEBI
   b) RBI
   c) MCA
   d) none of the above

7. The judicial authority under SARFESI is:
   a) SEBI
   b) RBI
   c) DRT
   d) MCA
8. Amalgamation of banking companies require..…... % voting of shareholders;
   a) 3/4th
   b) One half
   c) two third
   d) One fourth
9. Every banking company shall maintain liquid assets not less than …….% of the total time and demand liabilities.
   a) 5
   b) 10
   c) 20
   d) 25
10. Every Banking Company incorporated in India shall prepare a balance sheet and profit and loss account as on the last working day of the -
    a) Calendar Year
    b) Accounting Year
    c) Month
    d) None of the above
11. According to Banking Regulation Act 1949, no Banking Company shall pay dividend on its shares until all its -
    a) Depreciation is fully written off.
    b) "Capitalized expenses" have been completely written off
    c) Bad debts are provided in full.
    d) Contingent liability is settled.

**State True or False**

1. NBFCs come under Banking Regulation Act.
2. RBI approval is required for appointment of MD of a bank.
3. Banking companies cannot pay dividend unless it has written off capitalized expenses.

4. RIBI can cancel banking license without any notice
5. Maintenance of cash reserve ratio by non scheduled bank do not come under the preview of Banking Regulation Act.

**Fill in the blanks**

1. Banks can operate only with a licence by……
2. From January 2019, banks are supposed to comply with Basel…….norms.
3. SLR stands for……..
4. ……..can acquire shares of any bank in public interest
5. LAB stands for……
6. OBU stands for ……
7. …….. may acquire a banking company by compulsorily transferring shares or otherwise.
8. There is CBT cell in RBI. Here, CBT stands for……

**Short Essay Type Questions**

1. Discuss role of RBI in licencing of banks.
2. Discuss provisions relating to cash reserve ratio for banks
3. List out 5 major functions of RBI

**Essay Type Questions**

1. Discuss the object of Banking Regulation Act.
2. Discuss the role of RBI in licencing of commercial banks.
3. Discuss the procedure of appointment and removal of Directors of Banks
4. Explain how RBI controls the monetary system .
5. What is purpose of SARFESI Act?
6. Discus in brief, the functions of Asset Reconstruction company (ARC)

**Case Study (Solved)**

Mr. Krishnamurthy, a CA is now the CFO of large bank which is also a listed company. Mr. Aditya Kapoor, who was in the bank as MD since inception is retiring and the bank has to look for a M. The chairman of the bank is a retired IAS officer. The nomination and remuneration committee has considered few persons and feel that Mr. Krishnamurthy is the right candidate to take over as MD.

Discuss the steps to be taken tp appoint him, under the provisions of Companies Act and Banking Regulation Act.

**Solution**

Appointment managerial person has to be done n the basis of recommendation of the Nomination and Remuneration Committee of the Board of directors. Based on the recommendation, The Board should appoint the Manning Director, subject to approval in ensuing General meeting of the shareholders.

However, in case of baking company, apart from Companies Act, the provisions of Banking Regulation Act would also apply. Section 10B of the Act requires that the MD of Bank shall be appointed with prior approval of RBI. Therefore, RBI approval has to be taken.

## Answer

**Multiple Choice Questions (MCQs)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|---|---|---|---|---|---|---|---|---|---|
| b | d | d | b | d | b | c | c | d | b | b |

**State True or False**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| F | T | T | F | F |

**Fill in the blanks**

| | | | |
|---|---|---|---|
| 1 | RBI | 2 | III |
| 3 | Statutory liquidity ratio | 4 | Central Govt. |
| 5 | Local area banks | 6 | Offshore Banking Units |
| 7 | Central Govt | 8 | combating Finance for Terrorism |

# Laws and Regulations Related to Insurance Sector

8

**This Module Includes:**


**8.1 The Insurance Act, 1938**

**8.2 The Insurance Regulatory and Development Authority Act, 1999**

# Laws and Regulations Related to Insurance Sector

**SLOB Mapped against the Module**

To obtain an overview of multiple specialised laws and regulations governing insurance sectors in India.

**Module Learning Objectives:**

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

- Understanding the concept and principles of insurance;
- Being in Finance, insurance will be very important area of work; the module will make the student understand the importance of insurance.

# The Insurance Act, 1938

# 8.1

### 8.1.1. The Concept of Insurance Law

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. The situation 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.

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.

### 8.1.2. FDI in Insurance Sector in India

Based on the report of Malhotra Committee, 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.

India is poised to emerge as one of the fastest growing insurance markets in the world. While presently the Indian insurance market is the 10th (tenth) largest in the world, it is poised to become the 6th (sixth) largest by 2032. Up to 26% FDI is permitted through the automatic approval route. For FDI up to 49%, the approval of the Central Government is required. 100% FDI is permitted in insurance intermediaries, including insurance brokers, reinsurance brokers, insurance consultants, etc.

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.

### 8.1.3. Basic Principles on which laws of insurance are based are as follows:

**Principle of 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].

**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 willful 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 willful; (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.

**Warranties**

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.

**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.

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. 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].

**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. The happening of the event is neither in the control of the event the insurance company or the indemnified. 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.

**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 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.

**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).

**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 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.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 one, then the liability would be covered only from the time when it was issued.

### 8.1.4. Few important definitions

**(a) Authority:** 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.

**(b) Policy Holder:** "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.

**(c) Banking Company:** "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).

**(d) Controller of Insurance:** "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.

**(e) Court:** "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.

**(f) General Insurance Business:** "General insurance business" means fine, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them.

**(g) Health Insurance Business:** "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.

**(h) Government Security:** "Government Security" means a Government Security as defined in the Public Debt Act 1944 (18 of 1944).

**(i) 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 or 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.

(j) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business or health insurance business.

(k) **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.

**(l) 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.

**(m) Investment Company:** Section 2 (10A): "Investment Company" means a company whose principal business is the acquisition of shares, stocks, debentures or other securities.

**(n) 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.

**(o) 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.

**(p) "fire insurance business"** means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance policies;

**(q) "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

**(r) "marine insurance business"** means the business of effecting contracts of insurance upon vessels of any description, including cargoes, freights and other interests which may be legally insured, in or in relation to such vessels, cargoes and freights, goods, wares, merchandise and property of whatever description insured for any transit by land or water, or both, and whether or not including warehouse risks or similar risks in addition, or as incidental to such transit, and includes any other risks customarily included among the risks insured against in marine insurance policies;

### 8.1.5. Salient features of the Insurance Act

(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 capital requirement |
|---|---|
| Life or general | ₹ 100 Crores |
| Health | ₹ 100 Crores |
| Reinsurance | ₹ 200 Crores |

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:

No insurer shall be registered unless he has net owned funds of not less than rupees five thousand Crore.

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.

### 8.1.6. Audit of accounts of insurance companies (Section 12) & Submission of returns (Section 15)

The final accounts shall be made out in prescribed format. 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. If the authorities find that nay return is defective or inaccurate, it may call for further information or revised return.

### 8.1.7. 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 and shall cause an abstract of the report of such actuary to made in accordance with the regulations. The Authority may, extent such date. Where it appears that valuation made do not properly indicate the affairs of the company, may require further investigation and valuation.

### 8.1.8. Record of Policies and claims (Section 14)

1) 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.

(2) Every insurer shall, in respect of all business transacted by him, endeavor 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.

### 8.1.9. 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).

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.

### 8.1.10. 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.

### 8.1.11. Obligations of Insurer in respect of insurance business in 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 ₹25 crores. (Section 105B).

### 8.1.12. Power of investigation and inspection by authority (Section 33)

The Authority may, at any time, 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, 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 and the Investigating Officer shall supply to the insurer or intermediary or insurance intermediary. A copy of the report on such inspection. The officers of the insurer shall cooperate with the investigating authorities.

All concerned shall cooperate with the Investigating agency. 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.

### 8.1.13. 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.

### 8.1.14. 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. 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: 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.

No insurer shall 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 which means any scheme or programme or arrangement or plan 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.

No insurance agent or intermediary or insurance intermediary shall be eligible to be or remain a director in insurance company without permission of the Authority.

### 8.1.15. 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 3 years from the date of the policy 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 or 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.

### 8.1.16. 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.

### 8.1.17. Valuation of assets and liabilities (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.

### 8.1.18. 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.

# The Insurance Regulatory and Development Authority Act, 1999

# 8.2

### 8.2.1. Establishment of IRDA

The Insurance Regulatory and Development Authority (IRDA) was established in the year 1999 by the Indian Government with the following objectives.

(i) to project the interests of holders of insurance policies.

(ii) to regulate, promote and ensure orderly growth of the industry

(iii) matters connected therewith or incidental thereto.

The mission statement of IRDA is as follows:

(i) To protect the interest and secure fair treatment to policyholders;

(ii) To bring about speedy and orderly growth of the insurance sector for the benefit of the common man and provide long term funds;

(iii) To promote. Monitor and enforce high standards of integrity, financial soundness and far dealing by the insurers;

(iv) Take actions where such standards are inadequate or ineffectively enforced;

(v) To ensure speedy settlement of genuine claims, to prevent fraud, malpractice and to put in place grievance redressal machinery;

(vi) Bring about optimum amount of self regulation in day to day working consistent with the regulation,

### 8.2.2. The Functions of Insurance Regulatory and Development Authority

The Functions of Insurance Regulatory and Development Authority are to make policies, regulations, address grievances eh-relationship to the following:

(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 surveyors.

(g) Assistance in gaining correct information about policies.

(h) Creation of management information system.

(i) Promotion of Self regulation within the insurance sector.

(j) Issue of certificate of insurance company registration.

(k) regulation of investment by insurance companies.

(l) Supervising and monitoring insurance companies

### 8.2.3. Constitution of IRDA

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.

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.

### 8.2.4. 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.

### 8.2.5. Duties and powers of IRDA

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.

### 8.2.6. Finance Accounts and Audit

(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.

### 8.2.7. Amalgamation and transfer of insurance business.

No insurance business of an insurer shall be transferred to or amalgamated with the insurance business of any other insurer except in accordance with a scheme prepared under this section and approved by the Authority.

Any scheme prepared under this section shall set out the agreement under which the transfer or amalgamation is proposed to be effected, and shall contain such further provisions as may be necessary for giving effect to the scheme.

for "and certified copies of the following documents shall be furnished to the Central Government and shall"

### 8.2.8. Other matters

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

The Central Government shall constitute the authority, appoint chairperson and other members

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 Authority may by prior notification, establish Insurance Advisory Committee. This Committee consists of twenty- five members (maximum) excluding existing members.

The 'Authority' may by general or special order delegate powers and functions to any of its members or officers or employee.

The Central Government may by notification make rules relating to various administrative matters. The authority shall have power to make regulations.

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.

The Central Government has right to remove any difficulties or impediments by making notification in the Official Gazette within two years from the appointed day.

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. Minimum paid up capital for a life insurance business is ₹…….. Crore
   a) 50
   b) 75
   c) 100
   d) 125
2. Banking Regulation Act was enacted in the year:
   a) 1940
   b) 1942
   c) 1947
   d) 1949
3. Officer appointed by Central Govt. is called:
   a) IRDA
   b) Controller of Insurance
   c) Insurance Commissioner
   d) None of the above.
4. in case of insurance company, ……. % of assets have to be remained invested in Govt. securities.
   a) 10
   b) 15
   c) 20
   d) 25
5. Actuarial valuation on life insurance business has to be done once in .....
   a) 1 year
   b) 2 years
   c) 3 years
   d) 4 years
6. Insurance policy made by an insurer shall not be questioned after ……years.
   a) 1 year
   b) 2 years

c) 3 years

d) 4 years

7. Insurance business is regulated by:

a) SEBI

b) RBI

c) MCA

d) none of the above

8. IRDA was established in the year:

a) 1999

b) 2000

c) 2001

d) 2002

9. No insurer carrying on the business of life insurance and general insurance, shall be registered unless he has minimum paid up capital of_____.

a) 50 crores

b) 200 crores

c) 150 crores

d) 100 crores

10. The Chairman of the Insurance Regulatory and Development Authority shall hold office for a term of from the date on which he enters upon his office and should be eligible for reappointment.

a) 3 years

b) 4 years

c) 5 years

d) 6 years

11. The amount credited to The Insurance Regulatory and Development Authority Fund shall consist of:

a) all Government grants, fees and charges received by the Authority;

b) all sums received by the Authority from such other source as may be decided upon by the Central Government;

c) the percentage of prescribed premium income received from the insurer;

d) all of the above

12. IRDA shall, within _____ after the close of each financial year, submit to the Central Government a report giving a true and full account of its activities including the activities for promotion and development

of the insurance business during the previous financial year.

a) nine months

b) three months

c) one month

d) six months

13. The principle of _____ ensures that an insured does not profit by insuring with multiple insurers.

a) Subrogation

b) Contribution

c) Co-insurance

d) Indemnity

14. An actuary is expected to:

a) Make an exact forecast of the future liabilities of policies

b) Make a reasonable forecast of the future liabilities of policies

c) Calculate the premium required to cover a risk on a long-term basis

d) Find the probability of an insured event to happen in non-life policies

15. The Insurance Laws (Amendment) Act, was passed in the year

a) 2015

b) 2016

c) 2017

d) 2018

16. "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.

d) all the above

17. The amount of indemnity may be limited by certain conditions which may be:
    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) Any or all of the above.
18. In the case of fire and motor accident insurance the insurable interest has to be present
    a) both at the time of taking the policy and at the time of the accident
    b) At the time of taking the policy
    c) At the time of happening of the event
    d) None of the above

**State True or False**

1. One of the principle of insurance is "indemnity and subrogation".
2. Consumer protection Act do not apply to insurance.
3. An insurance agent can sign all documents relating to the policy.
4. Minimum paid up to capital for health insurance company is ₹300 cr.
5. The insurance sector is monitored by IRDA

**Fill in the blanks**

1. Insurance business is regulated by……
2. Insurance of a part of one insurer risk by another insurer is called……..
3. Minimum paid up capital in for life insurance is ₹…….. crores.
4. Policy shall not be questioned on any ground after lapse of……years from the commencement date.
5. Insurance company is the indemnifier where the policy holder is…….
6. The Life Insurance Corporation of India came into existence in the year ……
7. A contract of insurance is a contract 'uberrimea fidei' i.e., a contract of……..
8. The system of insurance of part of one insurer's risk by another Insurer who accepts the risk for a mutually acceptable premium. Is called ……..
9. "Controller of Insurance" is appointed by……
10. No insurer shall be registered unless he has net owned funds of not less than rupees ……..

**Short Essay Type Questions:**

1. List out 5 principles of insurance.
2. Write a short note on IRDA
3. Discuss the concept of insurable interest.

**Essay Type Questions:**

1. Discuss few principles of insurance.
2. What are the restrictions on agency of insurance under the Insurance Act?
3. List out the objects and functions of IRDA.
4. Discus provisions relating to valuation of assets and liabilities of insurance companies.

**Case study (solved)**

Ajit Kumar works as an accountant in a private company. He wants make argument with 3 or 4 insurance companies, both life and non life to get business for them at fixed monthly retaining fees. He has a room in his house where he can have an office. He wants to know where this possible and if so, where and how to get such agency contracts. Advise Ajit Kumar.

**Solution**

The Act provides that 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. Therefore, Ajit Kumar has to first become an insurance agent, If he is employed full time, he cannot be an agent.

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: 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. Ajit Muar has to chose from these options.

Ajit Kumar has to comply with various other restrictions of an agent as per regulation of IRDA and the Act.

**Answer**

**Multiple Choice Questions (MCQs)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|
| c | d | b | d | a | c | d | a |

**State True or False**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| T | F | F | F | T |

**Fill in the blanks**

| | | | |
|---|---|---|---|
| 1 | IRDA | 2 | Reinsurance |
| 3 | 100 | 4 | 3 |
| 5 | Indemnified | 6 | 1956 |
| 7 | utmost good faith | 8 | Re-insurance |
| 9 | Central Government | 10 | five thousand Crore |

# Specific Legal Provisions Related to MSME Sector

9

**This Module Includes:**

**9.1 Definition of MSME**

**9.2 Rights available to MSME, Measures for promotion of MSME under MSMED Act, 2006**

# Specific Legal Provisions Related to MSME Sector

**SLOB Mapped against the Module**

To obtain an overview of special provisions relating to MSME sector.

**Module Learning Objectives:**

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

- Understanding the provisions of MSME Act;
- If the student's woks for an MSME, shall know the facilities available to MSMEs:
- The special recognition and liability towards MSMEs by other companies.

# Definition of MSME

# 9.1

Micro, Small and Medium Enterprises (MSME) sector has now emerged as a highly dynamic sector Apart from providing large employment at comparatively lower capital cost than large industries but also help in industrialization by ordinary people. thereby, reducing regional imbalances, assuring more equitable distribution. MSMEs support large industries as ancillary units.

The primary responsibility of the promotion and development of MSMEs is of the State Governments. However, the Central Government supplements the efforts of State Governments through various initiatives. The role of the Ministry of MSME and its organizations is to assist the States in their efforts to encourage entrepreneurship, employment, and livelihood opportunities and enhance the competitiveness of MSMEs in the changed economic scenario

Most of our textile and handicraft sector is run by artisans, small traders, daily wage earners. They form the basics of rural industrialisation. Khadi and Village Industries (KVI) are two national heritages of India.

The Micro; Small and Medium Enterprises Development (MSMED) Act was notified in 2006 to address policy issues affecting MSMEs as well as the coverage and investment ceiling of the sector. The Act seeks to facilitate the development of these enterprises as also enhance their competitiveness. It provides the first-ever legal framework for recognition of the concept of "enterprise" which comprises both manufacturing and service entities. The Act also provides for a statutory consultative mechanism with a wide range of advisory functions. Establishment of specific funds for the promotion, enhancing competitiveness of these enterprises, notification of schemes/programmes for this purpose, progressive credit policies and practices, preference in Government procurements to products and services of the micro and small enterprises, more effective mechanisms for mitigating the problems of delayed payments to micro and small enterprises and assurance of a scheme for easing the closure of business by these enterprises are some of the other features of the Act.

With 3.6 cr. units, 8 cr. employees, MSME sector is the Second largest employer in India, after agriculture. It contributes to 45% of industrial production, 40% of exports, and constitutes of 37% of GDP and 31% services

**Definition of MSME**

Revised Classification applicable w.e.f 1st July 2020

Composite Criteria: Investment in Plant & Machinery/equipment and Annual Turnover

| Classification | Micro | Small | Medium |
|---|---|---|---|
| Manufacturing Enterprises and Enterprises rendering Services | Investment in Plant and Machinery or Equipment: Not more than ₹1 crore and Annual Turnover; not more than ₹5 crores | Investment in Plant and Machinery or Equipment: Not more than ₹10 crores and Annual Turnover; not more than ₹50 crores | Investment in Plant and Machinery or Equipment: Not more than ₹50 crores and Annual Turnover; not more than ₹250 crores |

**Notes:** calculation of investment in plant and machinery or equipment will be linked to ITR of the previous year, otherwise through self declaration. Here asset of tangible nature shall be a part of plant and machinery, other than land and furniture and fittings.

While calculation of turnover, exports shall be excluded and information shall be linked to Income Tax and GST returns.

In course of doing business, if a MSME unit goes to next category or is out of preview, it shall continue to avail non-tax benefit which it was originally entitled to for the next 3 years of coming to the next category (notification by MSME Dept.-1/11/2013)

# Rights available to MSME, Measures for Promotion of MSME under MSMED Act, 2006

# 9.2

Section 9 of the Act empowers to CG issue notification, guideline, formulate schemes for promotion and development of MSME units with regard to following issues:

i) Enhancing competitiveness

ii) Development of employee skill

iii) Management issues

iv) Technical upgradation

v) Marketing assistance

vi) Infrastructure facility

vii) Cluster development

viii)Strengthening backward and forward linkage

ix) Section 10 further ensures that smooth credit facility shall be available to MSMEs.

Extension of non –tax benefit

### 9.2.1. Separate Ministry

The Ministry of Micro, Small and Medium Enterprises, a branch of the Government of India, is the highest executive body for the formulation of policies and administration of rules, regulations and laws relating to micro, small and medium enterprises in India.

The Ministry of Small Scale Industries and Agro and Rural Industries was created in October 1999. In September 2001, the ministry was split into the Ministry of Small Scale Industries and the Ministry of Agro and Rural Industries. In May 200 they were merged into a single ministry. This Ministry now designs policies and promotes/ facilitates programmes, projects and schemes and monitors their implementation with a view to assisting MSMEs and help them to scale up.

The primary responsibility of promotion and development of MSMEs is of the State Governments. However, the Government of India, supplements the efforts of the State Governments through various initiatives. The role of the Ministry and Central Govt. nodal agencies are to assist the States in their efforts to encourage entrepreneurship, employment and livelihood opportunities.

### 9.2.2. Salient provisions of the Micro, Small and Medium Enterprises Development Act, 2006

This Act is to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto.

**Few important definitions**

(a) "Advisory Committee" means the committee constituted by the Central Government under sub-section (2) of section 7;

(b) "appointed day" means the day following immediately after the expiry of the period of fifteen days from the day of acceptance or the day of deemed acceptance of any goods or any services by a buyer from a supplier.

(c) "the day of acceptance" means,- (i) the day of the actual delivery of goods or the rendering of services; or (ii) where any objection is made in writing by the buyer regarding acceptance of goods or services within fifteen days from the day of the delivery of goods or the rendering of services, the day on which such objection is removed by the supplier;

(d) "the day of deemed acceptance" means, where no objection is made in writing by the buyer regarding acceptance of goods or services within 15 days from the day of the delivery of goods or the rendering of services, the day of the actual delivery of goods or the rendering of services;

(e) "Board" means the National Board for Micro, Small and Medium Enterprises established under section 3;

(f) "buyer" means whoever buys any goods or receives any services from a supplier for consideration;

(g) "enterprise" means an industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner, pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 or engaged in 65 of 1951. providing or rendering of any service or services;

(h) "supplier" means a micro or small enterprise, which has filed a memorandum with the authority referred to in sub-section (1) of section 8 and includes,-

### 9.2.3. National Board for Micro, Small and Medium Enterprises

The Central Government has established, a Board known as the National Board for Micro, Small and Medium Enterprises with head office at Delhi. The Board shall consist of the following members, namely:-

(a) the Minister in charge of the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises who shall be the ex-officio Chairperson of the Board;

(b) the Minister of State or a Deputy Minister, if any, in the Ministry having administrative control of the micro, small and medium enterprises who shall be ex officio Vice-Chairperson of the Board;

(c) six Ministers of the State Governments having administrative control of the departments of small scale industries or, as the case may be, micro, small and medium enterprises, to be appointed by the Central Government to represent such regions of the country as may be notified by the Central Government in this behalf, ex officio;

(d) three Members of Parliament of whom two shall be elected by the House of the People and one by the Council of States;

(e) the Administrator of a Union territory to be appointed by the Central Government, ex officio;

(j) the Secretary to the Government of India in charge of the Ministry or Department of The Central Government having administrative control of the micro, small and medium enterprises, ex officio;

(g) four Secretaries to the Government of lndia, to represent the Ministries of the Central Government dealing with commerce and industry, finance, food processing industries, labour and planning to be appointed by the Central Government, ex officio;

(h) the Chairman of the Board of Directors of the National Bank, ex-officio;

(i) the Chairman and managing director of the Board of Directors of the Small Industries Bank, ex-officio;

(j) the Chairman, Indian Banks Association, ex officio;

(k) one officer of the Reserve Bank, not below the rank of an Executive Director, to be appointed by the Central Government to represent the Reserve Bank;

(l) twenty persons to represent the associations of micro, small and medium enterprises, including not less than 3 persons representing associations of women's enterprises and not less than three persons representing associations of micro enterprises, to be appointed by the Central Government;

(m) three persons of eminence, one each from the fields of economics, industry and science and technology, not less than one of whom shall be a woman, to be appointed by the Central Government;

(n) two representatives of Central Trade Union Organisations, to be appointed by the Central Government; and

(o) one officer not below the rank of Joint Secretary to the Government of India in the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises to be appointed by the Central Government, who shall be the Member-Secretary of the Board, ex officio.

The term of office of the members of the Board, other than ex officio members of the Board, the manner of filling vacancies, and the procedure to be followed in the discharge of their functions by the members of the Board, shall be such as may be prescribed: Provided that the term of office of an ex officio member of the Board shall continue so long as he holds the office by virtue of which he is such a member.

The Board shall meet at least once in every three months in a year. The Board may associate with itself, any person or persons whose assistance or advice.

**Functions of the Board**

The Board shall, subject to the general directions of the Central Government, perform all or any of the following functions, namely:--

(a) examine the factors affecting the promotion and development of micro, small and medium enterprises and review the policies and programmes of the Central Government in regard to facilitating the promotion and development and enhancing the competitiveness of such enterprises and the impact thereof on such enterprises;

(b) make recommendations on matters referred above or on any other matter referred to it by the Central Government which, in the opinion of that Government, is necessary or expedient for facilitating the promotion and development and enhancing the competitiveness of the micro, small and medium enterprises; and

(c) advise the Central Government on the use of the Fund

### 9.2.4. Memorandum of micro, small and medium enterprise

(1) Any person who intends to establish,--

(a) a micro or small enterprise, may, at his discretion; or

(b) a medium enterprise engaged in providing or rendering of services may, at his discretion; or

(c) a medium enterprise engaged in the manufacture or production of goods pertaining to any industry, shall file the memorandum of micro, small or, as the case may be, of medium enterprise with such authority as may be specified by the State Government.

**However, any person who, before the commencement of this Act, established--**

(i) a small scale industry and obtained a registration certificate, may, at his discretion; and

(ii) an industry engaged in the manufacture or production of goods pertaining to any industry having investment in plant and machinery of more than ₹1 crore but not exceeding ₹10 crore filed an Industrial Entrepreneur's Memorandum,shall within 180 days from the commencement of this Act, file the memorandum, in accordance with the provisions of this Act.

### 9.2.5. Reference to Micro and small Enterprises Facilitation Council

(1) Any party to a dispute may, with regard to any amount due under section 17, make a reference to the Micro and Small Enterprises Facilitation Council.

(2) On receipt of a reference the Council shall either itself conduct conciliation in the matter or seek the assistance of any institution or centre providing alternate dispute resolution services by making a reference to such an institution or centre, for conducting conciliation

(3) Where the conciliation initiated as above) is not successful and stands terminated without any settlement between the parties, the Council shall either itself take up the dispute for arbitration.

(4) the Micro and Small Enterprises Facilitation Council or the centre providing alternate dispute resolution services shall have jurisdiction to act as an Arbitrator or Conciliator under this section in a dispute between the supplier located within its jurisdiction and a buyer located anywhere in India.

(5) Every reference made under this section shall be decided within a period of 90 days from the date of making such a reference.

### 9.2.6. Advisory Committee

The Central Government shall, by notification, constitute an Advisory Committee consisting of the following members, namely:-

(a) the Secretary to the Government of India in the Ministry or Department of the Central Government having administrative control of the small and medium enterprises who shall be the Chairperson, ex-officio;

(b) not more than five officers of the Central Government possessing necessary expertise in matters relating to micro, small and medium enterprises, members, ex-officio;

(c) not more than three representatives of the State Governments, members, ex officio; and

(d) one representative each of the associations of micro, small and medium enterprises, members, ex officio.

(e) The Member-Secretary of the Board shall also be the ex officio Member-Secretary of the Advisory Committee.

(f) The Central Government shall, prior to classifying any class or classes of enterprises under sub-section (l),

obtain the recommendations of the Advisory Committee.

(g) The Advisory Committee shall examine the matters referred to it by the Board in connection with any subject referred to in section 5 and furnish its recommendations to the Board.

### 9.2.7. Measures for promotion, development and enhancement of competitiveness of micro, small and medium enterprises

The Central Government may, from time to time, notification, such programmes, guidelines or instructions for the purposes of:

(i) facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises;

(ii) development of skill in the employees, management and entrepreneurs,

(iii) provisioning for technological upgradation;

(iv) marketing assistance or infrastructure facilities and cluster development of such enterprises with a view to strengthening backward and forward linkages,

(v) devise policies and practices in respect of credit to the micro, small and medium enterprises;

(vi) Procurement· preference policy.

(vii)Grants by Central Government its administration and etc.

### 9.2.8. Dedicated funds for the sector

(i) There shall be constituted, by notification, one or more Funds to be called by such name as may be specified in the notification and there shall be credited thereto any grants made by the Central Government under section The Central Government may, credit to the Fund or Funds by way of grants for the purposes of this Act, such sums of money as that Government may consider necessary to provide.

(ii) The Central Government shall administer Funds in such manner as may be prescribed.

(iii) The Fund or Funds shall be utilised exclusively for the MSME sector.

(iv) The Central Government shall be responsible for the coordination and ensuring timely utilisation and release of sums in accordance with such criteria as may be prescribed.

### 9.2.9. Delayed payments to micro and small enterprises

To MSME units shall exceed 45 days from the date of acceptance or the day of deemed acceptance., failing which the buyer shall be liable to pay compound interest with monthly rests to the supplier on that amount from the appointed day or, 'as the case may be; from the date immediately following the date agreed upon, at three times of the bank rate notified by the Reserve Bank.

Where any buyer is required to get his annual accounts audited under any law for the time being in force, such buyer shall furnish the following additional information in his annual statement of accounts, namely:- (1) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier as at the end of each accounting year; Interest not to be allowed as deduction from income.

### 9.2.10. MSME facilitation centres by State Government

(i) The State Government shall, by notification, establish one or more Micro and Small Enterprises Facilitation Councils, at such places, exercising such jurisdiction.

(ii) The Micro and Small Enterprise Facilitation Council shall consist of not less than three but not more than five members to be appointed from amongst the following categories, namely:-

(a) Director of Industries, or any other officer not below the rank of such Director.

(b) One or more office-bearers or representatives of associations of micro or small industry or enterprises in the State; and

(c) One or more representatives of banks and financial institutions lending to micro or small enterprises; or

(d) one or more persons having special knowledge in the field of industry, finance, law, trade or commerce.

Overriding effect Scheme for closure of business of micro, small and medium enterprises. Appointment of officers and other employees. Penalty for contravention of section 8 or section 22 or section 26. Jurisdiction of courts. Power to make rules. 10

### 9.2.11. Designated officers in Central/state Governments.

(1) The Central Government or the State Government may appoint such officers with such designations and such other employees as it thinks fit for the purposes of this Act and may entrust to them such of the powers and functions under this Act as it may deem fit.

(2) The Central Government may, by notification, make rules to carry out the provisions of this Act.

The State Government may, by notification, make rules to carry out the provisions of this Act.

### 9.2.12. Various schemes by Central Govt.

The schemes/ programmes undertaken by the Ministry and its organizations seek to facilitate/provide:

i) flow of credit from financial institutions/banks;

ii) technology upgradation and modernization;

iii) infrastructural facilities;

iv) modern testing facilities and quality certification;

v) access to modern management practices;

vi) entrepreneurship development and skill upgradation ;

vii) support for product development, design intervention and packaging;

viii)welfare of artisans and workers;

ix) assistance for better access to domestic and export markets etc.

The Government of India introduces several schemes for the benefit of these MSMEs. However, often the MSME business owners are not aware of these schemes and thus lose out on benefiting from them.

These Government schemes for MSMEs have several advantages that business owners can benefit from. Some of the benefits of the Government schemes are as follows:

(i) The Government schemes provide a sense of security to the entrepreneurs

(ii) Some schemes provide financial security to businesses and individuals

(iii) Certain schemes provide technological support and guidance to individuals

(iv) Overall, Government schemes help individuals and entrepreneurs improve their livelihood

But often businesses lose out on taking advantage of these schemes designed for them owing to a lack of information regarding the various Government schemes.

**Single window registration process**

The champions control room under the ministry and development institute/ DICs shall facilitate single point registration.

**Framework for revival and rehabilitation of MSME**

Respective banks, which has extended loan to MSME may revive the re-payment schedule of loan based on certain criteria. Banks shall form Committee which will look into each such MSME and suggest corrective action. The Restricting shall be monitoring by the debt restricting cell of the particular bank (notified on 27/5/2015 by MSME Dept.)

**Delay in payment to MSME**

The MSME – Samadhan ( Delayed Payment Monitoring System) is a portal created by the Office of DC(MSME), Ministry of Micro, Small and Medium Enterprises (MSME) where Micro and Small Enterprises (MSEs) can file their applications online regarding delayed payments.

The portal also has a dashboard giving information about the pending amount of MSEs with individual CPSEs/ Central Ministries, State Governments, etc. The CEO of PSEs and the Secretary of the concerned Ministries will be able to monitor the cases of delayed payment and issue necessary instructions to resolve such issues.

The Ministry of MSME has taken the initiative for filing online applications by the supplier MSME unit against the buyer of goods/services before the concerned MSEFC of his/her State/UT. These will be viewed by the MSEFC Council for their actions. These will also be visible to Concerned Central Ministries, Departments, CPSEs, State Government, etc for pro-active actions .This scheme and the portal are helpful for MSMEs to register an online complaint if payment is not received from the buyer or supplier.

All companies who get supplies of goods or services and the payment is due for 45 days or more from the date of acceptance of goods/services shall submit a half-yearly to MCA (notification by MSME Dept. date 2/11/2018)

**Procurement Preference Policy**

Section 11 of the Act provides that Central Govt./State Govt. shall issue preference policy notification for preference to be given to MSME in public procurement. Detailed notification was issued on 23/3/2012 by MSME Dept. The notification details the extent and method of processing from MSME units. The policy provides for reservation of certain items to be from MSME only, price preference, preference to women entrepreneurs, on programmes to MSMEs, special renter development etc.

**Establishment of Fund**

The CG has under the powers used in section 12 have established a fund called MSME Fund to be utilised exclusively for means specified in Act. to micro and small enterprises and assurance of a scheme for easing the closure of business by these enterprises are some of the other features of the MSMED Act Establishment of specific funds for the promotion, development and enhancing the competitiveness of these enterprises, notification of schemes/ programs for this purpose, progressive credit policies, and practices, preference in Government procurements to products and services of the micro and small enterprises, more effective mechanisms for mitigating the problems of delayed payments.

**Establishment of MSME Facilitation Centre**

Has established under 18 to facilitate MSME units and has to power to settle disputes between MSME and other

party, section, SG can also establish such facilitation council. MSMEs have the right to place their grievances to the council.

**Role of National Small Industries Corporation Limited (NSIC)**

NSIC, established in 1955, main function of the Corporation is to promote, aid and foster the growth of micro and small enterprises in the country, generally on commercial basis. It provides a variety of support services to micro and small enterprises in different areas like raw material procurement; product marketing; credit rating; acquisition of technologies; adoption of modern management practices, etc.

NSIC implements its various programmes and projects throughout the country through its 9 Zonal Offices, 39 Branch Offices, 12 Sub Offices, 5 Technical Services Centres, 3 Technical Services Extension Centres, 2 Software Technology Parks, 23 NSIC-Business Development Extension Offices and 1 Foreign Office.

**Digital MSME Scheme**

The Digital MSME is a Government scheme for MSME that was launched for promoting Information and Communication Technology (ICT) in the MSME Sector by adopting ICT tools and applications in the production and business process of MSMEs. The services that will be available for MSMEs through various service providers include-

- ERP
- Accounting
- Manufacturing Design
- Regulatory compliance including GST

The Digital MSME Scheme is aimed at creating awareness, supporting developments and e-platforms, thereby creating literacy, training and promoting digital marketing in MSME sectors.

**ECLGS or Emergency Credit Line Guarantee Scheme**

The ECLGS or the Emergency Credit Line Guarantee Scheme was launched by the Government of India as a special scheme, considering the COVID-19 crisis. The Scheme aims to provide 100% guarantee coverage to banks and NBFCs to enable them to extend emergency credit facilities to business enterprises / MSMEs in view of COVID-19 to meet their additional term loan or additional working capital requirements.

Recently, the Government extended the ECLGS to 31st March 2022 with the purpose to provide relief to MSMEs.

100% guarantee coverage for the additional funds sanctioned under the Emergency Credit Line Scheme.The interest rate charged is capped at 9.25% for banks and 14% for NBFCs.A maximum tenure of 4 years from the date of disbursement is stipulated under the Scheme.The moratorium period on the principal amount is 12 months.

**Secured Business Loan For MSME – SIDBI**

SIDBI is a primary financial institution that promotes, develops and finances Micro, Small and Medium Enterprises (MSME) through various schemes.

One such scheme is Secured Business Loan or SBL which was developed to provide faster dispensation of credit to MSMEs, especially those in the manufacturing segment and service sector. The maximum quantum of open term loan under the SBL Scheme will be up to Rs.10 crore for the eligible MSME units. With maximum repayment tenure is 10 years, which includes the moratorium period.The Scheme also provides foreign currency assistance for the creation of tangible assets subject to natural hedges and other terms and conditions.

**PMEGP Scheme**

The Prime Minister Employment Generation Programme or PMEGP is a credit-linked subsidy scheme introduced by the Government of India. The aim of introducing the Scheme is to promote the generation of employment opportunities through the establishment of micro-enterprises in rural as well as urban areas.

**Reservation policies for the manufacturing and production sector**

According to the Industries (Development and Regulation) Act, 1951, the items manufactured in the SSI (Small scale industry) sector have been given statutory reservation in government procurement. The Policy has two objectives

(i) To assure production of consumer goods is increased in the small scale sector.

(ii) To enhance employment opportunities through setting up small-scale industries in remote areas.

(iii) Easy licensing and approvals.

Those enterprises which produce the Certificate of MSME Registration while making applications for licenses, approvals, and registrations on any field for their business from the respective authorities then, they are given priority and the process has been more simplified for them.

**Special consideration on international trade fairs**

Under the International Cooperation Scheme, to provide financial assistance by reimbursement to the State/Central Government organizations, industries/enterprises Associations and registered societies/trusts and organizations associated with MSME for commissioning of MSME business delegations to other countries for exploring new areas of technology infusion/ up-gradation, fascilitating of joing ventures, improving market for MSMEs products and foreign collaborations.

**Training**

The National Institute for Entrepreneurship and Small Business Development is the premier organization of the Ministry of Skill Development and Entrepreneurship, engaged in training, consultancy, research, etc. in order to promote entrepreneurship and Skill Development. The major activities of the Institute include Training of Trainers, Management Development Programmes, Entrepreneurship-cum-Skill Development Programmes, Entrepreneurship Development Programmes and Cluster Intervention. The major activities of the Institute include Training of Trainers, Management Development Programmes, Entrepreneurship-cum-Skill Development Programmes, Entrepreneurship Development Programmes and Cluster Intervention.

**Recent announcement by Govt. as relief to MSME sector**

The Finance ministry of the Govt. has announced few financial relief package in the last budget. Some important issues are mentioned below.

(i) Three lakh crore Emergency Working Capital Facility for Businesses, including MSMEs:

(ii) With an objective to provide relief to the business, additional working capital finance of 20% of the outstanding credit (as on February 29, 2020), in the form of a Term Loan at a concessional rate of interest.

(iii) ₹20,000 crores Subordinate Debt for Stressed MSMEs: Provision made for ₹20,000 crores subordinated debt for 2,00,000 MSMEs which are NPA or are stressed. The government will support them with ₹4,000 crores to Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE).

(iv) Banks are expected to provide the subordinate-debt to promoters of such MSMEs equal to 15% of his existing stake in the unit subject to a maximum of ₹75 lakhs; ₹50,000 crores equity infusion through MSME Fund of Funds (FoF): Govt will set up an FoF with a corpus of ₹10,000 crores that will provide equity funding support for MSMEs. The FoF shall be operated through a Mother and a few Daughter funds. It is expected that with leverage of 1:4 at the level of daughter funds, the FoF will be able to mobilize equity of about ₹50,000 crores.

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. NSIC stands for:
   a) National Social Institute Corporation
   b) National Small Institute Corporation
   c) National Scheme for Industries and companies
   d) National Small Industries Corporation.
2. IF a unit has investment in plant an equipment of ₹55 crore and turnover of ₹300 crore. It will be classified as:
   a) micro
   b) small
   c) medium
   d) none of the above
3. While calculating the value of assets for ascertaining the classification, the value of the following is excluded.
   a) land
   b) furniture and fittings
   c) none of the above
   d) both of the (a) and (b)
4. While calculating the value of assets for ascertaining the classification, the value of the following is excluded.
   a) any sales
   b) domestic sales
   c) exports
   d) none of the above

**State True or False**

1. The apex policymaking body for MSME is Ministry of Industry and. Commerce.
2. The basis of categorization of MSME is investment in plant and machinery and turnover.
3. An entrepreneur shall require a license from The Central Govt. to start an MSME.
4. Delayed payments to MSME unit by any company is supposed to be reported in the annual report of the companies.
5. Banks are expected to provide subordinate loans to MSME 15% more than the existing loan limits.

**Fill in the blanks**

1. The threshold limit of micro enterprise is ……..of plant and machinery.
2. If payment to any MSME unit is delayed by …..days, the buyer has to pay interest.
3. NSIC stands for……
4. Govt. has recently earmarked ……...for subordinate debt for stressed MSMEs.
5. SIDBI stands for……
6. Under the new policy of the Govt., banks are expected to provide the subordinate-debt to promoters of such MSMEs equal to ……% of his existing stake in the unit.
7. PMEGP scheme relates to……...
8. The ECLGS stands for ……
9. Under the Secured Business Loan Scheme the maximum quantum of open term loan will be up to ₹……

**Short Essay Type Questions**

1. Discuss the method of calculation of value of plant and machinery.
2. Discuss functions of the National Board for Micro, Small and medium Enterprises.

**Essay Type Questions**

1. Discuss few majors taken to promote MSME sector units.
2. Explain the classification of micro, small and medium industry. What the basis of classification and how the figures are adjusted.
3. Discuss the contribution of MSMS sector in Indian economy.

**Case Study (Solved)**

1. Balaram is school drop out but took over his father's business after his sudden death. The business, a proprietorship firm, is manufacturing and selling rubber spares and is located at remote place in the District of West Bengal. Turnover of business was ₹342 crore. Though not audited or evaluated, the investment in plant and machinery is around ₹93 lakhs. The business is not registered with DIC but with GST. He pays income tax.

   He wants to expand his business and wants to know:

   (i) What category of industry the business is falling?

   (ii) Is registration compulsory?

   (iii) Where to register?

   (iv) What are the benefits of registration?

   **Solution:**

   (i) The business falls under micro enterprise as defined under MSME Act and Rules. Since the investment in Plant and Machinery or Equipment:

   Not more than ₹1 crore and Annual Turnover; not more than ₹5 crore.

(ii) Registration is not compulsory but lot of benefits are not available to unregistered parties.

(iii) Registration has to be taken in the office District Industries Centre(DIC)

(iv) Registered units shall get the benefit of loan, loan repayment moratorium, tax holiday, price preference by Govt. organizations etc.

## Answer

**Multiple Choice Questions (MCQs)**

| 1 | 2 | 3 | 4 |
|---|---|---|---|
| d | d | d | c |

**State True or False**

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| F | T | F | T | T |

**Fill in the blanks**

| | | | |
|---|---|---|---|
| 1 | ₹1 crore | 2 | 45 |
| 3 | National Small Industries Corporation | 4 | ₹ 20,000 crores |
| 5 | Small Industries Development bank. | 6 | 15 |
| 7 | Employment | 8 | Emergency Credit Line Guarantee Scheme |
| 9 | ₹10 crore | | |

# Laws and Regulations Related to Cyber Security and Data Privacy

10

**This Module Includes:**

**10.1 Information Technology Act, 2000 and Rules framed there under, Sensitive Personal Data Rules**

**10.2 Basic Principles of Data Privacy, Data Privacy and Business Intelligence**

**10.3 Cybercrime / Cyber Frauds - Meaning, Remedies and Penalties**

# Laws and Regulations Related to Cyber Security and Data Privacy

**SLOB Mapped against the Module**

To understand the role of cyber laws in ensuring data security and privacy issues.

**Module Learning Objectives:**

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

- The data security and authenticity;
- Protection of data of the company;
- Action which can be taken for cyber infringement or crime with online financial transactions, this module will have special interest for accountants.

# Information Technology Act, 2000 and Rules framed there under, Sensitive Personal Data Rules

# 10.1

## 10.1.1. Information Technology Act, 2000

### 10.1.1.1. Objects of the IT Act

(i) legal recognition to electronic transactions by recognizing digital signatures either by general public or Govt. official or agency, including publication of rules, regulations or any other matter including gazette notification.

(ii) facilitate electronic filing of documents and retention thereof in govt. records (public cannot insist for use of electronic mode only)

(iii) consequential amendments to other acts

(iv) to set up licensing, monitoring and certifying authority

### 10.1.1.2. Dispatch and receipt of records

(i) sent by originator, his agent, system programmed by the originator which operates automatically

(ii) dispatch would occur when it enters a resource outside the control of the originator

(iii) unless otherwise agreed by the parties receipt would occur when it enters the designated computer resource and in case not designated computer resource, when it is retrieved by the addressee

(iv) unless otherwise agreed by the parties place of dispatch shall be deemed to be place of business. same in case of receipt.

### 10.1.1.3. Controller of Certifying Authorities

The Controller of Certifying Authority(CCA) is to be appointed by Central govt. to recognize, license, regulate, standardize, supervise the certifying authorities. Central Govt. Controller may intercept any information in any computer for security purpose, declare any system as protected system and therefore prevent general or specific access. Certifying authorities, who are licensed by CCA shall issue digital signature certificate and perform other acts as specified by the Controller and perform other functions as decided by Controller.

### 10.1.1.4. Offences

The offences under this Act is applicable to any offence/contravention in any country/national if it involves a computer, system or network located in India. Offences can be:

(a) tampering with computer source documents.

(b) hacking: destruction, deletion, alteration of any data in any computer with an intention of damage/injury

(c) misrepresentation to controller or certifying authorities

(d) breach of confidentiality and privacy

(e) publishing false digital signature certificates

#### 10.1.1.5. Settlement of disputes

Central Govt. has appointed adjudicating authorities having it and legal knowledge. Cyber Regulations Appellate Tribunal has also been constituted. Any person not satisfied with the order of controller or adjudicating authorities may appeal within 45 days. Decision of appellate tribunal can be appealed to High Court within 6o days. Civil court does not have jurisdiction

### 10.1.2 Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011.

#### 10.1.2.1. What is data protection

Data Protection refers to the set of privacy laws, policies and procedures that aim to minimise intrusion into one's privacy caused by the collection, storage and dissemination of personal data. Personal data generally refers to the information or data which relate to a person who can be identified from that information or data whether collected by any Government or any private organization or an agency.

Data Protection laws provide a set of laws that deal with the matters related to privacy, policies, and procedures and it is imperative for the protection of one's privacy and regulating its collection.

#### 10.1.2.2. Data protection law in India

India currently is not having a separate data protection law and when the Information Technology Act, 2000 (hereinafter referred to as the "IT Act") first came into force on October 17, 2000 it lacked provisions for protection and the procedure to be followed to ensure the safety and security of sensitive personal information of an individual. This was taken care of in Information Technology (Amendment) Act, 2008 whose provisions came into force on October 27, 2009. Section 43A was inserted in the IT Act and the Central Government, notified the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011. The right to privacy in India was declared a fundamental right by the Hon'ble Supreme Court of India on August 24, 2017,

Important Provisions of IT Act related to Data Protection

- **Section 43A** of the IT Act explicitly provides that whenever a corporate body possesses or deals with any sensitive personal data or information, and is negligent in maintaining a reasonable security to protect such data or information, which thereby causes wrongful loss or wrongful gain to any person, then such body corporate shall be liable to pay damages to the person(s) so affected.
- Further, **Section 72A** provides for the punishment for disclosure of information in breach of lawful contract and any person may be punished with imprisonment for a term not exceeding three years, or with a fine not exceeding up to five lakh rupees, or with both in case disclosure of information is made in breach of lawful contract.

### 10.1.3. Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011

The Department of Information Technology notified Information Technology the 2011 Rules on April 11, 2011 vide notification no. G.S.R. 313(E). The main highlights of the 2011 Rules are as follows–

(i) The Rules 2011 only apply to bodies corporate and persons located in India.

(ii) Rule 3 of the 2011 Rules provides a list of items that are to be treated as "sensitive personal data", and includes inter alia information relating to passwords, credit/debit cards information, biometric information (such as DNA, fingerprints, voice patterns, etc. that are used for authentication purposes), physical, physiological and mental health condition, etc. It is further clarified that any information is freely available or accessible in the public domain is not considered to be sensitive personal data.

(iii) Rule 4 imposes a duty on Body Corporates seeking sensitive personal data to draft a privacy policy and make it easily accessible for people who are providing the information. This should be clearly published on the website of the body corporate and should contain details on the type of information that is being collected, the purpose for which it has been collected and the reasonable security practices that have been undertaken to maintain the confidentiality of such information.

(iv) Rule 5 provides the guidelines that need to be followed by a Body Corporate while collecting information and imposes the following duties on the Body Corporate:

Obtain consent from the person(s) providing information.

a. Information shall not be collected unless it is for lawful purpose, and is considered necessary for the purpose. The information collected shall be used only for the purpose for which it is collected and shall not be retained for a period longer than which is required;

b. Ensure that the person(s) providing information are aware about the fact that the information is being collected, its purposes & recipients, name and addresses of the agencies retaining and collecting the information;

c. Offer the person(s) providing information an opportunity to review the information provided and make corrections, if required;

d. Maintain the security of the information provided; and

e. Designate a Grievance Officer, whose name and contact details should be on the website who shall be responsible to address grievances of information providers expeditiously.

(v) prior permission of the information provider before disclosing such information to a third party unless .

(vi) Rule 8 provides the reasonable security processes and procedures that may be implemented by Body Corporates. International Standards (IS/ISO/IEC 27001) is one such standard which can be implemented by a body corporate to maintain data security. It is pertinent to note that an audit of reasonable security practices and procedures shall be carried cut by an auditor at least once a year or as and when the body corporate or a person on its behalf undertake significant upgradation of its process and computer resource.

# Basic Principles of Data Privacy and Business Intelligence

# 10.2

Business Intelligence (BI) is a technology-driven process for analyzing data and delivering actionable information that helps executives, managers and workers make informed business decisions. As part of the BI process, organizations collect data from internal IT systems and external sources, prepare it for analysis, run queries against the data and create data visualizations, BI dashboards and reports to make the analytics results available to business users for operational decision-making and strategic planning.

The ultimate goal of BI initiatives is to drive better business decisions that enable organizations to increase revenue, improve operational efficiency and gain competitive advantages over business rivals. To achieve that goal, BI incorporates a combination of analytics, data management and reporting tools, plus various methodologies for managing and analyzing data.

### 10.2.1. How the business intelligence process works?

A business intelligence architecture includes more than just BI software. Business intelligence data is typically stored in a data warehouse built for an entire organization or in smaller data marts that hold subsets of business information for individual departments and business units, often with ties to an enterprise data warehouse. BI data can include historical information and real-time data gathered from source systems as it's generated, enabling BI tools to support both strategic and tactical decision-making processes. Before it's used in BI applications, raw data from different source systems generally must be integrated, consolidated and cleansed using data integration and data quality management tools to ensure that BI teams and business users are analyzing accurate and consistent information. Steps in BI can be:

(a) data preparation, in which data sets are organized and modelled for analysis;

(b) analytical querying of the prepared data;

(c) distribution of key performance indicators (KPIs) and other findings to business users; and

(d) use of the information to help influence and drive business decisions.

Initially, BI tools were primarily used by BI and IT professionals. However, now, business analysts, executives and workers are using business intelligence platforms themselves, thanks to the development of self-service BI and data discovery tools. Self-service business intelligence environments enable business users to query BI data, create data visualizations and design dashboards on their own.

BI programs often incorporate forms of advanced analytics, such as data mining, predictive analytics, text mining, statistical analysis and big data analytics. A common example is predictive modelling that enables what-if analysis of different business scenarios. In most cases, though, advanced analytics projects are conducted by separate teams of data scientists, statisticians, predictive modelers and other skilled analytics professionals, while BI teams oversee more straightforward querying and analysis of business data.

### 10.2.2. Why business intelligence is important

Overall, the role of business intelligence is to improve an organization's business operations through the use of relevant data. Companies that effectively employ BI tools and techniques can translate their collected data into valuable insights about their business processes and strategies. Such insights can then be used to make better business decisions that increase productivity and revenue, leading to accelerated business growth and higher profits.

Without BI, organizations can't readily take advantage of data-driven decision-making. Instead, executives and workers are primarily left to base important business decisions on other factors, such as accumulated knowledge, previous experiences, intuition and gut feelings. While those methods can result in good decisions, they're also fraught with the potential for errors and missteps because of the lack of data underpinning them.

### 10.2.3. Benefits of business intelligence

A successful BI program produces a variety of business benefits in an organization. For example, BI enables C-suite executives and department managers to monitor business performance on an ongoing basis so they can act quickly when issues or opportunities arise. Analyzing customer data helps make marketing, sales and customer service efforts more effective. Supply chain, manufacturing and distribution bottlenecks can be detected before they cause financial harm. HR managers are better able to monitor employee productivity, labor costs and other workforce data.

Overall, the key benefits that businesses can get from BI applications include the ability to:

(i) speed up and improve decision-making;

(ii) optimize internal business processes;

(iii) increase operational efficiency and productivity;

(iv) spot business problems that need to be addressed;

(v) identify emerging business and market trends;

(vi) develop stronger business strategies;

(vii)drive higher sales and new revenues; and

(viii)gain a competitive edge over rival companies.

BI initiatives also provide narrower business benefits -- among them, making it easier for project managers to track the status of business projects and for organizations to gather competitive intelligence on their rivals. In addition, BI, data management and IT teams themselves benefit from business intelligence, using it to analyze various aspects of technology and analytics operations.

### 10.2.4. Types of business intelligence tools and applications

The list of BI technologies that are available to organizations includes the following:

**Ad hoc analysis.** It's the process of writing and running queries to analyze specific business issues 0n casual or temporary basis.

**Online analytical processing (OLAP).** OLAP tools enable users to analyze data along multiple dimensions, which is particularly suited to complex queries and calculations. bases.

**Mobile BI.** Here, BI applications and dashboards available on smartphones and tablets. This may only display two or three data visualizations and KPIs so they can easily be viewed on a device's screen.

**Real-time BI**. In real-time BI applications, data is analyzed as it's created, collected and processed to give users an up-to-date view of business operations, customer behavior, financial markets and other areas of interest. The

real-time analytics process often involves streaming data and supports decision analytics uses, such as credit scoring, stock trading and targeted promotional offers.

**Operational intelligence (OI).** Also called operational BI, this is a form of real-time analytics that delivers information to managers and frontline workers in business operations.

**Open source BI (OSBI).** Business intelligence software that is open source typically includes two versions: a community edition that can be used free of charge and a subscription-based commercial release with technical support by the vendor.

**Embedded BI.** Embedded business intelligence tools put BI and data visualization functionality directly into business applications. That enables business users to analyze data within the applications they use to do their job. Embedded analytics features are most commonly incorporated by application software vendors, but corporate software developers can also include them in home grown applications.

**Collaborative BI.** This is more of a process than a specific technology. It involves the combination of BI applications and collaboration tools to enable different users to work together on data analysis and share information with one another. For example, users can annotate BI data and analytics results with comments, questions and highlighting via the use of online chat and discussion tools.

**Location intelligence (LI).** This is a specialized form of BI that enables users to analyze location and geospatial data, with map-based data visualization functionality incorporated. Location intelligence offers insights on geographic elements in business data and operations. Potential uses include site selection for retail stores and corporate facilities, location-based marketing and logistics management.

### 10.2.5. Business intelligence platforms

Modern BI platforms typically include:

(i) data visualization software for designing charts and other infographics to show data in an easy-to-grasp way;

(ii) tools for building BI dashboards, reports and performance scorecards that display visualized data on KPIs and other business metrics;

(iii) data storytelling features for combining visualizations and text in presentations for business users; and

(iv) usage monitoring, performance optimization, security controls and other functions for managing BI deployments.

**In general terms, enterprise BI use cases include:**

(i) monitoring business performance or other types of metrics;

(ii) supporting decision-making and strategic planning;

(iii) evaluating and improving business processes;

(iv) giving operational workers useful information about customers, equipment, supply chains and other elements of business operations; and

(v) detecting trends, patterns and relationships in data.

Specific use cases and BI applications vary from industry to industry. For example, financial services firms and insurers use BI for risk analysis during the loan and policy approval processes and to identify additional products to offer to existing customers based on their current portfolios. BI helps retailers with marketing campaign management, promotional planning and inventory management, while manufacturers rely on BI for both historical and real-time analysis of plant operations and to help them manage production planning, procurement and distribution.

Airlines and hotel chains are big users of BI for things such as tracking flight capacity and room occupancy rates,

setting and adjusting prices, and scheduling workers. In healthcare organizations, BI and analytics aid in the diagnosis of diseases and other medical conditions and in efforts to improve patient care and outcomes. Universities and school systems tap BI to monitor overall student performance metrics and identify individuals who might need assistance, among other applications.

### 10.2.6. Business intelligence trends

In addition to BI managers, business intelligence teams generally include a mix of BI architects, BI developers, BI analysts and BI specialists who work closely with data architects, data engineers and other data management professionals. Business analysts and other end users are also often included in the BI development process to represent the business side and make sure its needs are met.

To help with that, a growing number of organizations are replacing traditional waterfall development with Agile BI and data warehousing approaches that use Agile software development techniques to break up BI projects into small chunks and deliver new functionality on an incremental and iterative basis. Doing so enables companies to put BI features into use more quickly and to refine or modify development plans as business needs change or new requirements emerge.

# Cybercrime/Cyber Fraud- Meaning, Remedies and Penalties

# 10.3

## 10.3.1. What is cyber crime?

Cybercrime is a broad term that is used to define criminal activity in which computers or computer networks are a tool, a target, or a place of criminal activity and include everything from electronic wracking to denial of service attacks. It is a general term that covers crimes like phishing, Credit card frauds, bank robbery, illegal downloading, industrial espionage, child pornography, kidnapping children via chat rooms, scams, cyber terrorism, creation of viruses. It also covers that traditional crimes in which computers or networks are used to enable the illicit activity. Cyber crime is increasing day by day, nowadays it has become a new fashion to earn money by fraud calls or to take revenge through hacking other accounts.

With the increasing use of computers in society, cybercrime has become a major issue. The advancement of technology has made man dependent on internet for all his needs. Internet has given man access to everything while sitting at one place. Social networking, online shopping, online studying, online jobs, every possible things that Man can think of can be done through the medium of internet. The cyber crime is different from any other crime happening in the society. The reason being, it has no geographical boundaries and the cyber criminals are unknown. It is affecting all the stakeholders from government, business to citizens alike. In India cybercrime is increasing with the increased use of Information and Communication Technology (ICT).

## 10.3.2. Types of Cyber crimes

Cyber crimes can be basically divided into three major categories:

**A. Cyber crimes against persons** like harassment occur in cyberspace or through the use of cyberspace. Harassment can be sexual, racial, religious, or other.

**B. Cyber crimes against property** like computer wreckage (destruction of others' property), transmission of harmful programs, unauthorized trespassing, unauthorized possession of computer information.

**C. Cyber crimes against Government** like Cyber terrorism

**A. Cyber crimes against persons are:**

**Cyber-Stalking:** It means to create physical threat that creates fear to use the computer technology such as internet, e-mail, phones, text messages, webcam, websites or videos.

**Obscenity:** It includes Indecent exposure/ Pornography (basically child pornography), hosting of web site containing these prohibited materials.

**Defamation:** It is an act of imputing any person to lower down the dignity of the person by hacking his mail account and sending some mails with using vulgar language to unknown persons.

**Hacking:** unauthorized control/access over computer system and act of hacking completely destroys the whole data as well as computer programmes.

**Cracking:** Cracking means that a stranger has broken into your computer systems without your knowledge and consent and has tampered with precious confidential data and information.

**Spoofing:** A spoofed e-mail may be said to be one, which misrepresents its origin. It shows its origin to be different from which actually it originates.

Spoofing is a blocking through spam which means the unwanted uninvited messages. Wrongdoer steals mobile phone number of any person and sending SMS via internet and receiver gets the SMS from the mobile phone number of the victim.

**Carding:** It means false ATM cards i.e. Debit and Credit cards used by criminals for their monetary benefits through withdrawing money from the bank account mala-fidely.

**Fraud:** It means the person who is doing the act of cyber crime i.e. stealing password and data storage has done it with having guilty mind which leads to fraud and cheating.

**Threat:** refers to threatening a person with fear for their lives or lives of their families through the use of a computer network i.e. E-mail, videos or phones.

**B. Cyber crimes against property**

There are certain offences which affects person or properties which are as follows:

Any unlawful act by which the owner is deprived completely or partially of his rights is an offence. The common form of IPR violation may be said to be software piracy, infringement of copyright, trademark, patents, designs and service mark violation etc.

**Squatting:** It means where two persons claim for the same Domain Name either by claiming that they had registered the name first on by right of using it before the other or using something similar to that previously.

**Vandalism:** Vandalism means deliberately destroying or damaging property of another. Thus cyber vandalism means destroying or damaging the data when a network service is stopped or disrupted. It may include within its purview any kind of physical harm done to the computer of any person.

**Hacking:** Hacktivism attacks those included Famous Twitter, blogging platform by unauthorized access/ control over the computer. Due to the hacking activity there will be loss of data as well as computer.

**Virus:** Viruses are programs that attach themselves to a computer or a file and then circulate themselves to other files and to other computers on a network. They usually affect the data on a computer, either by altering or deleting it. Worm attacks plays major role in affecting the computerize system of the individuals.

**Trespass:** It means to access someone's computer without the right authorization of the owner and does not disturb, alter, misuse, or damage data or system by using wireless internet connection.

**C. Cyber crimes against Government**

There are certain offences done by group of persons intending to threaten the international governments by using internet facilities. It includes:

- **Terrorism:** Cyber terrorism is a major burning issue in the domestic as well as global concern. The common form of these terrorist attacks on the Internet is by distributed denial of service attacks, hate websites and hate e-mails, attacks on sensitive computer networks etc. Cyber terrorism activities endanger the sovereignty and integrity of the nation.
- **Warfare:** It refers to politically motivated hacking to damage and spying. It is a form of information warfare sometimes seen as analogous to conventional warfare although this analogy is controversial for both its accuracy and its political motivation.

- **Piracy:** It means distributing pirated software from one computer to another intending to destroy the data and official records of the government.
- **unauthorized Information:**

  It is very easy to access any information by the terrorists with the aid of internet and to possess that information for political, religious, social, ideological objectives.

  (i) Tampering with Computer source documents - Sec.65

  (ii) Hacking with Computer systems, Data alteration - Sec.66

  (iii) Publishing obscene information - Sec.67

  (iv) Un-authorised access to protected system Sec.70

  (v) Breach of Confidentiality and Privacy - Sec.72

  (vi) Publishing false digital signature certificates - Sec.73

### 10.3.4. Cyber Laws to protect cyber crime:

Cyber crimes are a new class of crimes which are increasing day by day due to extensive use of internet these days. To combat the crimes related to internet The Information Technology Act, 2000 was enacted with prime objective to create an enabling environment for commercial use of I.T. The IT Act specifies the acts which have been made punishable. The Indian Penal Code, 1860 has also been amended to take into its purview cyber crimes.

### 10.3.5. The various offenses related to internet which have been made punishable under the IT Act and the IPC are enumerated below:

1. **Cyber crimes under the IT Act:**
   (i) Tampering with Computer source documents - Sec.65
   (ii) Hacking with Computer systems, Data alteration - Sec.66
   (iii) Publishing obscene information - Sec.67
   (iv) Un-authorised access to protected system Sec.70
   (v) Breach of Confidentiality and Privacy - Sec.72
   (vi) Publishing false digital signature certificates - Sec.73
2. **Cyber Crimes under IPC and Special Laws:**
   (i) Sending threatening messages by email - Sec 503 IPC
   (ii) Sending defamatory messages by email - Sec 499 IPC
   (iii) Forgery of electronic records - Sec 463 IPC
   (iv) Bogus websites, cyber frauds - Sec 420 IPC
   (v) Email spoofing - Sec 463 IPC
   (vi) Web-Jacking - Sec. 383 IPC
   (vii) E-Mail Abuse - Sec.500 IPC
3. **Cyber Crimes under the Special Acts:**
   (i) Online sale of Drugs under Narcotic Drugs and Psychotropic Substances Act
   (ii) Online sale of Arms Act

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. Certifying Authority get licence to operate from:
   a) Ministry of IT
   b) SEBI
   c) Controller of Certifying Authority
   d) none of the above
2. Which among the following is not an offence under IT Act.
   a) tampering with computer source documents.
   b) hacking: destruction, deletion, alteration of nay data in any computer with an intention of damage/ injury
   c) misrepresentation to controller or certifying authorities
   d) making a faulty contract
3. Information Technology (Reasonable Security Practices And Procedures And Sensitive Personal Data Or Information) Rules, was notified in the year:
   a) 2011
   b) 2012
   c) 2013
   d) 2014
4. OSBI stands for
   a) Operational source Business Intelligence
   b) Open source business Innovation
   c) Open source Business intelligence
   d) none
5. The key benefits that businesses can get from BI applications include the ability to:
   a) speed up and improve decision-making;
   b) optimize internal business processes;
   c) increase operational efficiency and productivity;
   d) all of the above

6. Decision of Cyber appellate Tribunal can be appealed to;

   a) High Court

   b) supreme Court

   c) None of the above

   d) not appealable

7. Information Technology (Reasonable Security Practices And Procedures And Sensitive Personal Data Or Information) Rules, 2011.

   a) only apply to bodies corporate and persons located in India.

   b) only apply to bodies corporate and persons located out of India.

   c) Apply to individuals

   d) All of the above

8. Which among the following is not a Cyber crimes under the IT Act:

   a) Tampering with Computer source documents.

   b) Hacking with Computer systems, Data alteration.

   c) Publishing obscene information.

   d) Sending threatening messages by email

9. Which of the following is not an cyber Offence to Public

   a) Terrorism:

   b) Warfare:

   c) Piracy

   d) Data alteration

10. Access someone's computer without the right authorization of the owner and does not disturb, alter, misuse, or damage data or system by using wireless internet connection, is called:

    a) Squatting

    b) Vandalism

    c) Hacking

    d) Trespass

**State True or False**

1. Tampering with source documents which will entered in a system is not a cyber offence.
2. Controller of Certifying authority is empowered to issue digital signature certificates.
3. In case of any dispute under the Act, the aggrieved party can to go to Cyber Appellate Tribunal as appeal
4. Access to someone's computer system without authority is called trespass, which is an offence.
5. Business Intelligence process facilitates analytical querying of the prepared data.

**Fill in the blanks**

1. CCA stands for ……..
2. If someone is aggrieved with the decision of adjudicating authority, he can appeal to……..
3. Set of rules which aims to preserve privacy of information is called……
4. Business Intelligence modules distributes KPIs. KPI stands for……
5. OLAP stands for……..
6. The act of imputing any person to lower down the dignity of the person by hacking his mail account and sending some mails with using vulgar language to unknown persons is called ……
7. Business intelligence tools which put BI and data visualization functionality directly into business applications is called as ……
8. Digital certificates re issued by……..
9 The Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules were notified in ……
10. The right to privacy in India was declared a fundamental right by the Hon'ble Supreme Court of India in the year……..

**Short Essay Type Questions**

1. List out 5 cyber offences
2. Write a short note on business intelligence
3. Discuss the concept of data protection

**Essay Type Questions**

1. Discuss few features of Business Intelligence
2. What are the various types of cyber crimes?
3. Discuss the purpose of Information Technology (Reasonable Security Practices And Procedures And Sensitive Personal Data Or Information) Rules, 2011.
4. What are the obligations of the corporate body collecting data from individuals.

## Answer

### Multiple Choice Questions (MCQs)

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|
| c | d | a | c | d | a | a | d | d | d |

### State True or False

| 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|
| F | F | T | T | T |

### Fill in the blanks

| | | | |
|---|---|---|---|
| 1 | Controller of Certifying authority | 2 | Cyber Appellate Tribunal |
| 3 | Data protection | 4 | Key performance indicators |
| 5 | Online analytical processing | 6 | Defamation |
| 7 | Embedded BI | 8 | Certifying Authority |
| 9 | 2011 | 10 | 2017 |

# Laws and Regulations Related to Anti - Money Laundering

11

**This Module Includes:**

**11.1 The Prevention of Money Laundering Act, 2002**

**11.2 The Prevention of Money Laundering (Maintenance of Record) Rules, 2005**

# Laws and Regulations Related to Anti - Money Laundering

**SLOB Mapped against the Module**

To obtain an overview of the laws and regulations associated with prevention of money laundering in India.

**Module Learning Objectives:**

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

- The concept of money laundering;
- The actions which can be taken by the authorities;
- Being in accounts, the students will need to have special interest in the module to identify authentic transaction in their work life.

# The Prevention of Money Laundering Act, 2002

# 11.1

### 11.1.1. Overview

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 by a person which 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 including its concealment, possession, acquisition or use and projecting or claiming it as untainted property shall be guilty of offence of money-laundering.".

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 a global problem. 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.

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. There are also Special Courts for various authorities under the Act, their appointment, powers, jurisdiction etc.

### 11.1.2. Objects of the Act

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.

### 11.1.3. Authorities under the Act

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. Central Govt.(CG) shall appoint adjudicating authority to exercise jurisdiction and powers conferred under the Act.

### 11.1.4. The process of Money Laundering

**(a) Placement:** The Money Launderer 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:** 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:** The Launderer 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 may 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.

### 11.1.5. Offence of Money Laundering

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 including its concealment possession, acquisition or use or projecting or claiming 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 on non compliance of the provisions of the Act.

The offences listed in the Schedule the Act, are scheduled offences and are divided into three parts - Part A,B and 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, offence under The Securities and Exchange Board of India, 1992, The Custom Act, 1962 etc.

**Part 'B'** of the Schedule are offences with total value invloved is ₹1 crore or more.

**Part 'C'** deals with trans-border crimes, and is a vital step in tackling Money Laundering across International boundaries.

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.

### 11.1.6. Punishment for the Offence of Money Laundering

Who ever 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. Property made out of proceeds of crime,directly or indirectly attached and/or confiscated by the authority.

### 11.1.7. Procedure of Investigation

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. 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.

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.

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.

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.

### 11.1.8. Enforcement Directorate (ED)

The Directorate of Enforcement 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.

### 11.1.9. 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.

### 11.1.10. Obligations of the Reporting Entity [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.

(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 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.

### 11.1.11. 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).

### 11.1.12. Appellate 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.

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.

Appellate Tribunal has been constituted to hear appeals against the orders of the Adjudicating Authorityand the authorities under the said Act.

### 11.1.13. 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. 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.

### 11.1.14. 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.

# The Prevention of Money Laundering (Maintenance of Record) Rules, 2005

# 11.2

**11.2.1. The Rules were made in 2005 and last revised in March 2023. Every reporting entity shall maintain record of all transactions, including record of-**

a) Cash transaction of more than ₹10 lakhs or its equivalent in foreign currency.

b) All series of integrated transaction below ₹10 Lakh per month

c) All transaction of receipt of ₹10 lakhs and more on its equivalent foreign currency

d) All transactions with counterfeit currency

e) Any suspicious transaction made in cash or otherwise including deposits or withdrawal into or from any an account, credit or debits into of from non-monetary accounts such as demat account, loan and advances including credit or loan substitutes, investment or contingent liability and transactions involving transfer of immovable property.

f) All cross border wire transfers of the value of more than Rupees Five lac rupees or its equivalent in foreign currency where either origin or destination of fund is in India

g) all purchase and sale by any person of immovable property valued at fifty lakh rupees or more that is registered by the reporting entity, as the case may be

Reporting entities shall keep record uniformly in prescribed format. The entity shall make out a mechanism and system of disseminating and analysing of records and information available to them. Few records are to be taken and retained in hard copy only. Every entity shall designate a principal officer, who shall report to the Director of Financial intelligence Unit.

The principal officer of the reporting entity shall furnish the information related to the reporting transactions every month to the Director by 15th of the succeeding month.

Every entity shall identify its clients and take required details to check the status and authenticity of the details furnished. Reporting entities shall then, within 10 days' file electronic data to central KYC records Registry established under this rule. The reporting entity can may have reasonable ground for believing on the statements of the clients/third party. For each of the category of client the required document/information will vary. The entities may conduct client due diligence which is a matter of detail.

**11.2.2. Central KYC records Registry**

A central KYC registry has been constituted in 2015 to keep centralised data which would include analysis, dissemination transforming of data. The registry will comply with the instructions issued the Regulation.

The Reserve bank may call for information, statement or other particulars from the central registry or cause an inspection of the central registry

**11.2.3. Digital KYC process**

The Regulations have made detailed process of accepting, verifying, authenticating and certifying KYC records of the clients, which is on line and secured. Digital payments, electronic record, live transactions are some of the systems which will reduce illegal and immoral transactions of people. The aadhar, telephone, bank account, income tax all are inter linked and hence all transactions now shall be transparent.

## EXERCISE

**Multiple Choice Questions (MCQs)**

1. Every reporting entity shall maintain record of:
   a) all transactions in cash of more than ₹10 lakhs.
   b) All series of integrated transaction below ₹10 Lakh per month
   c) All transaction of receipt of ₹ 10 lakhs and more on its equivalent foreign currency
   d) All of the above
2. FIU stands for:
   a) Financial Intelligence unit
   b) Financial Issue unit
   c) Featured Intelligence Unit
   d) None of the above
3) In part B of the schedule, offences involved a value of ₹ _____ is mentioned.
   a) 15 Lakh
   b) 50 lakh
   c) 75 lakh
   d) One crore
4. STR stands for:
   a) Suspicious Trade Report
   b) Special Trade Reserve
   c) Suspicious Transaction Reports
   d) Special Trade Reports
5. Reporting authority shall send the KYC data to Central Registry within _____ days.
   a) 5
   b) 10
   c) 15
   d) 20
6. The Money Launderer introduces the illegal funds into the financial systems. This is called:
   a) Placement
   b) Layering
   c) Integration
   d) None of the above.
7. The cases under PMLA can be tried n:
   a) Common courts
   b) High courts only
   c) Special designated courts
   d) (none of the above.

**Fill in the blanks**

1. The authority under PMLA is……..
2. Every scheduled offence is a……..offence under the act.
3. The maximum imprisonment in money laundering case is……years.
4. FIU stands for……..
5. STR stands for ……
6. Under PMLA, every reporting entity shall maintain record of all transactions, including record of cash transaction of more than ₹. ……lakhs
7. Central KYC records Registry has been constituted in the year ……...
8. The PMLA Record Rules were introduced in the year in ……..

**Short Essay Type Questions**

1. Discuss , in short, the object of money laundering.
2. Write a note on Special courts under PMLA.
3. what are the obligations of the reporting entity?

**Essay Type Questions**

1. Discuss the purpose of PMLA.
2. What is the function of central KYC Registry?
3. Discuss few obligations of the Reporting entity.

**Answer**

**Multiple Choice Questions (MCQs)**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|
| d | a | d | c | b | a | c |

**Fill in the blanks**

| | | | |
|---|---|---|---|
| 1 | Directorate of Enforcement, Ministry of Finance | 2 | Predicate |
| 3 | 7 | 4 | Financial Intelligence Unit |
| 5 | Suspicious Transaction report. | 6 | 10 |
| 7 | 2015 | 8 | 2005 |