Bestword's

A Textbook on Corporate and Economic Laws

32nd Edition

For CA (Final) May, 2021 Exams (New Syllabus)

Highlights

- Use of ***easy and lucid language, To-The-Point but comprehensive discussion*** and Student Friendly Approach would make the study of law simple, easy and interesting.
- ***Relevant background behind the legal provisions*** has been incorporated at relevant places. This would enable the students to understand the rationale behind the complicated legal provisions, create an interest in the subject and understand it well.
- ***The detailed discussion and inter-linking of topics*** would be helpful in building strong conceptual clarity.
- ***Self-created examples and illustrations and advanced Practical Problems*** have been included in various chapters so as to explain the intricate provisions of law.
- Incorporates ***Bird's eye view of every chapter*** (at the beginning of every chapter), including the sections, rules, regulations and forms covered in such chapter.
- All the time limits, monetary limits, keywords and important points have been ***highlighted by using the red colour***, which would facilitate quick reading, better understanding and quick revision.
- ***Incorporates numerous amendments made in the Companies Act, 2013, Securities Laws and Economic Laws.***
- The amendments and changes incorporated in the ***latest Study Material issued by ICAI for May, 2021 Exams*** have also been incorporated in this Book.
- The amendments made by ***the Companies (Amendment) Act, 2020*** have not been notified till 31st October, 2020 and so these amendments shall not be applicable for May, 2021 Exams. Accordingly, these amendments have ***not been incorporated in this Edition***.
- The Book contains ***more than 350 Theoretical Questions and 550 Practical Problems (with detailed answers).***
- ***More than 90%*** of the Questions covered in ICAI Study Material, Suggested Answers, Practice Manual, Revision Test Papers (RTPs), Mock Test Papers, Questions for Practice, etc. have been covered in this Book.
- A large number of ***Practical Problems asked in CS Examinations*** have been incorporated.
- The Book incorporates a ***'Ready Reckoner' consisting of 23 Appendices*** containing useful and handy Tables.
- Incorporates the ***Question Paper of November, 2020*** CA (Final) Examination (New Syllabus).
- Includes a ***'Trend' showing distribution of marks*** in Past 10 CA (Final) Examinations.
- The Book includes all the Amendments, Rules, Regulations, Notifications, etc. ***relevant for May, 2021 Exams.***
- The Book has been written as per the Latest Syllabus prescribed by ICAI. All such topics / sections as have been excluded vide ***ICAI's Announcements dated 24th June 2019, 22nd July 2019 and 15th July 2020*** have been eliminated from the Book.
- This Book is updated upto 31st October, 2020 and is ***meant for May, 2021 Exams (New Syllabus)***.

CA CS Munish Bhandari

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Contents at a Glance

Trend Analysis		I-4
Detailed Contents		I-5
Question Papers of Past 3 CA (Final) Examinations		I-23
Guidelines for preparing for exams and writing the exams		I-35
Chapter 1	Appointment and Qualifications of Directors	1.1 to 1.104
Chapter 2	Meetings of Board and its Powers	2.1 to 2.112
Chapter 3	Appointment and Remuneration of Managerial Personnel	3.1 to 3.50
Chapter 4	Inspection, Inquiry and Investigation	4.1 to 4.34
Chapter 5	Compromises, Arrangements and Amalgamations	5.1 to 5.30
Chapter 6	Prevention of Oppression and Mismanagement	6.1 to 6.30
Chapter 7	Registered Valuers	7.1 to 7.14
Chapter 8	Removal of Names of Companies from the Register of Companies	8.1 to 8.6
Chapter 9	Winding Up	9.1 to 9.38
Chapter 10	Companies Incorporated Outside India	10.1 to 10.16
Chapter 11	Government Companies	11.1 to 11.3
Chapter 12	National Company Law Tribunal and Appellate Tribunal	12.1 to 12.9
Chapter 13	Miscellaneous Provisions of the Companies Act, 2013	13.1 to 13.44
Chapter 14	Corporate Secretarial Practice	14.1 to 14.14
Chapter 15	The Foreign Contribution (Regulation) Act, 2010	15.1 to 15.30
Chapter 16	The Arbitration and Conciliation Act, 1996	16.1 to 16.32
Chapter 17	The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015	17.1 to 17.18
Chapter 18	The Securities and Exchange Board of India Act, 1992	18.1 to 18.28
Chapter 19	The Securities Contracts (Regulation) Act, 1956 and the Securities Contracts (Regulation) Rules, 1957	19.1 to 19.42
Chapter 20	The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002	20.1 to 20.24
Chapter 21	The Prevention of Money-laundering Act, 2002	21.1 to 21.32
Chapter 22	The Foreign Exchange Management Act, 1999	22.1 to 22.72
Chapter 23	The Insolvency and Bankruptcy Code, 2016	23.1 to 23.58
Appendices (Ready Reckoner)		A-1 to A-48

Trend Analysis

Frequency Table Showing Distribution of Marks in Last 10 CA (Final) Examinations

S. No.	*Name of the Chapter*	*Nov. 2015*	*May 2016*	*Nov. 2016*	*May 2017*	*Nov. 2017*	*May 2018*	*Nov. 2018*	*May 2019*	*Nov. 2019*	*Nov. 2020*
1	Appointment and Qualifications of Directors	16	8	10	16	10	4	20	16	20	12
2	Meetings of Board and its Powers	16	16	24	8	10	20		10	6	6
3	Appointment and Remuneration of Managerial Personnel		8	8	8	6	8	12			8
4	Inspection, Inquiry and Investigation	4	4	4	8	15	4	12		4	
5	Compromises, Arrangements and Amalgamations		4	6	4		8		4	4	8
6	Prevention of Oppression and Mismanagement	4	4		4		7	3	4		
7	Registered Valuers	Not in Syllabus from Nov. 2015 to Nov. 2017 Exams									
8	Removal of Names of Companies from the Register of Companies	Not in Syllabus from Nov. 2015 to May 2017 Exams					8		4	4	8
9	Winding Up	4	8	4	4		6		8	4	4
10	Companies Incorporated Outside India	4	4	4		4	2	10		8	
11	Government Companies		4	4							
12	National Company Law Tribunal and Appellate Tribunal				4		8	8			
13	Miscellaneous Provisions of the Companies Act, 2013	8	8	4	8	5	10	2	8		4
14	Corporate Secretarial Practice				4	2					
15	The Foreign Contribution (Regulation) Act, 2010	Not in Syllabus from Nov. 2015 to Nov. 2017 Exams					6	6	6	6	3
16	The Arbitration and Conciliation Act, 1996	Not in Syllabus from Nov. 2015 to Nov. 2017 Exams					3	3			3
17	The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015	Not in Syllabus from Nov. 2015 to Nov. 2017 Exams								4	4
18	The Securities and Exchange Board of India Act, 1992	4	4			4		10			
19	The Securities Contracts (Regulation) Act, 1956 and the Securities Contracts (Regulation) Rules, 1957	4	4	4	4		15	9	2	4	4
20	The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002	4	4	4	4	4	5	5	6	6	3
21	The Prevention of Money-laundering Act, 2002	4	4		4	4	6	6	9	9	9
22	The Foreign Exchange Management Act, 1999	4	4	4	4	4	6	6			3
23	The Insolvency and Bankruptcy Code, 2016	Not in Syllabus from Nov. 2015 to May 2017 Exams				10	10	10	9	9	9

Detailed Contents

Chapter 1
Appointment and Qualifications of Directors

Topic	*Name of the Topic*	*Section*	*Rule*	*Page*
1.1	Need for directors	–	–	1.5
1.2	Meaning of 'director' and 'Board of directors'	**2(34) and 2(10)**	–	1.6
1.3	Meaning of 'executive directors' and 'non-executive directors'	–	–	1.6
1.4	Only individuals to be directors and prohibition of assignment of office	**149 and 166**	–	1.7
1.5	Duties of directors	**166**	–	1.7
1.6	Director Identification Number (DIN)	**152(3) and 153 to 159**	**9, 10, 10A, 11, 12, 12A and 12B**	1.8
1.7	Qualifications and disqualifications of directors	**164**	**14**	1.13
1.8	Vacation of office by directors	**167**	–	1.15
1.9	Number of directors	**149(1) and (2)**	–	1.24
1.10	Number of directorships	**165**	–	1.26
1.11	Resignation of directors	**168**	**15 and 16**	1.31
1.12	Appointment of directors to be voted on individually	**162**	–	1.34
1.13	First directors	**152(1)**	–	1.36
1.14	General provisions relating to appointment of directors	**152(2) to (5)**	**8**	1.37
1.15	Rotational and non-rotational directors, and retirement of directors	**152(6) and (7)**	–	1.38
1.16	Right of persons other than retiring directors to stand for directorship	**160**	**13**	1.48
1.17	Appointment of directors by proportional representation	**163**	–	1.51
1.18	Appointment of woman director	**2nd proviso to section 149(1)**	**3**	1.52
1.19	Indian resident director	**149(3)**	–	1.56
1.20	Independent directors	**149**	**4 and 5**	1.57
1.21	Code for independent directors (Schedule IV to the Companies Act, 2013)	–	–	1.68
1.22	Manner of selection of independent directors and maintenance of databank of independent directors	**150**	**6**	1.70
1.23	Appointment of directors by small shareholders	**151**	**7**	1.74
1.24	Appointment of an additional director	**161(1)**	–	1.82
1.25	Filling of casual vacancies by the Board	**161(4)**	–	1.88
1.26	Appointment of an alternate director	**161(2)**	–	1.92
1.27	Appointment of directors by third parties, *i.e.* Nominee directors	**161(3)**	–	1.97
1.28	Removal of a director by shareholders	**169**	–	1.98
1.29	Register of directors and key managerial personnel and their shareholding	**170**	**17 and 18**	1.103
1.30	Members' right to inspect the Register of directors and key managerial personnel and their shareholding	**171**	–	1.104
1.31	Punishment for contravention of Chapter XI	**172**	–	1.104

Chapter 2
Meetings of Board and its Powers

Topic	*Name of the Topic*	*Section*	*Rule*	*Page*
2.1	An introduction to Board meetings	–	–	2.3
2.2	Voting at a Board meeting	–	–	2.4
2.3	Authority to call a Board meeting	–	–	2.6
2.4	Number of Board meetings	**173(1) and (5)**	–	2.6
2.5	Board meetings through electronic mode/video conferencing	**173(2)**	**3 and 4**	2.8
2.6	Notice of a Board meeting	**173(3) and (4)**	–	2.14
2.7	Quorum for a Board meeting	**174**	–	2.21
2.8	Recourse when quorum is not present	–	–	2.28
2.9	Passing of resolution by circulation	**175**	**5**	2.28
2.10	Place, time and day of a Board meeting	–	–	2.31
2.11	Chairperson of the Board meeting	–	–	2.33
2.12	Minutes	**118**	–	2.35
2.13	Inspection of minutes of general meeting	**119**	–	2.38
2.14	Validity of acts of directors	**176**	–	2.39
2.15	Audit committee	**177**	**6 and 6A**	2.40
2.16	Vigil mechanism for directors and employees	**177**	**7**	2.45
2.17	Nomination and Remuneration Committee	**178**	**6**	2.46
2.18	Stakeholders Relationship Committee	**178**	–	2.48
2.19	Powers of the Board	**179**	**8**	2.48
2.20	Restrictions on powers of the Board	**180**	–	2.52
2.21	Company to contribute to bonafide and charitable funds, etc.	**181**	–	2.60
2.22	Prohibitions and restrictions regarding political contributions	**182**	–	2.64
2.23	Contributions to National Defence Fund, etc.	**183**	–	2.70
2.24	Loans to directors, etc.	**185**	–	2.72
2.25	Restrictions with respect to layers of investment companies	**186(1)**	–	2.81
2.26	Loans and investments by a company	**186**	**11 and 13**	2.82
2.27	Non-applicability of section 186	**186(11)**	–	2.84
2.28	Register of loans etc.	**186(9) and (10)**	**12**	2.91
2.29	Investments of company to be held in its own name	**187**	**14**	2.92
2.30	Disclosure of interest by a director	**184**	**9**	2.93
2.31	Related party transactions	**188**	**15**	2.98
2.32	Registers of contracts or arrangements in which directors are interested	**189**	**16**	2.107
2.33	Contract of employment with managing or whole-time directors	**190**	–	2.108
2.34	Payment to directors for loss of office, etc. in connection with transfer of undertaking, property or shares	**191**	**17**	2.109
2.35	Restriction on non-cash transactions involving directors	**192**	–	2.110
2.36	Contracts by One Person Company	**193**	–	2.112

Chapter 3
Appointment and Remuneration of Managerial Personnel

Topic	*Name of the Topic*	*Section*	*Rule*	*Page*
3.1	Definition of 'managing director'	**2(54)**	–	3.3
3.2	Definition of 'manager'	**2(53)**	–	3.4
3.3	Definition of 'whole time director'	**2(94)**	–	3.4

3.4	Appointment of managing director, whole-time director or manager	**196**	**3 and 7**	3.5
3.5	Eligibility for appointment as a managerial person as per Schedule V (Part I of Schedule V)	–	–	3.9
3.6	Remuneration of a managerial person as per Schedule V (Part II of Schedule V)	–	–	3.11
3.7	Procedural requirements for appointment or payment of remuneration as per Schedule V (Part III of Schedule V)	–	–	3.14
3.8	Managerial remuneration	**197**	**4, 5 and 6**	3.14
3.9	Calculation of profits	**198**	–	3.20
3.10	Recovery of remuneration in certain cases	**199**	–	3.21
3.11	Company to fix limit with regard to remuneration	**200**	–	3.22
3.12	Forms of, and procedure in relation to, certain applications	**201**	7	3.22
3.13	Compensation for loss of office	**202**	–	3.37
3.14	Appointment of key managerial personnel	**203**	**8 and 8A**	3.40
3.15	Secretarial audit for bigger companies	**204**	**9**	3.48
3.16	Functions of company secretary	**205**	**10**	3.50

Chapter 4
Inspection, Inquiry and Investigation

Topic	*Name of the Topic*	*Section*	*Rule*	*Page*
4.1	Power to call for information, inspect books and conduct inquiries	**206**	–	4.3
4.2	Conduct of inspection and inquiry	**207**	–	4.5
4.3	Report on inspection made	**208**	–	4.6
4.4	Search and seizure	**209**	–	4.6
4.5	Investigation into affairs of company	**210**	–	4.8
4.6	Investigation into the affairs of a company on an order made by the Tribunal	**213**	–	4.11
4.7	Establishment of Serious Fraud Investigation Office	**211**	3	4.14
4.8	Investigation into the affairs of a company by Serious Fraud Investigation Office	**212**	–	4.15
4.9	Security for payment of costs and expenses of investigation	**214**	5	4.19
4.10	Firm, body corporate or association not to be appointed as inspector	**215**	–	4.19
4.11	Investigation of membership of a company	**216**	–	4.19
4.12	Procedure, powers, etc., of inspectors	**217**	6	4.20
4.13	Temporary protection of employees	**218**	–	4.22
4.14	Power of inspector to conduct investigation into affairs of related companies, etc.	**219**	–	4.24
4.15	Seizure of documents by inspector	**220**	–	4.25
4.16	Freezing of assets of company on inquiry and investigation	**221**	–	4.26
4.17	Imposition of restrictions upon securities	**222**	–	4.27
4.18	Inspector's report	**223**	–	4.30
4.19	Actions to be taken in pursuance of inspector's report	**224**	–	4.30
4.20	Expenses of investigation	**225**	–	4.32
4.21	Voluntary winding-up of company, etc., not to stop investigation proceedings	**226**	–	4.32
4.22	Saving for legal advisers and bankers	**227**	–	4.33
4.23	Inquiry, inspection and investigation of foreign companies	**228**	–	4.34
4.24	Penalty for furnishing false statement, mutilation, destruction of documents	**229**	–	4.34

Chapter 5
Compromises, Arrangements and Amalgamations

Topic	Name of the Topic	Section	Page
5.1	Power to compromise or make arrangements with creditors and members	**230**	5.3
5.2	Power of Tribunal to enforce compromise or arrangement	**231**	5.10
5.3	Merger and amalgamation of companies	**232**	5.10
5.4	Merger or amalgamation of certain companies	**233**	5.20
5.5	Merger or amalgamation of company with foreign company	**234**	5.22
5.6	Power to acquire shares of shareholders dissenting from scheme or contract approved by majority	**235**	5.23
5.7	Purchase of minority shareholding	**236**	5.25
5.8	Power of Central Government to provide for amalgamation of companies in public interest	**237**	5.27
5.9	Registration of offer of schemes involving transfer of shares	**238**	5.29
5.10	Preservation of books and papers of amalgamated companies	**239**	5.29
5.11	Liability of officers in respect of offences committed prior to merger, amalgamation, etc.	**240**	5.30

Chapter 6
Prevention of Oppression and Mismanagement

Topic	Name of the Topic	Section	Page
6.1	The 'Majority Rule'	–	6.1
6.2	Application to Tribunal for relief in cases of oppression, etc.	**241**	6.5
6.3	Right to apply under section 241	**244**	6.6
6.4	Powers of the Tribunal and consequence of termination or modification of certain agreements	**242 and 243**	6.16
6.5	Class action	**245**	6.27
6.6	Application of certain provisions to proceedings under section 241 or 245	**246**	6.30

Chapter 7
Registered Valuers

Topic	Name of the Topic	Section	Page
7.1	Registered Valuers	**247**	7.3
Appendix - The Companies (Registered Valuers and Valuation) Rules, 2017			7.4

Chapter 8
Removal of Names of Companies from the Register of Companies

Topic	Name of the Topic	Section	Page
8.1	Power of Registrar to remove name of the company from the register of companies	**248**	8.1
8.2	Restrictions on making application under section 248 in certain situations	**249**	8.3
8.3	Effect of company notified as dissolved	**250**	8.5
8.4	Fraudulent application for removal of name	**251**	8.5
8.5	Appeal to Tribunal	**252**	8.5

Chapter 9
Winding Up

Topic	Name of the Topic	Section	Page
9.1	Introduction	–	9.2
9.2	Winding up by Tribunal	**270**	9.2
9.3	Circumstances in which company may be wound up by Tribunal	**271**	9.2
9.4	Petition for winding up	**272**	9.3

9.5	Powers of the Tribunal	**273**	9.4
9.6	Directions for filing statement of affairs	**274**	9.5
9.7	Company Liquidators and their appointments	**275**	9.6
9.8	Removal and replacement of liquidator	**276**	9.7
9.9	Intimation to Company Liquidator, provisional liquidator and Registrar	**277**	9.7
9.10	Effect of winding up order	**278**	9.8
9.11	Stay of suits, etc., on winding up order	**279**	9.8
9.12	Jurisdiction of Tribunal	**280**	9.8
9.13	Submission of report by Company Liquidator	**281**	9.9
9.14	Directions of Tribunal on report of Company Liquidator	**282**	9.10
9.15	Custody of company's properties	**283**	9.10
9.16	Promoters, directors, etc., to cooperate with Company Liquidator	**284**	9.11
9.17	Settlement of list of contributories and application of assets	**285**	9.11
9.18	Obligations of directors and managers	**286**	9.13
9.19	Advisory committee	**287**	9.14
9.20	Submission of periodical reports to the Tribunal	**288**	9.14
9.21	Powers and duties of Company Liquidator	**290**	9.14
9.22	Provision for professional assistance to Company Liquidator	**291**	9.15
9.23	Exercise and control of Company Liquidator's powers	**292**	9.16
9.24	Books to be kept by Company Liquidator	**293**	9.16
9.25	Audit of Company Liquidator's accounts	**294**	9.16
9.26	Payment of debts by contributory and extent of set-off	**295**	9.17
9.27	Power of Tribunal to make calls	**296**	9.17
9.28	Adjustment of rights of contributories	**297**	9.17
9.29	Power to order costs	**298**	9.17
9.30	Power to summon persons suspected of having property of company, etc.	**299**	9.17
9.31	Power to order examination of promoters, directors, etc.	**300**	9.18
9.32	Arrest of person trying to leave India or abscond	**301**	9.19
9.33	Dissolution of company by Tribunal	**302**	9.20
9.34	Appeals from orders made before commencement of Act	**303**	9.20
9.35	Debts of all descriptions to be admitted to proof	**324**	9.20
9.36	Overriding preferential payments	**326**	9.20
9.37	Preferential payments	**327**	9.22
9.38	Fraudulent preference	**328**	9.26
9.39	Transfers not in good faith to be void	**329**	9.29
9.40	Certain transfers to be void	**330**	9.29
9.41	Liabilities and rights of certain persons fraudulently preferred	**331**	9.29
9.42	Effect of floating charge	**332**	9.29
9.43	Disclaimer of onerous property	**333**	9.32
9.44	Transfers, etc., after commencement of winding up to be void	**334**	9.33
9.45	Certain attachments, executions, etc., in winding up by Tribunal to be void	**335**	9.33
9.46	Offences by officers of companies in liquidation	**336**	9.33
9.47	Statement that company is in liquidation	**344**	9.34

9.48	Books and papers of company to be evidence	**345**	9.35
9.49	Inspection of books and papers by creditors and contributories	**346**	9.35
9.50	Disposal of books and papers of company	**347**	9.35
9.51	Company Liquidation Dividend and Undistributed Assets Account	**352**	9.35
9.52	Liquidator to make returns, etc.	**353**	9.37
9.53	Meetings to ascertain wishes of creditors or contributories	**354**	9.37
9.54	Court, Tribunal or person, etc., before whom affidavit may be sworn	**355**	9.37
9.55	Powers of Tribunal to declare dissolution of company void	**356**	9.37
9.56	Commencement of winding up by Tribunal	**357**	9.38
9.57	Exclusion of certain time in computing period of limitation	**358**	9.38

Chapter 10
Companies Incorporated Outside India

Topic	*Name of the Topic*	*Section*	*Page*
10.1	Definition of a foreign company	**2(42)**	10.3
10.2	Meaning of certain terms	**386**	10.3
10.3	Application of Act to foreign companies	**379**	10.7
10.4	Documents, etc., to be delivered to Registrar by foreign companies	**380**	10.8
10.5	Accounts of foreign company	**381**	10.11
10.6	Display of name, etc. of foreign company	**382**	10.12
10.7	Service of documents on foreign company	**383**	10.12
10.8	Debentures, annual return, registration of charges, books of account and their inspection	**384**	10.13
10.9	Fee for registration of documents	**385**	10.13
10.10	Dating of prospectus and particulars to be contained therein	**387**	10.13
10.11	Provisions as to expert's consent and allotment	**388**	10.14
10.12	Registration of prospectus	**389**	10.15
10.13	Offer of Indian Depository Receipts	**390**	10.15
10.14	Application of sections 34 to 36 and Chapter XX	**391**	10.16
10.15	Punishment for contravention	**392**	10.16
10.16	Company's failure to comply with provisions of this Chapter not to affect validity of contracts, etc.	**393**	10.16

Chapter 11
Government Companies

Topic	*Name of the Topic*	*Section*	*Page*
11.1	Definition of a Government company	**2(45)**	11.1
11.2	Annual report of a Government company	**394**	11.2
11.3	Annual reports where one or more State Governments are members of companies	**395**	11.3

Chapter 12
National Company Law Tribunal and Appellate Tribunal

Topic	Name of the Topic	Section	Page
12.1	Definitions	**407**	12.2
12.2	Orders of Tribunal	**420**	12.2
12.3	Appeal against orders of Tribunal	**421**	12.2
12.4	Expeditious disposal by Tribunal and Appellate Tribunal	**422**	12.6
12.5	Appeal to Supreme Court	**423**	12.6
12.6	Procedure before Tribunal and Appellate Tribunal	**424**	12.6
12.7	Power to punish for contempt	**425**	12.7
12.8	Delegation of powers	**426**	12.7
12.9	President, Members, officers, etc., to be public servants	**427**	12.7
12.10	Protection of action taken in good faith	**428**	12.7
12.11	Power to seek assistance of Chief Metropolitan Magistrate, etc.	**429**	12.7
12.12	Civil court not to have jurisdiction	**430**	12.8
12.13	Vacancy in Tribunal or Appellate Tribunal not to invalidate acts or proceedings	**431**	12.8
12.14	Right to legal representation	**432**	12.8
12.15	Limitation	**433**	12.8
12.16	Transfer of certain pending proceedings	**434**	12.8

Chapter 13
Miscellaneous Provisions of the Companies Act, 2013

Topic	Name of the Topic	Section	Page
13.1	Provision relating to Nidhis and its application, etc.	**406**	13.4
13.2	Special Courts	**435 to 438, and 440**	13.9
13.3	Dissolution of Company Law Board and consequential provisions	**466**	13.10
13.4	Offences to be non cognizable	**439**	13.11
13.5	Mediation and Conciliation Panel	**442**	13.13
13.6	Power of the Central Government to appoint Company Prosecutors	**443**	13.14
13.7	Appeal against acquittal	**444**	13.14
13.8	Compensation for accusation without reasonable cause	**445**	13.14
13.9	Application of fines	**446**	13.14
13.10	Factors for determining level of punishment	**446A**	13.14
13.11	Lesser penalties for One Person Companies or small companies	**446B**	13.15
13.12	Punishment for fraud	**447**	13.15
13.13	Offences and penalties under the Act	**450**	13.15
13.14	Adjudication of penalties	**454**	13.16
13.15	Penalty for repeated default	**454A**	13.17
13.16	Dormant company	**455**	13.17
13.17	Process and relevance of back office of MCA	–	13.19
13.18	Condonation of Delay Scheme, 2018	–	13.20

Appendix 1: Definitions contained in section 2 of the Companies Act, 2013	–	13.23
Appendix 2: The Companies (Restriction on Number of Layers) Rules, 2017	–	13.34
Appendix 3: The Companies (Mediation and Conciliation) Rules, 2016	–	13.35
Appendix 4: The Companies (Adjudication of Penalties) Rules, 2014	–	13.41

Chapter 14
Corporate Secretarial Practice

Topic	*Name of the Topic*	*Section*
14.1	Nature of resolutions and requirements of drafting a resolution	14.1
14.2	Key points for drafting minutes of a Board meeting	14.9

Chapter 15
The Foreign Contribution (Regulation) Act, 2010

Topic	*Name of the Topic*	*Section*	*Page*
15.1	Extent, application and commencement of the Act	**1**	15.3
15.2	Objectives of the Act	–	15.3
15.3	Structure of the Act	–	15.3
15.4	Definitions	**2**	15.3
15.5	Prohibition on acceptance of foreign contribution	**3**	15.6
15.6	No prohibition on acceptance of foreign contribution by any person or organisation covered under section 3 in certain cases (Section 4)	**4**	15.7
15.7	Restriction on acceptance of foreign hospitality	**6**	15.10
15.8	Prohibition to transfer foreign contribution to other person	**7**	15.12
15.9	Restriction to utilise foreign contribution for administrative purpose	**8**	15.13
15.10	Power of Central Government to prohibit receipt of foreign contribution, etc., in certain cases	**9**	15.14
15.11	Power to prohibit payment of currency received in contravention of the Act	**10**	15.16
15.12	Registration of certain persons with Central Government	**11**	15.17
15.13	Grant of certificate of registration or prior permission	**12**	15.18
15.14	Power of CG to require Aadhaar number, etc., as identification document	**12A**	15.20
15.15	Suspension of certificate of registration	**13**	15.20
15.16	Cancellation of certificate of registration	**14**	15.20
15.17	Surrender of certificate	**14A**	15.21
15.18	Management of foreign contribution of person whose certificate has been cancelled or surrendered	**15**	15.21
15.19	Renewal of certificate	**16**	15.22
15.20	Foreign contribution through scheduled bank	**17**	15.23
15.21	Intimation of receipt and utilisation of foreign contribution	**18**	15.24
15.22	Maintenance of accounts	**19**	15.24
15.23	Audit of accounts	**20**	15.24
15.24	Disposal of assets created out of foreign contribution	**22**	15.25
15.25	Confiscation of article or currency or security obtained in contravention of the Act	**28**	15.25
15.26	Adjudication of confiscation	**29 and 30**	15.25
15.27	Appeals	**31**	15.25
15.28	Revision of orders by the Central Government	**32**	15.26
15.29	Offences and penalties	**33 to 38**	15.27

15.30	Offences by companies	**39**	15.28
15.31	Bar on prosecution of offences under the Act	**40**	15.28
15.32	Composition of certain offences	**41**	15.28
15.33	Power to call for information or document	**42**	15.29
15.34	Investigation into cases under the Act	**43**	15.29
15.35	Power of Central Government to give directions	**46**	15.29
15.36	Delegation of powers	**47**	15.29
15.37	Power to make rules	**48**	15.29
15.38	Power to exempt in certain cases	**50**	15.30
15.39	Act not to apply to certain Government transactions	**51**	15.30
15.40	Application of other laws not barred	**52**	15.30
15.41	Power to remove difficulties	**53**	15.30

Chapter 16
The Arbitration and Conciliation Act, 1996

Topic	*Name of the Topic*	*Section*	*Page*
16.1	Introduction	–	16.2
16.2	Alternative Dispute Resolution	–	16.3
16.3	Meaning of arbitration	–	16.4
16.4	Features of arbitration	–	16.5
16.5	Advantages of arbitration	–	16.6
16.6	Distinction between arbitration and litigation	–	16.6
16.7	Definitions	**2**	16.7
16.8	Arbitration agreement	**7**	16.8
16.9	Disputes which can be submitted to arbitration	–	16.8
16.10	Legal requirements for a valid arbitration agreement	–	16.9
16.11	Kinds of arbitration agreements	–	16.12
16.12	Form of arbitration agreement, scope and subject matter of arbitration etc.	–	16.12
16.13	Legal effect of arbitration agreement	**8**	16.12
16.14	Competence of arbitral tribunal to rule on its jurisdiction	**16**	16.13
16.15	Termination of an arbitration agreement	–	16.14
16.16	Arbitral tribunal	–	16.14
16.17	Grounds for determining independence and impartiality (Fifth Schedule)	–	16.15
16.18	Disqualifications for appointment as arbitrator (Seventh Schedule)	–	16.17
16.19	Types of arbitration procedures	–	16.18
16.20	Number of arbitrators	**10**	16.18
16.21	Appointment of arbitrators	**11**	16.18
16.22	Duties of the arbitrator	–	16.20
16.23	Termination of arbitrator	–	16.21
16.24	Time limit for arbitral award	**29A**	16.22
16.25	Kinds of arbitral award	–	16.23
16.26	Requirements for an arbitral award	**29 and 31**	16.24
16.27	Setting aside the arbitral award	**34**	16.25
16.28	Consequences where an application is made for setting aside an arbitral award	–	16.26

16.29	Finality of arbitral awards	**35**	16.27
16.30	Enforcement of arbitral award	**36**	16.27
16.31	Introduction to conciliation	–	16.27
16.32	Features of conciliation	–	16.27
16.33	Difference between mediation and conciliation	–	16.28
16.34	Difference between arbitration and conciliation	–	16.29
16.35	Applicability and scope of conciliation	**61**	16.30
16.36	Number of conciliators	**63**	16.30
16.37	Appointment of conciliators	**64**	16.30
16.38	Submission of statements to conciliator	**65**	16.30
16.39	Bar on arbitral or judicial proceedings	**77**	16.31
16.40	Role of conciliator	**67**	16.31
16.41	Stages in settlement agreement	**67, 72, 73 and 74**	16.31
16.42	Confidentiality of information	**70 and 75**	16.32
16.43	Role of conciliator in other proceedings	**80**	16.32

Chapter 17
The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015

Topic	*Name of the Topic*	*Regulation*	*Page*
17.1	Introduction	–	17.2
17.2	Main Features of the Regulations	–	17.2
17.3	Applicability of the Regulations	**3**	17.3
17.4	Common obligations of listed entities	**5, 6, 7 and 27**	17.3
17.5	Grievance Redressal Mechanism	**13**	17.4
17.6	Board of Directors	**17**	17.4
17.7	Maximum number of directorships	**17A**	17.7
17.8	Committees under the SEBI (LODR) Regulations, 2015	–	17.7
17.9	Audit Committee	**18**	17.7
17.10	Nomination and Remuneration Committee	**19**	17.9
17.11	Stakeholders Relationship Committee	**20**	17.9
17.12	Risk Management Committee	**21**	17.10
17.13	Related party transactions	**23**	17.10
17.14	Corporate governance requirements with respect to subsidiary of a listed entity	**24**	17.11
17.15	Restrictions on number of committees in which a director can be a member	**26**	17.12
17.16	Other corporate governance requirements	**27**	17.12
17.17	Prior intimations of Board meetings	**29**	17.12
17.18	Holding of specified securities and shareholding pattern	**31**	17.13
17.19	Statement of deviation(s) or variation(s)	**32**	17.14
17.20	Compliances by listed entities – At quarterly intervals	–	17.14
17.21	Compliances by listed entities – At yearly intervals	–	17.14
17.22	Financial results	**33**	17.15
17.23	Annual report	**34**	17.16
17.24	Documents and information to shareholders	**36**	17.16

17.25	Record date or date of closure of transfer books	**42**	17.17
17.26	Website	**46**	17.17

Chapter 18
The Securities and Exchange Board of India Act, 1992

Topic	*Name of the Topic*	*Section*	*Page*
18.1	Objectives of the SEBI Act, 1992	–	18.3
18.2	Establishment and management of SEBI	**3, 4 and 5**	18.4
18.3	Removal of member from office	**6**	18.5
18.4	Meetings	**7**	18.5
18.5	Member not to participate in meetings in certain cases	**7A**	18.5
18.6	Vacancies, etc. not to invalidate proceedings of Board	**8**	18.5
18.7	Functions of SEBI	**11**	18.6
18.8	Regulation or prohibition of issue of prospectus etc.	**11A**	18.8
18.9	Collective investment scheme	**11AA**	18.8
18.10	Power to issue directions and levy penalty	**11B**	18.9
18.11	Powers of SEBI to order investigation	**11C**	18.9
18.12	Cease and desist proceedings	**11D**	18.11
18.13	Prohibition of manipulative and deceptive devices, insider trading etc.	**12A**	18.11
18.14	Penalty for failure to furnish information, return, etc.	**15A**	18.12
18.15	Penalty for failure by any person to enter into agreement with clients	**15B**	18.12
18.16	Miscellaneous provisions on penalties	–	18.12
18.17	Penalty for default in case of stock brokers	**15F**	18.13
18.18	Meaning of insider and price sensitive information, and penalty for insider trading	**15G**	18.13
18.19	Penalty for non-disclosure of acquisition of shares and takeovers	**15H**	18.14
18.20	Penalties – Miscellaneous	–	18.14
18.21	Procedure for adjudication	**15-I and 15J**	18.16
18.22	Settlement of administrative and civil proceedings	**15JB**	18.17
18.23	Establishment of Securities Appellate Tribunal	**15K**	18.17
18.24	Composition of Securities Appellate Tribunal	**15L**	18.17
18.25	Qualifications for appointment as Presiding Officer or Member of Securities Appellate Tribunal	**15M**	18.18
18.26	Appointment of Presiding Officer and Judicial Members	**15MA**	18.18
18.27	Search-cum-Selection Committee for appointment of Technical Members	**15MB**	18.18
18.28	Vacancy not to invalidate selection proceeding	**15MC**	18.19
18.29	Tenure of office of Presiding Officer, etc.	**15N**	18.19
18.30	Salary and allowances and other terms and conditions of service of Presiding Officers	**15O**	18.19
18.31	Filling up of vacancies	**15P and 15PA**	18.20

18.32	Resignation and removal	**15Q**	18.20
18.33	Appointment, qualification and the other terms and conditions of service	**15QA**	18.20
18.34	Orders constituting Securities Appellate Tribunal to be final and not to invalidate its proceedings	**15R**	18.21
18.35	Staff of the Securities Appellate Tribunal	**15S**	18.21
18.36	Appeal to Securities Appellate Tribunal	**15T**	18.21
18.37	Procedure and powers of the Securities Appellate Tribunal	**15U**	18.22
18.38	Right to legal representation	**15V**	18.23
18.39	Limitation	**15W**	18.23
18.40	Presiding Officer, Members and staff of Securities Appellate Tribunals to be public servants	**15X**	18.23
18.41	Civil Court not to have jurisdiction	**15Y**	18.23
18.42	Appeal to Supreme Court	**15Z**	18.23
18.43	Power of Central Government to issue directions	**16**	18.23
18.44	Power of Central Government to supersede SEBI	**17**	18.23
18.45	Powers of SEBI to prevent undesirable transactions in securities	–	18.24
18.46	Failure to pay penalty	**24**	18.24
18.47	Composition of certain offences	**24A**	18.25
18.48	Power to grant immunity	**24B**	18.25
18.49	Cognisance of offences by Courts	**26**	18.25
18.50	Special Courts	**26A to 26E**	18.26
18.51	Contravention by companies	**27**	18.26
18.52	Recovery of amounts	**28A**	18.27
18.53	Continuance of proceedings	**28B**	18.28
18.54	Powers of SEBI not to apply to International Financial Services Centre	**28C**	18.28

Chapter 19
The Securities Contracts (Regulation) Act, 1956 and the Securities Contracts (Regulation) Rules, 1957

Topic	*Name of the Topic*	*Section*	*Page*
19.1	Objectives of the Act	–	19.3
19.2	Non-applicability of the Act	**28**	19.3
19.3	Definitions	**2**	19.4
19.4	Meaning of stock exchange, recognised stock exchange and prohibition of unrecognised stock exchange	**2 and 19**	19.6
19.5	Definitions on corporatisation and demutualisation	**2**	19.7
19.6	Recognition of stock exchanges	**3 and 4**	19.8
19.7	Renewal of recognition of a stock exchange	–	19.9
19.8	Qualifications for membership of a recognised stock exchange	–	19.10
19.9	Withdrawal of recognition of a stock exchange	**5**	19.12
19.10	Power of CG/SEBI – Calling periodical returns or directing inquiries	**6 and 7**	19.13
19.11	Powers of SEBI to issue directions	**12A**	19.17
19.12	Power of Central Government to supersede governing body of a recognised stock exchange	**11**	19.18
19.13	Power of Central Government to suspend business of recognised stock exchanges	**12**	19.19

19.14	Power of Central Government to prohibit contracts in certain cases	**16**	19.20
19.15	Contracts in notified areas illegal in certain circumstances	**13**	19.21
19.16	Contracts in notified areas to be void in certain circumstances	**14**	19.21
19.17	Licensing of dealers in securities in certain areas	**17**	19.21
19.18	Power of recognised stock exchanges to make bye-laws	**9**	19.22
19.19	Power of recognised stock exchange to make rules restricting voting rights, etc.	**7A**	19.23
19.20	Power of SEBI to make or amend bye-laws of recognised stock exchanges	**10**	19.24
19.21	Power of Central Government to make or amend the rules of a stock exchange	**8**	19.25
19.22	Members not to act as principals	**15**	19.26
19.23	Contracts in derivative	**18A**	19.26
19.24	Power of a stock exchange to establish additional trading floor	**13A**	19.26
19.25	Listing of securities	**21 , 22A, 22B, 22C, 22D, 22E and 22F**	19.27
19.26	Delisting of securities	**21A**	19.29
19.27	Special provisions for public issue and listing of certain securities	**17A**	19.31
19.28	Clearing corporation	**8A**	19.31
19.29	Title to dividends	**27**	19.32
19.30	Right to receive income from collective investment scheme	**27A**	19.33
19.31	Penalties	**23**	19.34
19.32	More penalties	**23A to 23H**	19.35
19.33	Procedure for adjudication	**23I and 23J**	19.37
19.34	Settlement of administrative and civil proceedings	**23JA**	19.37
19.35	Recovery of amounts	**23JB**	19.38
19.36	Continuance of proceedings	**23JC**	19.38
19.37	Appeal to Securities Appellate Tribunal	**23L**	19.39
19.38	Offences	**23M**	19.40
19.39	Composition of certain offences	**23N**	19.40
19.40	Offences by companies	**24**	19.42
19.41	Special Courts	**26A and 26C**	19.42
19.42	Powers of SEBI not to apply to International Financial Services Centre	**29B**	19.42

Chapter 20
The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

Topic	*Name of the Topic*	*Section*	*Page*
20.1	Definitions	**2**	20.3
20.2	Registration of asset reconstruction companies	**3**	20.6
20.3	Cancellation of certificate of registration	**4**	20.7
20.4	Acquisition of rights or interest in financial assets	**5**	20.8
20.5	Transfer of pending applications to any one of Debts Recovery Tribunals in certain cases	**5A**	20.9
20.6	Notice to borrower and discharge of obligation of such borrower	**6**	20.10
20.7	Issue of security by raising of receipts or funds by asset reconstruction company	**7**	20.11
20.8	Measures for assets reconstruction	**9**	20.11

20.9	Other functions of an asset reconstruction company	**10**	20.12
20.10	Resolution of disputes	**11**	20.12
20.11	Power of Reserve Bank to determine policy and issue directions	**12**	20.12
20.12	Power of Reserve Bank to call for statements and information	**12A**	20.13
20.13	Power of Reserve Bank to carry out audit and inspection	**12B**	20.13
20.14	Enforcement of security interest	**13**	20.14
20.15	Chief Metropolitan Magistrate or District Magistrate to assist secured creditor in taking possession of secured asset	**14**	20.18
20.16	Manner and effect of takeover of management	**15**	20.19
20.17	No compensation to directors for loss of office	**16**	20.21
20.18	Application against measures to recover secured debts	**17**	20.21
20.19	Appeal to Appellate Tribunal	**18**	20.22
20.20	Validation of fees levied	**18A**	20.23
20.21	Right to lodge a caveat	**18C**	20.23
20.22	Right of borrower to receive compensation and costs in certain cases	**19**	20.23
20.23	Provisions of this Act not to apply in certain cases	**31**	20.24

Chapter 21
The Prevention of Money-laundering Act, 2002

Topic	*Name of the Topic*	*Section*	*Page*
21.1	Objectives of the Act	–	21.2
21.2	Definitions	**2**	21.2
21.3	Punishment for money-laundering	**4**	21.5
21.4	Verification of identity by reporting entity	**11A**	21.7
21.5	Banking companies financial institutions and intermediaries to maintain records	**12**	21.7
21.6	Access to information	**12A**	21.9
21.7	Powers of director to impose fine	**13**	21.9
21.8	No civil or criminal proceedings against reporting entity, its directors and employees	**14**	21.10
21.9	Attachment of property involved in money-laundering	**5**	21.10
21.10	Adjudicating Authorities, composition, powers, etc.	**6**	21.12
21.11	Adjudication	**8**	21.12
21.12	Vesting of property in Central Government	**9**	21.14
21.13	Appeal to Appellate Tribunal	**25 and 26**	21.14
21.14	Procedure and powers of Appellate Tribunal	**35**	21.16
21.15	Decision to be by majority	**38**	21.16
21.16	Civil court not to have jurisdiction	**41**	21.17
21.17	Appeal to High Court	**42**	21.17
21.18	Special Courts	**43**	21.17
21.19	Offences triable by Special Courts	**44**	21.18
21.20	Offences to be cognizable and non-bailable	**45**	21.19

21.21	Application of Code of Criminal Procedure, 1973 to proceedings before Special Court	**46**	21.20
21.22	Appeals and revision	**47**	21.20
21.23	Authorities under the Act	**48**	21.20
21.24	Definitions	**55**	21.21
21.25	Agreements with foreign countries	**56**	21.21
21.26	Letter of request to a contracting State in certain cases	**57**	21.21
21.27	Assistance to a contracting State in certain cases	**58**	21.22
21.28	Punishment for vexatious search	**62**	21.22
21.29	Punishment for false information or failure to give information, etc.	**63**	21.22
21.30	Cognizance of offences	**64**	21.22
21.31	Code of Criminal Procedure, 1973 to apply in certain cases	**65**	21.23
21.32	Disclosure of information	**66**	21.23
21.33	Recovery of fine or penalty	**69**	21.23
21.34	Offences by companies	**70**	21.23
21.35	Act to have overriding effect	**71**	21.24
21.36	Continuation of proceedings in the event of death or insolvency	**72**	21.24

Chapter 22
The Foreign Exchange Management Act, 1999

Topic	*Name of the Topic*	*Section*	*Page*
22.1	Objectives of FEMA	–	22.3
22.2	Difference between FEMA and FERA	–	22.3
22.3	Definitions	**Sec. 2**	22.4
22.4	Definitions relating to residential status	**2(u), (v) and (w)**	22.6
22.5	Regulation and management of foreign exchange	**3 and 4**	22.13
22.6	Receipts by a person resident in India – General permission	–	22.14
22.7	Authorised person	**10 to 12**	22.14
22.8	Current account transactions	**2(j) and 5**	22.16
22.9	Rules on current account transactions	–	22.17
22.10	Capital account transactions	**2(e) and 6**	22.26
22.11	Regulations on capital account transactions	–	22.27
22.12	Export of goods and services	**2(l) and 7**	22.31
22.13	Foreign Exchange Management (Export of Goods & Services) Regulations, 2015	–	22.32
22.14	Repatriation of foreign exchange and exemptions	**2(y), 8 and 9**	22.40
22.15	Adjudicating Authority	**16**	22.41
22.16	Penalties	**13**	22.41
22.17	Procedure for adjudication	**14 and 16**	22.43
22.18	Power to recover arrears of penalty	**14A**	22.45
22.19	Compounding of contravention	**15**	22.45
22.20	Appeal to Special Director (Appeals) and Appellate Tribunal	**17, 18 and 19**	22.47
22.21	Appeal to High Court	**35**	22.49

22.22	Directorate of Enforcement	36	22.49
22.23	Power of search, seizure, etc.	37	22.50
22.24	Empowering other officers	38	22.50
22.25	Presumption as to documents in certain cases	39	22.50
22.26	Suspension of operation of this Act	40	22.50
22.27	Power of Central Government to give directions	41	22.51
22.28	Death or insolvency in certain cases	43	22.51
22.29	Bar of legal Proceedings	44	22.51
22.30	Powers of RBI not to apply to International Financial Services Centre	44A	22.51
22.31	Repeal and saving	49	22.51
22.32	Contravention by companies	42	22.52
22.33	Repatriation of sale proceeds of immovable property	–	22.52
22.34	Borrowing in foreign currency by persons other than an authorised dealer	–	22.53
22.35	Lending in foreign currency by persons other than an authorised dealer	–	22.53
22.36	Master direction issued by RBI w.r.t. External Commercial Borrowings (ECB)	–	22.54
22.37	Overseas Direct Investment (Direct Investment / Financial Commitment outside India) (ODI)	–	22.66
22.38	Master Direction issued by RBI w.r.t. Import of goods and services and other matters	–	22.69

Chapter 23
The Insolvency and Bankruptcy Code, 2016

Topic	*Name of the Topic*	*Section*	*Page*
23.1	Introduction – Shifting existing regime 'Debtor in possession' to a 'Creditor in control'	–	23.3
23.2	Evolution of the Code	–	23.3
23.3	Purpose of the Code	–	23.4
23.4	Extent of the Code	–	23.4
23.5	Commencement of the Code	–	23.4
23.6	Applicability of the Code	2	23.4
23.7	'Insolvency' vis-à-vis 'bankruptcy'	–	23.4
23.8	Meaning of insolvency resolution	–	23.5
23.9	Meaning of liquidation	–	23.5
23.10	Who can initiate the proceedings of liquidation?	–	23.5
23.11	Key features of the Code	–	23.5
23.12	Penal Provisions	–	23.6
23.13	Structure of the Code	–	23.6
23.14	Five Pillars of the Code	–	23.6
23.15	Definitions	3	23.7
23.16	Definitions applicable to Part II of the Code	5	23.8
23.17	Application of Part II of the Code	4	23.11
23.18	Persons who may initiate corporate insolvency resolution process	6	23.12
23.19	Initiation of corporate insolvency resolution process by financial creditor	7	23.12
23.20	Insolvency resolution by operational creditor	8	23.15

23.21	Application for initiation of corporate insolvency resolution process by operational creditor	**9**	23.15
23.22	Initiation of corporate insolvency resolution process by corporate applicant	**10**	23.22
23.23	Suspension of initiation of corporate insolvency resolution process	**10A**	23.23
23.24	Persons not entitled to make application	**11**	23.23
23.25	Time-limit for completion of insolvency resolution process	**12**	23.23
23.26	Withdrawal of application admitted under section 7, 9 or 10	**12A**	23.24
23.27	Declaration of moratorium and public announcement	**13**	23.25
23.28	Moratorium	**14**	23.26
23.29	Public announcement of corporate insolvency resolution process	**15**	23.28
23.30	Appointment and tenure of interim resolution professional	**16**	23.28
23.31	Management of affairs of corporate debtor by interim resolution professional	**17**	23.28
23.32	Committee of creditors	**21**	23.29
23.33	Appointment of resolution professional	**22**	23.31
23.34	Resolution professional to conduct corporate insolvency resolution process	**23**	23.32
23.35	Meeting of committee of creditors	**24**	23.32
23.36	Duties of resolution professional	**25**	23.33
23.37	Rights and duties of authorised representative of financial creditors	**25A**	23.33
23.38	Replacement of resolution professional by committee of creditors	**27**	23.34
23.39	Approval of committee of creditors for certain actions	**28**	23.35
23.40	Preparation of information memorandum	**29**	23.35
23.41	Persons not eligible to be resolution applicant	**29A**	23.36
23.42	Submission of resolution plan	**30**	23.38
23.43	Approval of resolution plan	**31**	23.40
23.44	Liability for prior offences, etc.	**32A**	23.41
23.45	Initiation of liquidation	**33**	23.42
23.46	Appointment of liquidator and fee to be paid	**34**	23.42
23.47	Powers and duties of liquidator	**35**	23.43
23.48	Liquidation estate	**36**	23.44
23.49	Powers of liquidator to access information	**37**	23.45
23.50	Consolidation of claims	**38**	23.45
23.51	Verification of claims	**39**	23.46
23.52	Admission or rejection of claims	**40**	23.46
23.53	Determination of valuation of claims	**41**	23.46
23.54	Appeal against the decision of liquidator	**42**	23.46
23.55	Preferential transactions and relevant time	**43**	23.46
23.56	Order in case of preferential transactions	**44**	23.47
23.57	Avoidance of undervalued transactions	**45**	23.47
23.58	Relevant period for avoidable transactions	**46**	23.48
23.59	Application by creditor in cases of undervalued transactions	**59**	23.48
23.60	Order in cases of undervalued transactions	**48**	23.48
23.61	Transactions defrauding creditors	**49**	23.49
23.62	Extortionate credit transactions	**50**	23.49

23.63	Orders of Adjudicating Authority in respect of extortionate credit transactions	**51**	23.49
23.64	Secured creditor in liquidation proceedings	**52**	23.49
23.65	Distribution of assets	**53**	23.50
23.66	Dissolution of corporate debtor	**54**	23.52
23.67	Fast track corporate insolvency resolution process	**55 to 58**	23.52
23.68	Voluntary liquidation of corporate persons	**59**	23.54
23.69	Power of the Central Government to notify financial service providers, etc.	**227**	23.55
23.70	Eligibility for resolution professional	**-**	23.56

Appendices
(Ready Reckoner)

Sl. No.	*Topic*	*Page*
Appendix 1	Matters requiring Ordinary Resolution	A-1
Appendix 2	Matters requiring Special Resolution	A-2
Appendix 3	Matter requiring approval of members – No vote cast against the resolution	A-2
Appendix 4	Matters requiring Special Notice	A-3
Appendix 5	Matters requiring passing of resolution by postal ballot	A-3
Appendix 6	Matters requiring resolution to be passed in Board meeting only	A-3
Appendix 7	Matters requiring unanimous resolution of the Board	A-4
Appendix 8	Provisions of the Companies Act, 2013 whose applicability is dependent upon the provisions contained in the articles of the company	A-4
Appendix 9	Matters requiring approval of the Central Government	A-4
Appendix 10	Applicability of various provisions of the Companies Act, 2013	A-5
Appendix 11	Contraventions and punishments under various provisions of the Companies Act, 2013	A-7
Appendix 12	An introduction to Rules under the Companies Act, 2013	A-14
Appendix 13	An introduction to E-Forms under the Companies Act, 2013	A-16
Appendix 14	The Companies Act, 2013 – Summary of Chapters	A-16
Appendix 15	The Companies Act, 2013 – Arrangement of Sections	A-17
Appendix 16	The Companies Act, 1956 – Arrangement of Sections of Part IX-A (Provisions relating to Producer Companies)	A-28
Appendix 17	Exemptions to Government Companies	A-29
Appendix 18	Exemptions to Private Companies	A-32
Appendix 19	Exemptions to Companies Licenced u/s 8	A-34
Appendix 20	Exemptions to Specified IFSC public companies	A-36
Appendix 21	Exemptions to Specified IFSC private companies	A-40
Appendix 22	Exemptions to Nidhis	A-43
Appendix 23	Glossary of legal terms and maxims	A-44

Question Papers of Past 3 CA (Final) Examinations

Paper 4: Corporate and Economic Laws
CA (Final) (New Syllabus)
May, 2019 Examination

PART – I
(Multiple Choice Questions)

Part I of the Question Paper contained the Multiple Choice Questions (MCQs) (consisting of 30 marks), which was taken back by ICAI, *i.e.* No candidate was allowed to take with him Part I of the Question Paper. Accordingly, Part I of the Question Paper could not be included in this Book.

PART – II
(Descriptive Questions)

Maximum Marks: 70

1. Question paper comprises 06 questions. Answer Question No. 1 which is compulsory and any 04 out of the remaining questions.
2. Working notes should form part of the answer.
3. Answers to the questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi Medium, his/her answers in Hindi will not be evaluated.

1. (a) Two (2) out of Ten (10) directors on the Board of XYZ Limited have retired by rotation at an Annual General Meeting. These two (2) vacancies or place of retiring directors is not filled up and the meeting has also not expressly resolved *'not to fill the vacancy'*. Since the AGM could not complete its business, it is adjourned to a later date.

   Neither place of retiring directors could be filled up at this adjourned meeting nor did the meeting expressly resolve, *'not to fill the vacancy'*. Analyse & apply relevant provisions of the Companies Act, 2013 and decide:

   (i) Whether in such a situation the retiring directors shall be deemed to have been reappointed at the adjourned meeting?

   (ii) What will be your answer in case at the adjourned meeting, the resolutions for reappointment of these directors were lost?

   (iii) Whether such directors can continue in case the directors do not call the Annual General Meeting? **(8 Marks)**

   (b) M/s. Tristar Ltd. (an unlisted public limited company) with the annual turnover of Rs 700 crores entered into a contract of purchasing of raw material from M/s. PTC Pvt. Ltd. during the year 2018. M/s. Tristar Ltd. appointed Mr. Sudhir, a director of the company, to act in this deal of transaction on behalf of the company. Mr. Sudhir is also one of the member of M/s. PTC Pvt. Ltd. Mr. Sudhir settled the said transaction of purchase for Rs. 85 crores and entered into the contract. After a few transactions executed under the contract, the Board of M/s. Tristar Ltd. finds degradation in the quality of the raw material supplied. Further, in a Board meeting this contract was challenged considering it as a related party transaction and in contravention to section 188(1) of the Companies Act, 2013 read with rules framed thereunder. During the period Mr. Sudhir was appointed as director in a newly incorporated company M/s. Raaga Limited.

   In the light of the given facts, examine the following situations as per the Companies Act, 2013:

   (i) What is the legal position of the contract entered between M/s. Tristar Ltd. through its director Mr. Sudhir, and M/s. PTC Pvt. Ltd.?

   (ii) Is there any contravention of section 188(1)? If yes, then state the liability of the wrongdoer.

   (iii) Comment upon the appointment of Mr. Sudhir as a director in M/s. Raaga Limited. **(6 Marks)**

2. (a) (i) A group of shareholders consisting of 30 members decide to file a petition before the Tribunal for relief against oppression and mismanagement by the Board of directors of M/s. Aravalli Manufacturing Company Limited having a paid up share capital of Rs. 1 crore. The company has a total of 500 members and the group of 30 members holds one-tenth of the total paid-up share capital accounting for one-fifteenth of the issued share capital. The grievance of the group is that due to the mismanagement by the Board of directors, the company is incurring losses and has not declared any dividend for the past five years. In the light of the provisions of the Companies Act, 2013, please advise the group of shareholders regarding the admission of the petition and the relief thereof. **(4 Marks)**

(ii) A meeting of members of ABC Limited was convened as per the orders of the Court to consider a scheme of compromise and arrangement. Notice of the meeting was sent to 1000 members holding in aggregate 500000 equity shares. The meeting was attended by 800 members holding 350000 shares. 450 members holding 240000 shares voted in favour of the scheme; 200 members holding 60000 shares voted against the scheme. The remaining 150 members abstained from voting. Explain with reference to the provisions of the Companies Act, 2013, whether the scheme is approved by the requisite majority. **(4 Marks)**

(b) A Nationalized Bank had provided a term loan of Rs. 20 crores to Allwell Pharma Limited at an interest rate of 12% p.a. and principal amount is payable in equal half yearly instalments of Rs. 2 crores in 5 years from the date of disbursement of loan. The loan is fully secured against the plant and machinery of the company. The company was regular in paying 3 half yearly installments along with the interest during the first two years. Due to recession in the market and increased competition from multinational companies, the price of the goods manufactured by the company had fallen down and consequently the company had to close down the plant. Hence, the company failed to pay the 4th instalment, but it paid the interest amount as and when due.

After a period of 2 months (60 days) from the due date of the 4th installment, the Bank decided to sell the loan to an Asset Reconstruction Company. It has also decided to sell a loan of Rs. 50 lakhs given to a farmer which is secured against the agricultural land. The Manager seeks your advice on the above proposals in the light of the Provisions of the SARFASEI, Act, 2002. **(6 Marks)**

3. (a) Info-tech Overtrading Ltd. was ordered to be compulsory wound up by an order dated 10th March, 2019 by the Tribunal. The official liquidator who has taken control of the assets and other records of the company has noticed that:

(i) One of the contributory whose calls are pending to be paid is about to leave India for evading payment of calls and;

(ii) A person having books of accounts of the company in his possession may abscond to avoid examination of books of accounts in respect of the affairs of the company.

Apprehending such possibilities, Tribunal detained such contributory for next 6 month disallowing him to leave India as well as arrest & seize books of accounts from the person who may possibly abscond to avoid examination of the affairs of the company.

Referring to the provisions of Companies Act, 2013, answer the following in current scenario:

(i) What is the validity of Tribunal's order for detention of contributory disallowing him to leave India?

(ii) Is it correct on Tribunal's part to arrest and seize books of accounts from the person planning to abscond to avoid examination of books of accounts in respect of the affairs of the company? **(8 Marks)**

(b) (i) Mr. Dawood Moosa, a known smuggler was caught in transfer of funds illegally exporting narcotic drugs from India to some countries in Africa. State the maximum punishment that can be awarded, to him under Prevention of Money-Laundering Act, 2002. **(2 Marks)**

(ii) Mr. Robert has been arrested for a cognizable and non-bailable offence under Part A of the Schedule punishable for a term of imprisonment for more than three years under the Prevention of Money-Laundering Act, 2002. He seeks your advice as to how can he be released on bail. Advise him. **(4 Marks)**

4. (a) (i) ABC Primex Ltd., an unlisted company is into profitable manufacturing business. It has net worth of more than Rs. 10 crore since preceding last four full years with net tangible assets of Rs. 5 crore in each of the four preceding years. Around 80% of the net tangible assets are held in monetary assets (readily convertible into cash). It has consistent track record of declaring dividend for last 5 years. With the expansion plan, company plans to raise funds through Initial Public Offer (IPO). Advice the company on:

(A) Eligibility of the company to raise funds through IPO route.

(B) Will it be eligible for IPO if company has changed its name to XYZ Primex Ltd. since last 6 months and 60% of the revenue for the preceding one full year earned by it from the activity indicated by the new name?

(C) Will your answer be different if there are any outstanding convertible securities issued by the company earlier? **(4 Marks)**

(ii) (A) What are the factors to be considered by the Adjudicating Officer while adjudging the quantum of penalty under Sec. 23I of the Securities Contract (Regulation) Act, 1956? **(2 Marks)**

(B) Define the term 'Derivative' as appearing in the Securities Contract (Regulation) Act, 1956. **(2 Marks)**

(b) After giving a reasonable opportunity of being heard, Central Government cancelled the certification of registration of Toastea Ltd., a company registered under FCRA on the ground of public interest. 2.5 years have passed since such cancellation. Company has submitted its written declaration not to involve in such activity again and request to restore the registration. Advise Toastea Ltd. on its eligibility for re-registration or grant of prior permission. Also state the circumstances under which Government can cancel the certificate of registration granted to a person under the Foreign Contribution (Regulation) Act, 2010. **(6 Marks)**

5. (a) Gulmohar Ltd. is a company registered in India for last 5 years. Since last 2 financial years, it has not been carrying on any business or operations and has not filed financial statements and annual returns saying that it has not made any significant accounting transaction during the last two financial years. Considering the current situation, directors of the company are contemplating to apply to Registrar of Companies to obtain the status of dormant or inactive company.

Advise them on:

(i) Whether Gulmohar Ltd. is eligible to apply to Registrar of Companies to obtain dormant status for the company?

(ii) Will your answer be different if Gulmohar Ltd. is continuing payment of fees to Registrar of Companies and payment of rentals for its office and accounting records for last two financials years?

(iii) Is special resolution in general meeting a pre-requisite to make an application to Registrar of Companies for obtaining the status of dormant company?

(iv) What will be your answer if it is found after making an application of dormant company to Registrar of Companies that an investigation is pending against the company which was ordered 6 months ago? **(8 Marks)**

(b) The following particulars relate to M/s Star House (P) Limited which has gone into Corporate Insolvency Resolution Process (CIRP):

S. No.	Particulars	Amount in Rupees
1.	Amount realized from the sale of liquidation of Assets	7,00,000
2.	Secured Creditors who has relinquished the security	2,50,000
3.	Unsecured Financial Creditors.	2,00,000
4.	Income Tax Payable within a period of two years preceding the liquidation commencement date.	25,000
5.	Cess Payable to State Government within a period of one year preceding the liquidation commencement date.	10,000
6.	Fees payable to resolution professional.	37,500
7.	Expenses incurred by the resolution professional in running the business of M/s. Star House (P) Limited on going concern.	17,500
8.	Workmen salary payable for a period of thirty months preceding the liquidation commencement date. The workmen salary is equal per month.	1,50,000
9.	Equity Shareholders.	5,00,000

State the priority order in which the liquidator shall distribute the proceeds under the Insolvency & Bankruptcy Code, 2016. **(6 Marks)**

6. (a) M/s. Bright Motors (P) Limited at the Annual General Meeting (AGM) held on 30.09.2016 appointed Mr. Anmol as a non-executive director on the Board of the company for a period of three years. On 2nd October, 2017 Mr. Anmol suffered a severe heart failure and expired. The Board of directors of the company on 16th October, 2017 appointed Mr. Prateek to fill the casual vacancy so created. The appointment of Mr. Prateek was made for a term of three years by the Board. Subsequently at the AGM held on 29-09-2018 Mr. Prateek's appointment was not proposed or approved as the Board was of the view that it is not required. But the CFO of the company is of the opinion that the Board of directors have contravened the provisions of the Companies Act, 2013 in respect of non-approval of the appointment of Mr. Prateek and his office tenure. Decide. **(4 Marks)**

OR

The following information is provided in respect of M/s. Fortune Limited under three different case scenarios on the borrowing powers of the Board of directors of the company. Mr. Murli, the CFO seeks your advice with explanations as to the nature of resolution which needs to be passed under each of the case scenarios as per the provisions of section 180(1)(c) of the Companies Act, 2013. Detailed workings should form part of your answer.

Particulars	**Case I (Rs. in Crores)**	**Case II (Rs in Crores)**	**Case III (Rs in Crores)**
Equity Share Capital (Paid- up)	150	150	150
Preference Share Capital (Paid-up)	50	50	50
Securities Premium Account	50	50	50
Free Reserves	20	20	20
Total:	**270**	**270**	**270**
Working Capital Loan (repayable on demand-Existing) from Sigma Capital Limited	50	50	50
Cash Credit Limit from a scheduled bank (repayable on demand-Existing)	120	120	120
6 months loan for purchase of Plant & Machinery from scheduled bank-(proposed)	30	40	130
24 months loan for purchase of Plant & Machinery from scheduled bank- (proposed)	10	20	150
Total	**210**	**230**	**450**

(4 Marks)

(b) Mr. Dhruv is a Director of M/s LT Limited and XT Limited respectively. M/s LT Limited did not file its financial statements for the year ended 31st March 2016, 2017 & 2018 respectively with the Registrar of Companies (ROC) as mandated under the Companies Act, 2013. M/s LT Limited also did not pay interest on loans taken from a public financial institution from 1st April 2017 and also failed to repay matured deposits taken from public on due dates from 1st April 2017 onwards.

Answer the legality of the following in the light of the relevant provision of the Companies Act, 2013:

(i) Whether Mr. Dhruv is disqualified under Companies Act, 2013 and if so, whether he can continue as a Director in M/s LT Limited? Further can he also seek reappointment when he retires by rotation at the AGM of M/s XT limited scheduled to be held in September 2019?

(ii) Mr. Dhruv is proposed to be appointed as an Additional Director of M/s MN Limited in June 2019. Is he eligible to be appointed as an Additional Director in M/s MN Limited? Decide. **(4 Marks)**

(c) (i) Who is a 'Reporting Entity' under the Prevention of Money Laundering Act, 2002 and what are the obligations cast on them under Sec. 12 of the Act? The Bank account of Amar has been attached by the order of an Assistant Director for a period of 180 days. The lawyer of Amar objected to this attachment. Decide the validity of the attachment. **(3 Marks)**

(ii) Continental Rubber Limited is a supplier of raw materials to Smooth Latex Limited. It filed a petition before the NCLT for the recovery of Rs. 10,00,000 from Smooth Latex Limited. Smooth Latex Limited, the Corporate Debtor, has other financial creditors to the extent of Rs. 1,50,00,000 and they also joined together and filed petitions to NCLT. The Corporate Debtor has a total of 40 financial creditors and 2 operational creditors. Further, all the financial creditors are having equal voting rights/shares.

Notice was issued on 1st August, 2018 for the conduct of the first meeting to be held on 5th August, 2018 at a common venue. The meeting was attended by all 40 financial creditors and 2 operational creditors. A resolution was passed to appoint Mr. TK as a Resolution Professional. 25 of the financial creditors voted in favour of the resolution and 10 voted against the resolution and 5 financial creditors and 2 operational creditors abstained from voting. Decide whether the resolution passed is valid? In the light of the provisions of Insolvency and Bankruptcy Code, 2016 read with rules framed thereunder, explain the requirements of issue of notice and quorum for the conduct of the meeting. **(3 Marks)**

Paper 4: Corporate and Economic Laws
CA (Final) (New Syllabus)
November, 2019 Examination

PART – I

(Multiple Choice Questions)

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(Descriptive Questions)

Maximum Marks: 70

1. Question paper comprises 6 questions. Answer Question No. 1 which is compulsory and any 4 out of the remaining 5 questions.
2. Working notes should form part of the answer.
3. Answers to the questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi Medium, his/her answers in Hindi will not be evaluated.

1. (A) You are the CFO and in-charge of legal compliances of a large multinational company in India. The Board of Directors of the Company are broad based and comprise of competent directors who are Indian as well as Foreign Nationals. Mr. 'X', who is a Director (Business Development) on the Board is very often on business tour abroad. He approached you and wants to know from you the regulatory provisions of the Companies Act, 2013 relating to appointment of Alternate Directors. Analyse the following situations and advise suitably, Mr. X referring to the provisions of the Companies Act, 2013.

    (a) To how many directors can a person be appointed as an alternate director and how many votes does he have in one Board Meeting?

    (b) If the original director joins the Board Meeting through video conferencing without returning to India, then, can the alternate director appointed in his place attend the same board meeting? If yes, whose presence and vote will be counted?

    (c) In case of a private company, where an alternate director is appointed in place of a non-executive director whose term is indefinite, then, what will be the tenure of such alternate director, provided the original director does not return to India for a longer period say 3-4 years?

    (d) Can an Executive Director/Whole Time Director/Managing Director appoint alternate directors? **(8 Marks)**

   (B) The Articles of Association of M/s. DEF Limited (Non-Government Company) restricts the Company to contribute to National Defence Fund in any financial year for a sum not exceeding Rs. 5 Lakhs. The Articles is silent about contribution to bonafide Charitable Fund and to a Political Party. The Company earned net profit during the last five financial years as under:

Financial years	Net Profit (Rs. in lakhs)
2018-19	45
2017-18	25
2016-17	20
2015-16	15
2014-15	10

The Board of Directors proposes to contribute in July 2019 for the first time during the financial year 2019-20:

(i) Rs. 7 Lakhs to National Defence Fund

(ii) Rs. 3 Lakhs to a bonafide Charitable Fund

(iii) Rs. 5 Lakhs to a Political Party

The Company seeks your advice on the following matters in respect of each of the above proposals under the provisions of the Companies Act, 2013.

(i) The appropriate approving authority;

(ii) The quantum of contribution that can be made;

(iii) The mode of payment of such contribution. **(6 Marks)**

2. (A) A group of shareholders of M/s. FMG Limited made a complaint to the concerned Registrar of Companies (RoC), that the business of the Company is being carried on for unlawful and fraudulent purposes and filed an application to enquire into the affairs of the Company. Referring to and analyzing the provisions of the Companies Act, 2013, decide:

(i) Whether the RoC has the power to order for an inquiry into the affairs of the Company?

(ii) If yes, state the procedure to be followed by the RoC.

(iii) Whether the inquiry should be pursued by the RoC in case the complaint is withdrawn by the same group of shareholders subsequent to the Order for enquiry?

(iv) Whether the Central Government has the power to direct the RoC to carry out the inquiry? **(4 Marks)**

(B) At the meeting of the members of M/s QRS Limited, a scheme of compromise and arrangement was approved by requisite majority. The National Company Law Tribunal (NCLT) after complying the provisions issued an Order, approving the scheme of compromise and arrangement.

List out the matter to be provided in the Order issued by NCLT under Section 230(7) of the Companies Act, 2013. When shall the Order be filed with ROC? **(4 Marks)**

(C) M/s AWP Limited defaulted in repayment of a term loan taken from a Nationalized Bank against the security created as first charge on its Land & Buildings. The Bank classified the debt from M/s AWP Limited as Non-Performing Asset. The Bank issued Notice pursuant to Section 13 of the SARFAESI Act, 2002 to the Company to discharge its liabilities in full within a period of 60 days from the date of Notice.

The Company objected for full settlement and the time limit for settlement. The Bank did not respond to the objection of the Company. In the light of the provisions of the SARFAESI Act, 2002 decide:

(i) Whether the objection of the Company is valid?

(ii) Whether the Bank has to respond to the objection of the Company?

(iii) Whether the Bank has right to enforce the security interest without the intervention of the Court? **(6 Marks)**

3. (A) In the light of the provisions of the Companies Act, 2013, examine whether the following Companies can be considered as a 'Foreign Company':

(i) M/s Red Stone Limited is a Company registered in Singapore. The Board of Directors meets and executes business decisions at their Board Meeting held in India.

(ii) M/s Blue Star Public Company Limited registered in Thailand has authorized Mr. 'Y' in India to find customers and to enter into contracts with them on behalf of the Company.

(iii) M/s Xex Limited Liability Company registered in Dubai has installed its main server in Dubai for maintaining office automation software by Cloud Computing for its client in India. **(8 Marks)**

(B) Mr. 'B' purchased a flat out of the proceeds earned by Drug Trafficking. The flat was attached by the Director, Directorate of Enforcement after complying the procedures under Section 5 of the Prevention of Money Laundering Act, 2002 (PMLA, 2002). Mr 'B' got a stay from the High Court for any proceedings under the said Act. The stay was subsequently vacated.

State the relevant provisions of the PMLA, 2002 for computing the period of provisional attachment including extension, if any.

Whether Mr. 'C', son of Mr. 'B' can occupy the flat during the period of provisional attachment? **(6 Marks)**

4. (A) 'X' Stock Exchange Limited was granted recognition by Securities and Exchange Board of India (SEBI). The stock brokers of the Stock Exchange did not pay much heed to the concept of governance and focused on increasing their wealth and snubbed the protection of investors. Their activities were against the interest of the trade and general public.

(i) Examine whether the Central Government / SEBI has the power to withdraw the recognition granted to 'X' Stock Exchange Limited under the provisions of Securities Contracts (Regulations) Act, 1956?

(ii) Whether a person can be a member of an unrecognized Stock Exchange for the purpose of performing any contracts in Securities? **(4 Marks)**

(B) The composition of Audit Committee of M/s MKBTC Limited an unlisted Public Company, as on 31-3-2019 comprised of 7 Directors including 4 independent Directors. The majority of the members of the Audit Committee has the ability to read and understand the financial statements but none of them has accounting or related financial management expertise. The Company listed its Securities in a recognized Stock Exchange in the month of August 2019. Referring to the regulations of Securities and Exchange Board of India (Listing Obligation and Disclosure Requirements) Regulations 2015, decide whether the existing Audit Committee can continue after listing of its Securities? **(4 Marks)**

(C) In the light of the provision of the Foreign Contribution (Regulation) Act, 2010 examine and decide whether the following persons in India are permitted to receive the amount/articles in the following situations:

(i) M/s KG & Co. a partnership firm obtained loan from a club registered in London for its business purpose.

(ii) Hello FM, a registered association, received funds from a foreign company for establishing Frequency Model Radio Station to broadcast audio news.

(iii) Mr. Happy received a wrist watch as marriage anniversary gift from his uncle, a citizen of USA. The market value of the wrist watch is Rs. 25,000. **(6 Marks)**

5. (A) Due to an unprecedented flood, all the fixed assets of a company were damaged extensively beyond renovation of repair. The cost of replacement of assets were huge and the sum insured on the fixed assets did not cover all the assets. Therefore, the operations of the company were permanently discontinued. Meanwhile, based on a winding-up petition filed by the secured creditors, the High Court passed a winding-up order. The workers of the company opposed to the winding-up petition and also filed an appeal against the winding-up order. The workers are not sure whether their appeal would be heard in the winding-up proceedings. Examine, under the provisions of the Companies Act, 2013, whether the appeal filed by the workers would succeed and their dues/interest will be protected in priority? **(4 Marks)**

(B) M/s KIL Limited, a listed company, proposed to acquire a plant for consideration other than cash from Mr. KK, a director. The Managing Director of the Company identified Mr. JK a registered valuer under the provisions of the Companies Act, 2013 for the purpose of valuation of the plant. Mr. KK acquired the plant 48 months back from a partnership firm in which the spouse of Mr. JK is a partner. The Managing Director of the Company issued an order appointing Mr. JK as a registered valuer. Examine and decide whether the decision of appointment and the mode of appointment is valid under the provisions of the Companies Act, 2013? **(4 Marks)**

(C) In view of the deep recession prevailing in the market for the past three years M/s. Infra Limited (Corporate Debtor), which was facing the brunt of financial crisis, could not pay salaries and wages to its workmen and employees for the past 6 months. The workmen and the employees, who are the members of a recognized Trade Union "Infra Labor Federation" made a complaint in his regard. Thereafter, the Trade Union approached and urged the Management of the Company in person and through representations in writing to settle the arrears of wages and salaries due to its members. The Corporate Debtor neither disputed nor took any actions to settle the amount. Under the circumstances, Infra Labor Federation filed an application before the Adjudicating Authority i.e. with the National Company Law Tribunal for initiating a Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code, 2016.

In the light of the provisions of the Insolvency and Bankruptcy Code, 2016, examine the following:

(i) Validity of the Application.

(ii) What will be the "Initiation date" for initiating the Corporate Insolvency Resolution Process? **(6 Marks)**

6. (A) Mr. 'K' is a small shareholder director in M/s KGP Tyres Limited from 1st April 2018 and in M/s VSR Cotton Mills Limited from 1st April 2019, in compliance with the relevant provisions of the Companies Act, 2013. M/s KGP Tyres Limited has not paid interest on the public deposits due from 1st July 2018. In the light of the information given above, examine the following under the provisions of the Companies Act 2013.

(i) Whether the office of Mr. 'K' small shareholder director, shall become vacant in M/s KGP Tyres Limited and M/s VSR Cotton Mills Limited?

(ii) If yes, state the period from which the office of the directorship shall become vacant. **(4 Marks)**

OR

Mr 'R' holds directorship in 10 Public Companies and 11 Private Companies as on 31.05.2019. One of the above Private Company is a dormant Company. Apart from the dormant Company, on 30.06.2019 a Private Company (in which Mr. R is holding directorship) has become a subsidiary of a Public Company.

In the light of the provisions of the Companies Act, 2013 examine and decide:

(i) The validity of holding directorship of Mr 'R' with reference to number of directorship as on 31.05.2019 and as on 30.06.2019.

(ii) Whether a Company has power to specify any lesser number of Companies in which a director of the Company may act as a director? **(4 Marks)**

(B) Mr. Thangavel is a Director in 7 Companies with a DIN (Director Identification Number) allotted to him. Again, another DIN was inadvertently allotted to him which was never used for fling any document with any Authority. He desires to surrender the second DIN and keep all his directorship with the first DIN. Advise him the procedure to be followed under the provisions of the Companies Act, 2013 and the Rules made thereunder for surrendering the second DIN inadvertently obtained by him. **(4 Marks)**

(C) Mr. 'K' used his car for smuggling cash and the Special Court found on conclusion of trial that an offence of money laundering was committed by Mr. 'K' under the provisions of the Prevention of Money Laundering Act, 2002 (PMLA, 2002). The car was under hypothecation to a Nationalized Bank for the car loan obtained. Referring to provisions of the PMLA, 2002, examine whether the car can be confiscated despite the existence of encumbrance? **(3 Marks)**

(D) The Committee of Creditors of M/s XYZ Limited proposes to appoint Mr. Ajit, an Insolvency Professional as Insolvency Resolution Professional in the matter of corporate insolvency process of M/s XYZ Limited Mr. Ajit was a promoter of M/s ABC Limited which is a holding company of M/s XYZ Limited. Examine and decide whether Mr. Ajit is eligible for appointment as an Insolvency Resolution Professional under the Provisions of Insolvency and Bankruptcy Code, 2016. **(3 Marks)**

Paper 4: Corporate and Economic Laws

CA (Final) (New Syllabus)

November, 2020 Examination

PART – I

(Multiple Choice Questions)

Part I of the Question Paper contained the Multiple Choice Questions (MCQs) (consisting of 30 marks), which was taken back by ICAI, *i.e.* No candidate was allowed to take with him Part I of the Question Paper. Accordingly, Part I of the Question Paper could not be included in this Book.

PART – II

(Descriptive Questions)

Maximum Marks: 70

1. Question paper comprises 6 questions. Answer Question No. 1 which is compulsory and any 4 out of the remaining 5 questions.
2. Working notes should form part of the answer.
3. Answers to the questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi Medium, his/her answers in Hindi will not be evaluated.

1. (a) You are a young women Chartered Accountant from India, having graduated from a top notch business school in India and later on became a Certified Public Accountant (CPA) from USA. You have a special acumen for providing scratch to end business advisory and regulatory related solutions. Your client, M/s. New Tech Software Solutions Limited (NTSSL) is a listed entity engaged in developing customised software packages for two and three wheeler auto mobile manufacturers in India and abroad. The Company follows strict corporate governance norms in letter and spirit and has the following composition of Board of Directors:

NAME	DESIGNATION/CATEGORY
Mr. X	CEO and Managing Director
Mr. Y	Non-independent and Non-Executive Director
Mr. A, Mr. B, Mr. C and Mr. D	Independent Directors
Mrs. E	Independent, Women Directors

During the financial year 2019-2020, the Company made the following remuneration to its Directors:

NAME	Amount (in Rs.)
Mr. X – CEO & MD	Monthly remuneration of Rs. 50,000 + Commission of Rs. 1,50,000 calculated as a percentage of net profits
Mr. Y	Commission at the rate of 1% of the net profit.

Others

(i) Mr. Y was paid a fee Rs. 1,00,000 for the services rendered by him as a graduate civil engineer for valuing the assets of the Company. Though he is not a Registered Valuer, he carried out the valuation on the assumption that, valuation can be done by a person having such qualifications and experience for registered valuers.

(ii) Payment of Rs. 5,00,000 insurance premium towards Directors and Officers Liability Policy to protect the Company against any negligence on the part of Mr. X, the Managing Director. A claim of Rs. 1,00,000 was lodged with the Insurance Company as a result of guilty of negligence of Mr. X.

With the above information, the said Company approached you seeking certain clarifications. Clearly explaining the relevant provisions of the Companies Act, 2013 and the Rules made thereunder, provide your professional advice to the following questions as raised by the Company:

(i) Whether the payments made to Mr. X and Mr. Y forms part of an overall maximum managerial remuneration?

(ii) Whether payment of insurance premium towards Directors and Officers Liability Policy form part of remuneration of Mr. X?

(iii) Who is the approving/recommending authority for the payments made to Mr. Y? **(8 Marks)**

(b) You are the CFO and in-charge of compliances of a listed entity. The Company is professionally managed and has earned a niche in the market for its robust management practices. Mr. Edward, an eminent American business man, currently living in Germany, joined the Company as an Executive Director. On assuming his mantle, he being a foreign director residing abroad, approached you to specifically understand the relevant provisions of the Companies Act, 2013 relating to participation of directors in Board Meetings conducted through Video Conferencing in respect of the following matters:

(i) What shall be the venue of Board Meeting through video conference?

(ii) How the statutory registers placed at the scheduled venue of the meeting shall deemed to have been signed by the directors participating through electronic mode?

(iii) Whether meetings can be convened through audio/teleconferencing i.e. without video facility?

You are required to provide correct legal-position to the above queries after examining and evaluating the provisions of the Companies Act, 2013. **(6 Marks)**

2. (a) RMP Limited was facing acute financial difficulties as operations were continuously disrupted and the Company was facing the brunt of:

(i) Non-Availability of Raw Materials,

(ii) Loss of demand for the Company's products,

(iii) Frequent lockdown due to workmen's unrest.

On the verge of liquidation, the Management proposed one last arrangement between creditors and the Company, whereby, the creditors will have to forego 50% of their dues to the Company. This has evoked strong protest from some of the creditors who may block the arrangement.

Examine the arrangement in the light of the Companies Act, 2013 and advise the course of action / procedure to be adopted by the company to implement the arrangement. **(4 Marks)**

(b) As a part of amalgamation, Harsha Limited acquired 90% of the issued capital of Ananya Limited. The issued, subscribed and paid up capital of Ananya Limited is Rs. 100 Crores. Out of remaining minority shareholding of Ananya Limited, Rs. 8 Crores are held by Mr. Raju. Mr. Raju was not satisfied with the amount decided under the scheme and therefore negotiated for a higher price. As a result, he received an extra amount of Rs. 10 Lacs. The other minority shareholders claim that Mr. Raju is not entitled to the entire extra amount of Rs. 10 Lacs.

Examine the validity of claim made by other minority shareholders under the relevant provisions of the Companies Act, 2013. **(4 Marks)**

(c) Under the auspicious of the Foreign Exchange Management Act, 1999, (the Act) examine whether the given situations fall under "Current Account Transactions" or not as defined in the Act?

(i) Mr. S, a resident in India, imports machinery from a vendor in UK for installing in his factory.

(ii) An Indian resident imports machinery from a vendor in US for installing in his factory on a credit period of 3 months.

(iii) An Indian resident transfers US$ 1,000 to his NRI brother in New York as "gift". The funds are sent from resident's Indian Bank account to the NRI brother's Bank account in New York. **(3 Marks)**

(d) Glow Bright Limited, engaged in business of printing of advertisement material, took a term loan of Rs. 5 Crores from a Bank against security created as first charge on its printing machines. Glow Bright Limited made default in re-payment of term loan to the Bank. Consequently, the Bank issued notice to the Company under

SARFAESI Act, 2002 to discharge its liabilities. Answer the following with reference to provisions of SARFAESI Act, 2002:

(i) What is the maximum period within which Glow Bright Limited must pay its liabilities?

(ii) What if Glow Bright Limited failed to discharge its liabilities within the specified time limit? **(3 Marks)**

3\. (a) Digital Era Limited (DEL), is a start-up Company, incorporated in the year 2017 under the provisions of the Companies Act, 2013. The main object of the Company is to manufacture and market two wheelers adopting a new technology of using hydrogen as a fuel to run the vehicle in lieu of petrol. Despite several experiments, the technology of hydrogen fuelled engine for the two wheelers was not successful. As per the requirements of the Companies Act, 2013, no business was commenced and no financial statements were filed with the Registrar of Companies (RoC). Eventually the Board of Directors of the Company resolved to apply to the RoC for getting the name of the Company struck-off from the Register of Companies.

The RoC, after satisfying that all the compliances specified under Section 248 of the Companies Act, 2013 have been met by the Company and after publishing a notice for general public and also in the official gazette, the name of the Company was struck-off from the Register of Companies w.e.f. 7th January, 2020.

Earlier in the year 2018, Mr. Amrit, had supplied certain spares to the Company for Rs. 2,50,000 and despite his several requests, the amount was not settled by the Company. In September 2020, he came to know from his close aides that DEL has some assets available with them. Thereafter, with a view to recover his dues from the Company, he approached you seeking your professional guidance. As a competent professional, advise Mr. Amrit, the following, in the light of the provisions of the Companies Act, 2013:

(i) Whether the assets of the Company shall be made available for the discharge of its liabilities even after the date of the order removing the name of the Company from the Register of Companies?

(ii) Can an aggrieved person file an appeal against the order of the RoC? If so, state the legal provisions in this regard.

(iii) When and under what circumstances can the RoC restore the name of the Company?

(iv) State the circumstances and the time frame within which the Tribunal can order the name of the Company to be restored to the Register of Companies?

(v) Can the name of a Company registered under Section 8 of the Companies Act, 2013 be removed from the Register of Companies? **(8 Marks)**

(b) Three Companies belong to Gopal group based out of Bengaluru. Each of the three companies are into businesses as under:

Company A	Chit Funds
Company B	Housing Finance
Company C	Payment System Operator

In the light of the relevant provisions of the Prevention of Money Laundering Act, 2002, examine the following:

(i) Who is a "beneficial owner" under the Prevention of Money Laundering Act, 2002?

(ii) Whether each of the above businesses fall within the definition of "Financial Institution"?

(iii) What are the Obligations of a financial institution regarding maintenance of records?

(iv) Whether a Civil Court have jurisdiction to entertain any suit or proceeding in respect of any matter which the Appellate Tribunal is empowered by or under this Act?

(v) Can an injunction be granted by any Court or Other Authority in respect of any action taken or to be taken in pursuance of any power conferred on the Appellate Tribunal? **(6 Marks)**

4\. (a) As on 01.04.2019, the composition of the Board of Directors of M/s. Apex Ltd, an unlisted, Public Limited Company comprised of 7 directors as under:

S. No.	Name	Designation
01	Mr. X	Mr. X Executive Chairman (Executive and Non-Independent)
02	Mr. Y	Managing Director and CEO (Executive and Non-Independent)
03	Mrs. Z	Women Director (Non-Independent)
04	Mr. A	Independent
05	Mr. B	Independent
06	Mr. C	Independent
07	Mr. D	Independent

As on 01.04.2019, the constitution of the Audit Committee comprised of the following Directors:

Name	Designation
Mr. Y	Chairman
Mr. X	Member
Mrs. Z	Member
Mr. Y	Member

The majority of the members of the Audit Committee have the ability to read and understand the financial statements but none of them have accounting or related financial management expertise. During January, 2020, the Company went for an Initial Public Issue (IPO) and got its shares listed on a recognized Stock Exchange. Referring to SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015:

(i) State, how a qualified and an independent Audit Committee should be constituted?

(ii) Whether the present constitution of the Audit Committee is in order and whether it can continue post listing of its securities in the Stock Exchange? **(4 Marks)**

(b) MNK Limited has incurred heavy losses during the preceding 3 consecutive financial years and has a negative net worth of Rs. 525 crore as at 31st March, 2020. Trading in securities of Company has remained suspended for a period of more than 9 months. CSE, a recognized-Stock Exchange, delisted the securities of MNK Limited. Mr. Y was having 25,000 shares of MNK Limited, purchased at Rs. 100 per share, aggrieved against the decision of the Stock Exchange to delist the securities of MNK Limited. Referring to the provisions of the Securities Contracts (Regulation) Act, 1956 examine:

(i) Whether CSE a recognized Stock Exchange can delist the securities of MNK Limited?

(ii) If yes, state the grounds for delisting. **(4 Marks)**

(c) Mr, Soumak is an editor of a daily business news on BNN TV. He received a salary of US $ 1,80,000 from Mr. Bob. Mr. Bob is a US citizen resident in India and operates BNN TV business operations in India. Mr. Bob received such payment i.e. salary given to Mr. Soumak from his parent Company BNN Inc. of USA. Examine under the provisions of the Foreign Contribution (Regulation) Act, 2010, whether receipt of salary by Mr. Soumak is prohibited? **(3 Marks)**

(d) Shyam started a fresh juice shop and contacted Naresh for supply of fruits and vegetables. Most of the communication between them happened over email. On the email, they decided the payment, terms and other conditions of service. For initial 5 months, Shyam was regular in making payment to Naresh for the fruits bought, but later on stopped making payments. Naresh filed a Suit against Shyam in a Magisterial Court but Shyam contended that the matter should be settled through Arbitration. Referring to provision of the Arbitration and Conciliation Act, 1996, state whether the contention of Shyam is correct. **(3 Marks)**

5. (a) By an order dated 25th June, 2020, NCLT had ordered for winding up of Kamath Trading Limited. Consequently, Official Liquidator took control for the assets and other records of the Company. During the winding up proceedings, the Official Liquidator came across a transaction where some of the properties of the Company was sold to a small Private Company. Mr. Nag, who was interested in that small Private Company happened to be the brother of Director of Kamath Trading Limited. The sale of the said properties took place on 20th March, 2020 at a price which was Rs. 58 Lacs less than the market price.

In the light of the facts given above, examine, with reference to relevant provisions of the Companies Act 2013, what action the Tribunal can take in this regard? **(4 Marks)**

(b) In the annual general meeting of XYZ Ltd. held on 28th May, 2020, while discussing on the matter of retirement and reappointment of director Mr. X, allegations of fraud of Rs. 20 lakhs in Bombay branch of the Company were marked against him by some members. This resulted into disorder and confusion in the meeting. The Chairman declared initiating an inquiry against the director. Mr. X, however, could not be re-appointed in the meeting. The matter was published in the newspapers next day. On the basis of such news, examine whether the Court can take cognizance of the matter and take action against the Director on its own? Justify your answer with reference to the provisions of the Companies Act, 2013. **(4 Marks)**

(c) Pursuant to Section 33 of the Insolvency and Bankruptcy Code, 2016 (IBC, 2016) a liquidation order was passed against Luci Soya Limited (LSL) (Corporate Debtor) by the Adjudicating Authority (NCLT). Mr. Solanki, was appointed as the liquidator by the NCLT. Upon resuming his mantle, Mr. Solanki started collecting claims from all the creditors within the time frame as prescribed in the IBC, 2016. While initiating the liquidation process as per provisions of the IBC, 2016, Mr. Solanki proposed to include the equity shares of one of its subsidiary as part of the liquidation estate in relation to the corporate debtor. Besides this, one of the unsecured financial creditor demanded that, at the time of distribution of liquidation proceeds, his dues may be

paid before the government dues are paid. Mr. Solanki also observed that pending legal proceedings against the corporate debtor, 'A' Ltd, an Operational creditor, has filed a case with the Arbitral Tribunal praying for an arbitral award against LSL.

On the basis of the above Information and in the light of the Insolvency and Bankruptcy Code, 2016, answer the following:

(i) Whether the proposal of Mr. Solanki to include the equity shares of the subsidiary Company of LSL as part of liquidation estate tenable?

(ii) How should Mr. Solanki deal with the demand of the unsecured financial creditor?

(iii) Whether 'A' Ltd. will succeed in its prayer for an arbitral award against LSL? **(6 Marks)**

6. (a) Excel Limited is a listed Company with a turnover of Rs. 60 crores in the FY 2016-2017. The Company appoints Ms. R as the women director on 1st March, 2017. Ms. R is already a director in twelve companies including ten public companies. Also, Ms. R is a Chartered Accountant in practice. Further, also, Ms. R is a Director in Supreme Ltd. where she is acting in a professional capacity. Since lots of proposal for the holding of directorship in various companies are lined up before Ms. R, so in order to retain her, the Remuneration and Nomination Committee proposed to enhance the remuneration of Ms. R from 4 Lacs per month to 6 Lacs per month. However, Supreme Limited was running in losses in the last 2 years.

Evaluate in the light of the given facts, the following with reference tothe provisions of the Companies Act, 2013:

(i) The validity of appointment of Ms. R in Excel Limited.

(ii) Analyse the proposition of enhancement of remuneration of Ms. R in Supreme Ltd.

OR

Evaluate the following cases of appointment of Director(s), with reference to the relevant provisions of the Companies Act, 2013:

(i) Ms. Nisha was appointed as director of LMN Limited on 10th October, 2020 in place of Ms. Rachna, who resigned from her office on 31st May, 2020 six months before expiry of term of her office. LMN Limited had its Board meeting on 31st July 2020. Whether appointment of Ms. Nisha is valid?

(ii) The Board of Directors of a Company appointed Mr. Sarvesh as an additional director on 30th July, 2020. Mr. Sarvesh continued to hold his office till 15th October, 2020. The Company had its annual general meeting on 30th October, 2020 which should have held on 30th September, 2020. Whether Mr. Sarvesh can hold office till 15th October, 2020? **(4 Marks)**

(b) Eighty two shareholders of Perish Limited, a listed Company holding shares of nominal value of Rs. 19,000 each proposed Mr. Babulal as a Director on the Board. The paid-up share capital of Perish Limited is Rs. 6.2 Crores (6,20,000 equity shares of Rs. 100 each). The Company has 800 such shareholders, who are holding shares of nominal value of Rs. 19,000 or less. Examine with reference to relevant provisions of the Companies Act 2013, whether Mr. Babulal can be appointed as a Director of Perish Limited? **(4 Marks)**

(c) The Adjudicating Authority under the Prevention of Money Laundering Act, 2002 (the Act) made an order under Section 8(3), confirming the provisional attachment of property made under Section 5(1) of the said Act. Mr. Rana, owner of the attached property, aggrieved by the order, wanted to make an appeal to the Appellate Tribunal. However, before making an appeal Mr. Rana is adjudicated as an insolvent. Explain, with reference to the relevant provisions of the said Act, whether appeal could be made to Appellate Tribunal in the present case? **(3 Marks)**

(d) Abhi Limited entered into an agreement with Atulya Gas Limited for purchase of natural gas, which is not specified as an essential supply. On failure of Abhi Limited to make payments, Atulya Gas Limited issued notice to Abhi Limited that further supply of gas would be stopped if payments are not made immediately. On further non-payment, Atulya Gas Limited filed a petition before NCLT for initiating Corporate Insolvency Resolution process against Abhi Limited. On 15th March, 2020 the petition was admitted. On 30th April, 2020, Atulya Gas Limited disconnected gas supply to Abhi Limited for non-payment. As a result of disconnection of gas supply, operations of Abhi Limited came to a halt. The Resolution professional filed a petition to NCLT seeking Atulya Gas Limited to resume the supply of natural gas, as natural gas was an important material for production of electricity by Abhi Limited.

Referring to the provisions of Insolvency and Bankruptcy Code, 2016, answer the following:

(i) When the moratorium period will expire in this case?

(ii) Whether Resolution Professional will be successful in his petition filed with NCLT? **(3 Marks)**

Guidelines for preparing for exams and writing the exams

1. Structure of the Book

The Book contains –

(a) Basic theory (in point-form)

(b) Practical Problems from CA Examinations (All relevant Practical Problems asked in CA (Final) Exams since year 2000 till date)

(c) Practical Problems from CS Examinations (for few topics only)

(d) Advanced Practical Problems (for few topics only; these problems have been given so as to explain the intricate provisions of law)

(e) Content given in the Boxes (Such points as are important from understanding point of view or examination point of view have been given in the Boxes)

(f) Appendices, at the end of the Book (Ready Referencer for quick revision of time limits, applicability of various provisions, etc.)

2. Right methodology for studying this Book

(a) Each Chapter is divided into various topics (*e.g.* Chapter 1 contains topic 1.1, topic 1.2. and so on). When a student starts studying any topic, he should first study it with the objective of developing an understanding of the topic, *i.e.* to understand the intention of the legislature, and not to learn the contents of the topic (First Reading). Immediately after the first reading is completed, the student should again study that topic with the objective of learning the contents of the topic (Second Reading).

(b) Within next 1 day, the student should revise that topic, preferably, by closing the book and murmuring or speaking whatever he retains, and keep opening the book as and when he finds that he does not remember the contents (First Revision).

(c) Within next 1 week, the student should revise that topic again using the same methodology as was used for First Revision (Second Revision).

(d) Within next 1 month, the student should revise that topic again using the same methodology as was used for First Revision and Second Revision (Third Revision).

(e) A student should make self-assessment of his own understanding by answering the Practical Problems given in the Book. This should be done only at the time of 'Third Revision' or even after that. 'Self-assessment' requires reading the question and writing the answer (in short) without first referring to the answer given in the Book, and then comparing your answer with the answer given in the Book. In case, you missed something in your answer, identify the reason and make sure that the same mistake is not repeated in future.

(f) If a student decides not to follow the above approach, and decides to start the first revision only after a reading of the entire chapter is completed, this may prove to be fatal, since few chapters are so lengthy that it may take few days or even weeks to complete a single chapter, and till then the student would have forgotten almost all the contents of most of the topics.

(g) Generally, 3 to 4 revisions of the subject are sufficient. However, if a student is not able to revise the entire subject in 20 hours, more revision is required.

Making 'own summarised notes' is not suggested, as it generally consumes a lot of time. Instead, utilise that time in revising the subject (by keeping the book closed).

3. General tips for preparation of the subject

(a) The Paper 'Corporate and Economic Laws' (previously named as 'Corporate and Allied Laws' under the Old Syllabus) is not only technical in nature, but also very vast in terms of coverage. Also, the day-to-day increasing level of CA Examinations makes this Paper really demanding. To perform well in this Paper, the students require complete conceptual understanding of the Subject. Mugging up the legal provisions cannot be of any help. The students need to develop an ability to apply the legal provisions to the real life situations.

(b) Selective study doesn't help. Preparing only such topics as have been frequently asked in the exams may prove to be fatal.

(c) Many students prepare the Company Law portion thoroughly and don't prepare the economic laws well. This approach can again prove to be fatal.

(d) Remember 'everything is important'.

(e) Many a times in the past, questions have been asked in the exams which are based on such provisions as have not been included in any ICAI Publication and even in this Book. Don't get disturbed by such questions as such questions do not form part of every examination paper.

4. Practical Problems asked in past exams under the Companies Act, 1956

(a) The practical problems asked in the past exams as per the provisions of the Companies Act, 1956 have also been included in this Book.

(b) The answers to all such practical problems have been given as per the provisions contained in the Companies Act, 2013.

(c) In some practical problems, the Author has made certain changes in the wordings of the practical problems so that such practical problems are in line with the provisions contained in the Companies Act, 2013.

5. Identifying as to whether a provision contains sub-sections or clauses

(a) Many a times students get confused as to whether a particular provision is to be termed as a sub-section or a clause.

(b) Consider the following text of section 2 as contained in the Companies Act, 2013:

"In this Act, unless the context otherwise requires, —

(1) "Abridged prospectus" means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf;

(2) "Accounting standards" means the ..."

Section 2 of the Companies Act, 2013 does not contain any sub-section. Section 2(1) in the Companies Act, 2013 means 'clause (1) of section 2' (Reason: Before (1), some words, *viz.* "In this Act, unless the context otherwise requires, –" have been used). Thus, it would be wrong to read / write section 2(1) of the Companies Act, 2013 as sub-section (1) of section 2; the correct way of reading or writing it is 'clause (1) of section 2'.

(c) Now consider the following text of section 149 as contained in the Companies Act, 2013:

"(1) Every company shall have a Board of Directors consisting of individuals as ..."

Section 149 of the Companies Act, 2013 contains sub-sections. Section 149(1) in the Companies Act, 2013 means 'sub-section (1) of section 149' (Reason: Before (1), no words like "In this Act, unless the context otherwise requires, –" have been used). Thus, it would be wrong to read / write section 149(1) of the Companies Act, 2013 as clause (1) of section 149; the correct way of reading or writing it is 'sub-section (1) of section 149'.

6. Revision of the subject immediately before exams

(a) The syllabus would appear to be very lengthy as you would have around '20 productive hours' to revise the entire subject. But, do not panic, and be confident if you have studied sincerely and revised the syllabus.

(b) There is nothing to panic or worry, if you cannot remember each and every time limit, monetary limit, etc. Even if you have forgotten some provisions, it does not mean that your performance in the exam would be poor. Any negative thoughts would only result in wastage of precious time which is meant for revision.

(c) You should rehearse complete revision of the subject at least 2 times in advance, so that you know a day before exam as to how much time you need to devote to each chapter.

(d) Do not go through the 'Practical Problems' a day before exams; otherwise you won't be left with sufficient time to revise the entire syllabus. So, cover all the practical problems at least 2 times in advance, say 15 days before exams.

7. How important is writing the names of the case laws?

(a) Not many questions are asked on decided cases. Most of the questions are either direct questions or situation based questions (also termed as practical problems or case studies). In answering a situation based question, a student needs to apply his concepts and analyse the situation, as the same situation never came up before the Courts or Tribunals in the past. Very few questions asked in the exams are from the cases decided in the past.

(b) On a close scrutiny of past examination papers, one would find that few questions asked in examinations have been based on such case laws as have not been mentioned in any ICAI Publication and even in this Book.

(c) If a student writes the name of a case law of which the examiner evaluating the answer sheet is unaware, the student would not get any benefit by writing such case law. So, the students should not waste their time in remembering the names of case-laws from here and there.

8. Learning and writing the section numbers

(a) In company law, it is very much required to remember the section numbers, and write all the relevant section numbers in exams.

(b) Students should not make any special effort for remembering the numbers of the sub-sections. However, certain sub-sections, which are very important (*e.g.* Section 161(1) is for additional director, section 161(2) is for alternate director, section 161(3) is for nominee directors, and section 161(4) is for director filling a casual vacancy), need to be learnt.

(c) In the Companies Act, 2013, the students are advised to learn the numbers of the Rules prescribed under the Companies Act, 2013.

(d) In the Securities and Economic Laws, the students may decide to remember numbers of such sections / Rules / Regulations as are very important. Students would be able to identify as to which section / Rule / Regulation is important, once they have completed studying the entire chapter.

9. Which language is to be used in writing the exams?

(a) Many students believe that they can secure good marks only by writing the language used in the Bare Act. It is a myth.

(b) Many students believe that unless they write the same language as given in the publications of ICAI (*viz.* study material, suggested answers and practice manual), they would not be able to score good marks. It is also a myth.

(c) A student who writes the answers in his own language would also score good marks if his answer is proper. The answer would be proper, if –

- (i) Correct section number / Rule No. / Regulation No. (as applicable) is quoted;
- (ii) Relevant section / Rule / Regulation is adequately explained;
- (iii) Keywords, as used in the Bare Act are used (The student would witness that the language used by the Author in this Book is of his own, which makes the study of law simple, but the Author has used the same keywords in this Book as have been used in the Bare Act);
- (iv) The answer is written in points, and not in long paragraphs;
- (v) The name of the case-law, if any, is quoted along with brief facts, the judgment and the reasons for the judgment;
- (vi) In case of a case study / practical problem, the given case is compared with the provisions contained in the Act, the given case study / practical problem is analysed, and the answer ends with a clear conclusion.

(d) If a student obtains the certified copies from ICAI after the result is declared, he would get to know that good marks have been awarded to him in all such answers where he has written the 'proper answer' as explained above, even though the language used is not of the Bare Act and not of any 'ICAI Publication'.

10. Whether answers written by students in CA (Final) Exams are evaluated on the basis of the answers given by ICAI in Suggested Answers and Practice Manual?

(a) In an RTI Application made by the Author to ICAI, ICAI has replied that the answers prepared by ICAI for evaluation of answer sheets of the students who appear in CA (Final) exams (termed as 'Model Answers') are different from the 'Suggested Answers' made available by ICAI for sale and uploaded on the website of ICAI.

(b) Further, it is not lawfully possible for any person to obtain these Model Answers even under the Right to Information Act, 2005 since such disclosure is exempted under section 8(1)(e) of the said Act as was held by the Supreme Court in *ICAI* v *Shaunak H. Sayta*.

(c) In the Suggested Answers issued by ICAI, students would find a disclaimer which reads as under:

> ***The Suggested Answers hosted on the website do not constitute the basis for evaluation of the students' answers in the examination.*** **The answers are prepared by the Faculty of the Board of Studies with a view to assist the students in their education.** ***While due care is taken in preparation of the answers, if any errors or omissions are noticed, the same may be brought to the attention of the Director of Studies.*** **The Council of the Institute is not in any way responsible for the correctness or otherwise of the answers hosted herein.**

11. Difference in some answers given in this Book as compared to the answers given in the Suggested Answers

(a) Wherever the Answer given by the Author does not match with the Answer given in any ICAI Publication, the Author has mentioned the same by way of a 'Note' at the end of such Answer. The students are advised not to put any query to the Author in this regard. The students may, if they deem fit, inquire in this regard from Board of Studies, ICAI (bosnoida@icai.in and feedbackbos@icai.org). It is again reiterated that the Answers given in any ICAI Publication shall not be the basis for evaluation of students' answers in the exams.

(b) The Author has also witnessed that ICAI has, in the past, corrected various Answers as given in ICAI Publications.

(c) The students would find that most of the answers given in this Book are more detailed than the answers given in the ICAI Publications (so that the students should be able to understand the concept well, and at the same time writing such detailed answers would fetch them better marks in exams).

(d) One reason for difference in the answers given by the Author and the answer given in the Suggested Reasons is that many amendments have taken place in the Companies Act, 2013, the Rules prescribed under the Companies Act, 2013, Securities Laws and Economic laws. Because of such amendments, the legal position has changed. However, the answers given by ICAI in the Suggested Answers are not revised / updated by ICAI to give effect to such amendments. For example, section 185 of the Companies Act, 2013 has been amended by the Companies (Amendment) Act, 2017, and such amendment has become applicable for May, 2019 and onwards CA (Final) Exams. The questions asked in all the Exams prior to May, 2019 Exams were answered by ICAI without incorporating the amendment made by the Companies (Amendment) Act, 2017, and these answers shall remain same in the Suggested Answers, *i.e.* ICAI does not amend / update / change the answers of such questions as per the amended section 185. However, the Author of this Book has answered all the questions and practical problems as per the amended provisions, as applicable for exams.

12. General tips for attempting the examination paper (*viz.* direct questions as well as practical problems)

(a) The first question to be answered should be one in which you are 100% confident and would take least time to answer.

(b) Attempt all the parts of one question simultaneously.

(c) Start the answer to every question or part of a question with a fresh page.

(d) Always write 'to the point'. Do not write such points as have not been asked in the question or are not relevant.

(e) Do not use your own abbreviations. However, standard abbreviations (*e.g.* AGM, EGM, NCLT, ROC etc.) may be used.

(f) Always write the answers in points, and avoid paragraphs. If necessary, use sub-points or / and bullets.

(g) Write short and simple sentences. However, if a legal provision is negatively drafted, it is not advisable to write such provision using positive language; write such provision using the negative language.

(h) Use the 'keywords' as much as possible.

(i) Do not use examples or illustrations as they would make the answer unnecessarily lengthy. However, if the content is very limited, you may use examples or illustrations so that the answer does not appear to be too short, or you may elaborate the same point again by restating the provision in different words.

(j) Underline the important keywords, time limits, monetary limits, names of the case laws, section numbers, etc. as you write the answers. If you plan to underline after writing all the answers, it would consume more time, and you might not be left with the time to underline; so keep on underlining as you write. Do not use pencil or scale or a different coloured pen to underline as it would result in wastage of time. Underlining would help in proper evaluation of your answers and may help you score some bonus marks.

(k) Use headings and sub-headings, wherever possible.

(l) Try to attempt the entire paper. Even if you don't know the answer of a particular question, try to attempt it by applying the knowledge of some related provisions and common sense, as there is no negative marking. But, remember, attempt such question at the end.

13. How to write answer to a direct question?

(a) Understand the question. If the question is lengthy, underline the relevant words.

(b) Before you start writing, plan your answer as to which points you must include in the answer, and which points you should skip without compromising the quality of the answer. Considering the weightage of the question and availability of time, plan the length of the answer.

(c) Start your answer by quoting the section number and a small introduction (of say, one to three lines) of the topic on which the question has been asked.

(d) Write your answer in points, and use headings and sub-headings, if required.

14. How to write answer to a situation based question / case study / practical problem?

(a) Do not start your answer with the conclusion, *viz.* 'Yes' or 'No'.

(b) Divide your answer into the following parts:

(i) ***The legal position:*** State the relevant provisions of the law.

(ii) ***The given case:*** Summarise the facts given in the question in your own words. It is not advisable to copy the language given in the question.

(iii) ***Analysis of the case:*** This is the most important part of the answer wherein you need to compare the given facts with the relevant provisions of the law.

Depending upon the facts, 'the given case' and 'analysis of the case' may be clubbed into one heading. *viz.* 'the given case and analysis of the case'.

(iv) ***Conclusion:*** Clearly write your answer as to what would happen in the given case. Conclusion should be short, say, between 2 to 5 lines.

Presentation of Practical Problem from the Chapter 'Appointment and Qualifications of Directors'

Mr. Abhi was appointed as an additional director of Pioneer Limited on 14th March, 2016. The annual general meeting of the company was scheduled to be held on 29th September, 2016 but due to heavy rains and floods all records of the company were destroyed. In order to rebuild the records, the company approached the Registrar of Companies for extension of time for holding the annual general meeting till 30th December, 2016. In the light of the Companies Act, 2013 advise Mr. Abhi, who was appointed as additional director during the year. **[CA (Final) May 2017]**

Ans. The given problem relates to section 161(1) read with section 96 of the Companies Act, 2013.

The legal position

1. As per section 161(1), an additional director holds office upto the date of next annual general meeting or the last day on which the annual general meeting should have been held, whichever is earlier.
2. If the AGM is not held upto the last day AGM ought to have been held as per section 96, the additional director shall have to vacate his office on the last day on which the AGM ought to have been held.
3. As per section 96, the company shall hold AGM within 6 months of the close of the financial year.
4. As per section 96, the Registrar may, for any special reason, grant extension of time (not exceeding 3 months).

The given case and analysis of the case

5. AGM of Pioneer Ltd. could not be held on 29th September, 2016 due to heavy rains and floods. Generally, such reasons are considered as 'special reason' within the meaning of section 96, and accordingly extension of time is granted by the Registrar.6. Pioneer Ltd. has applied to the Registrar for extension of time for holding the AGM till 30th December, 2016. The question is silent as to whether the Registrar has granted extension of time or not.
7. Assuming that the Registrar granted the extension of time for holding the AGM till 30th December, 2016, the issue that arises is 'whether Mr. Abhi can continue as additional director till 30th December, 2016?'
8. The last date for holding the AGM without any extension of time is 30th September, 2016, and the last date for holding AGM including extension of time is 30th December, 2016.
9. As per section 161(1), the additional director cannot continue beyond the last date on which the AGM ought to have been held. However, in the situation raised in the given question in which the extension of time is granted by the Registrar, section 161(1) is silent as to whether the additional director can continue in office upto the last date of the AGM including the extension granted by the Registrar.
10. As per reasonable interpretation, where extension is granted by the Registrar, the additional director should have a right to continue in office upto the date of the AGM including the extension granted by the Registrar.

Conclusion

11. Mr. Abhi is entitled to continue in office as additional director upto 30th December, 2016. If for any reason AGM is not held upto 30th December, 2016, Mr. Abhi shall have to vacate his office on 30th December, 2016.

15. Length of the answer

(a) There can be no standard criterion as to what is the desired length of the answer. Length of the answer depends upon various factors like, weightage of the question, time available with the student to answer the question, contents that the student retains etc.

(b) Though it is not advisable to generalise, yet the students keep on asking the same question again and again, and so the generalisation is as follows:

(i) A question carrying 3 to 4 marks should be answered in 1 to 1.5 pages.

(ii) A question carrying 6 to 8 marks should be answered in 2 to 2.5 pages.

16. Time management during the exams

(a) Assuming that a student answers MCQs of 30 marks in 30 minutes, he will have 150 minutes to answer the remaining question paper of 70 marks. A student should keep 10 minutes time in reserve to review the answers written by him and making the corrections. So, a student has 140 effective minutes to answer the questions carrying 70 marks. Applying the averages, for answering a question carrying 4 marks, a student should not devote more than 8 minutes, and for answering a question carrying 6 marks, the time for answering it should be less than 12 minutes.

(b) If you find that time spent in answering a particular question has already exceeded the time limit, and in next one or two minutes you won't be able to complete the answer, it would be a wise decision to keep the answer pending and move on to the next question, and come back and complete such answer if you have time at the end.

17. Mock test

(a) Take two to three mock tests before the final exams.

(b) Prepare for the mock tests by not spending more than 20 hours in revision.

(c) Attempt the mock test under examination conditions.

(d) Evaluate your own performance and improve upon your weak areas.

18. Amendments

(a) This Book contains all the amendments which, as per the opinion of the Author, shall be applicable for May, 2021 Exams.

(b) However, the Author has not included in this Book such amendments as have not been brought into force till 31st October, 2020 (e.g. amendments made by the Companies (Amendment) Act, 2020, amendments made by the Arbitration and Conciliation (Amendment) Ordinance, 2020, certain amendments made by the Arbitration and Conciliation (Amendment) Act, 2019, certain amendments made in the Prevention of Money-laundering Act, 2002 by the Finance (No. 2) Act, 2019, etc.), since such amendments shall not be made applicable by ICAI for May, 2021 Exams.

(c) The Companies (Winding Up) Rules, 2020 were notified in the Official Gazette by the Central Government on 24th January, 2020 and came into force with effect from 1st April, 2020. However, these Rules were not made applicable by ICAI for November, 2020 Exams. So, the Author of this Book is of the opinion that these Rules shall not be made applicable by ICAI for May, 2021 and onwards Exams. Accordingly, these Rules have not been included in this Book.

(d) If any amendment that has not been included in this Book is made applicable by ICAI for May, 2021 Exams, the Author shall upload the amended topics / sections on www.bestword.in.

आओ समझें कैसे करें preparation of paper law
ताकि exam में न रह जाये कोई भी flaw

Law का याद हो जायेगा हर section
अगर करते रहोगे आपस में interaction

Book बन्द करके करना हमेंशा revision
तो result आएगा pass with first division

Revision करना एक दिन, एक हफ्ते और एक महीने के बाद
ताकि जो कुछ भी समझा है वह रहे हमेशा याद

नहीं रटना and emphasis देना on understanding of concepts
तो result आऐगा न only good or better, but the best

Language of Bare Act या book याद करना नहीं है जरूरी
याद रखोगे अगर Headings, Points and Keywords, तो तैयारी होगी पूरी

शुरूआत करना उन questions से जिनमें हो confidence और न करना पड़े guess
ध्यान रखना कि करना है जरूर examiner को impress

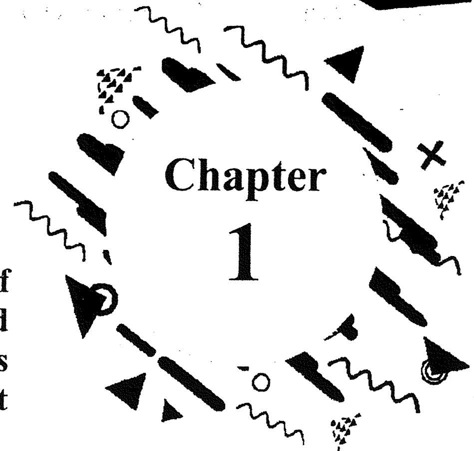
जो कुछ भी हो important उसे जरूर करना underline
Scale, pencil या black pen use करने में न करना खराब time

Use करना points and avoid use of long paragraph
5 नम्बर के लिए sufficient होगा page one and a half

Exams से पहले जरूर देना mock test
तो result आने पर होगा बड़ा fest
At last, I wish you all, all the best.

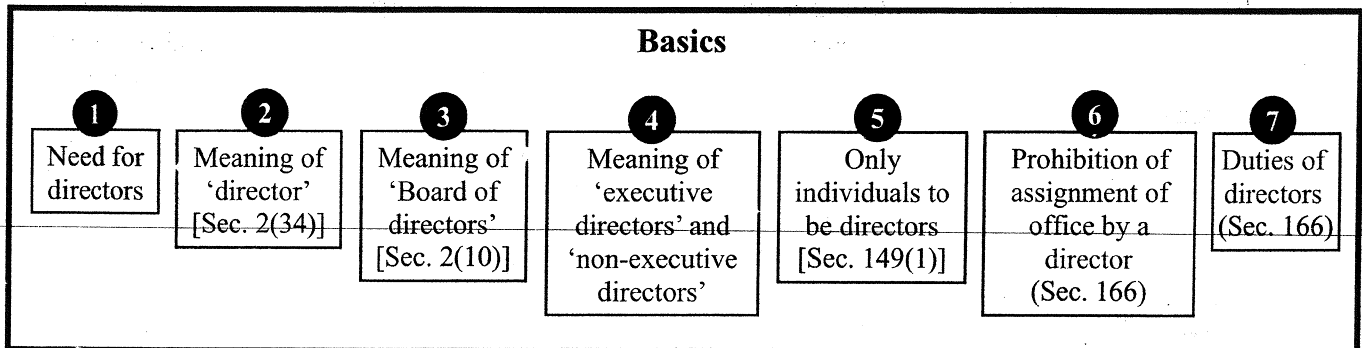
लेखकः सी.ए. सी.एस. मुनीष भण्डारी

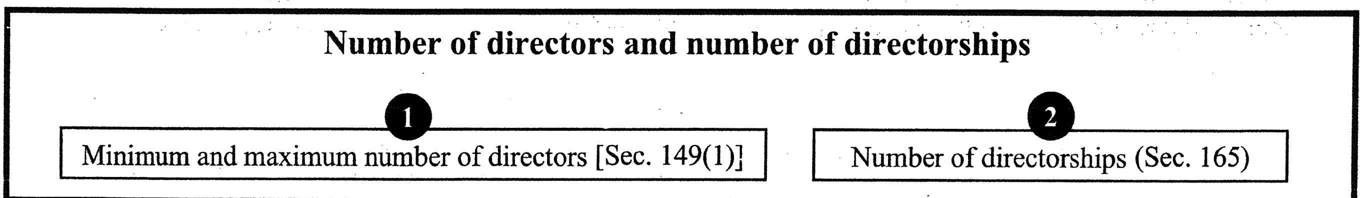
Appointment and Qualifications of Directors

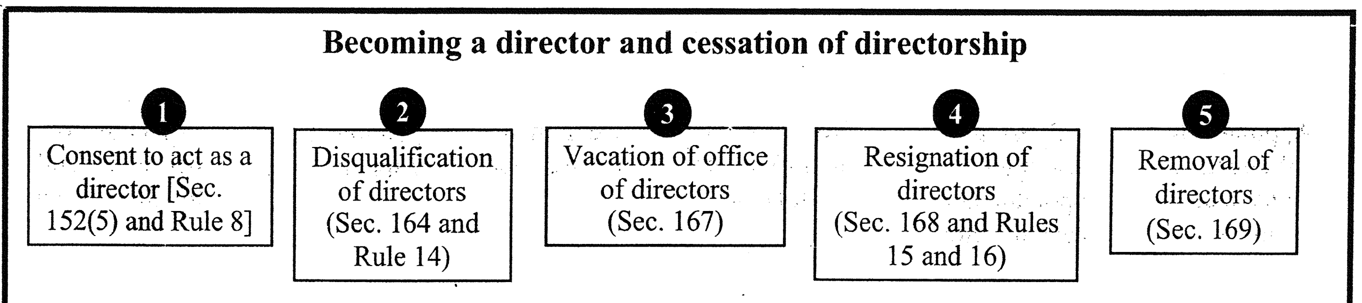


(Chapter XI of the Companies Act, 2013 consisting of Sections 149 to 172 and the Companies (Appointment and Qualification of Directors) Rules, 2014) and the Companies (Creation and Maintenance of databank of Independent Directors) Rules, 2019)

Bird's eye-view of the Chapter







Kinds of directors and their appointments

1. First directors [Sec. 152(1)]
2. Woman director [2nd proviso to Sec. 149(1) and Rule 3]
3. Indian Resident director [Sec. 149(3)]
4. Appointment of directors by proportional representation (Sec. 163)
5. Appointment of directors by small shareholders (Sec. 151 and Rule 7)

Kinds of directors and their appointments

(A) Independent directors (IDs)

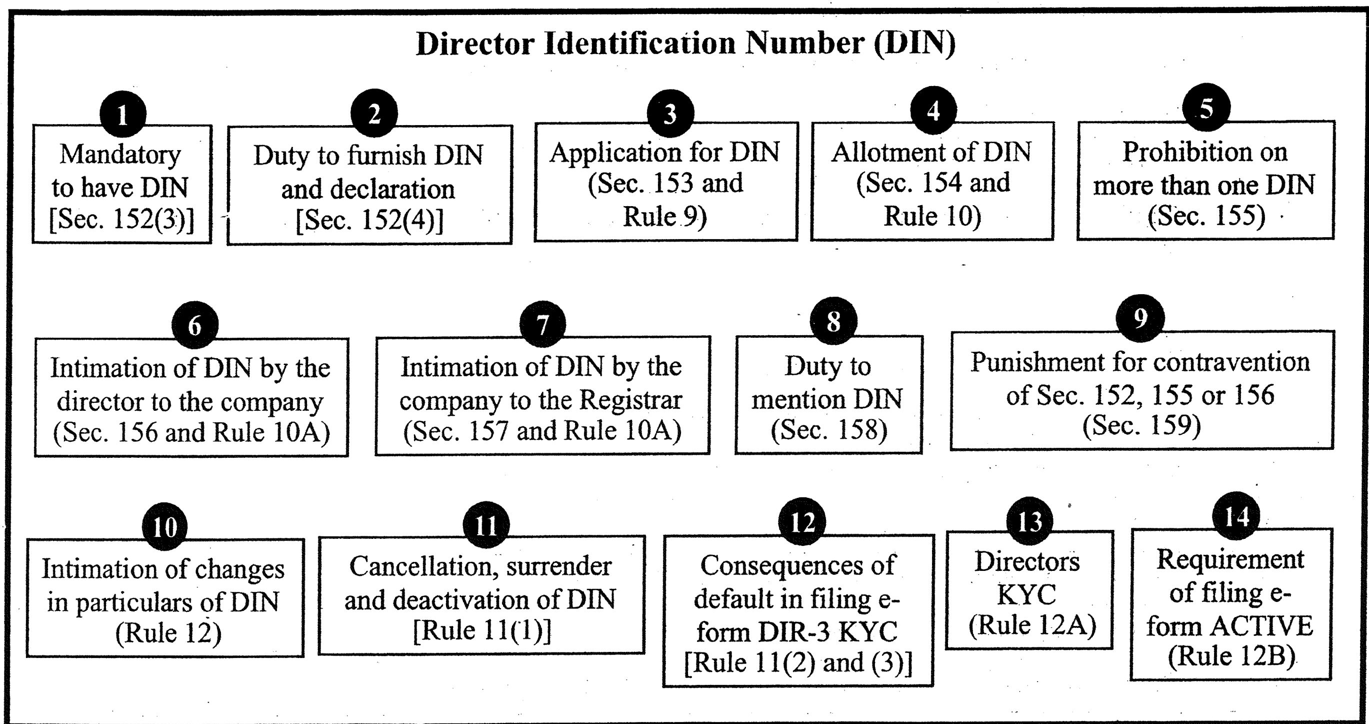
1. Applicability and number of IDs [Sec. 149(4) and Rule 4]
2. Criteria of independence for an ID [Sec. 149(6) and Rule 5]
3. Submission of declaration of independence by an ID [Sec. 149(7)]
4. Code of Conduct for IDs (Sec. 149(8) and Schedule IV)
5. Other terms and conditions for IDs [Sec. 149(9) to (13)]
6. Manner of selection of IDs and maintenance of databank (Sec. 150 and Rule 6)

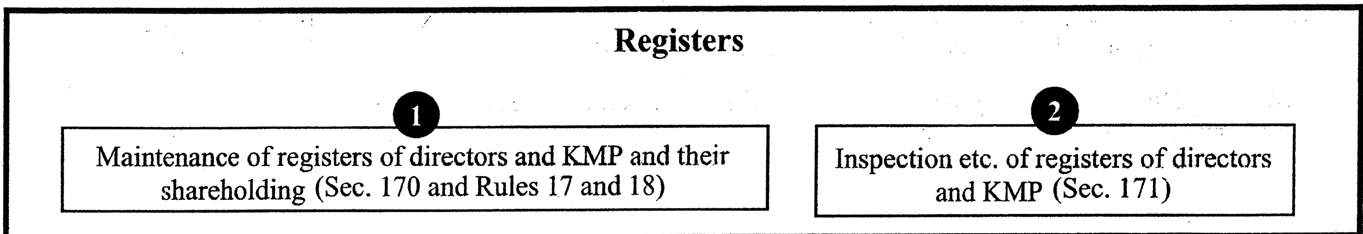
(B) Appointment of directors by Board [Sec. 161]

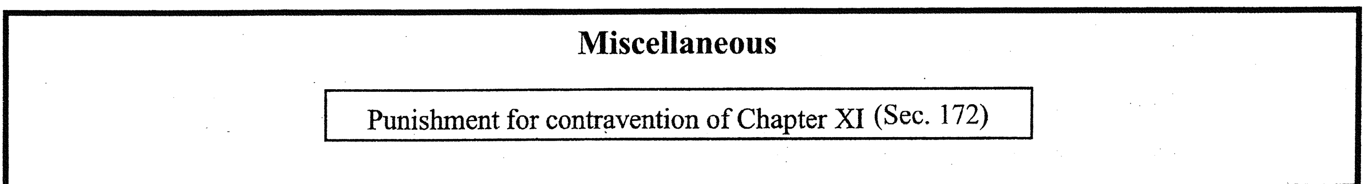
1. Appointment of additional director [Sec. 161(1)]
2. Appointment of alternate director [Sec. 161(2)]
3. Appointment of nominee directors [Sec. 161(3)]
4. Appointment of director filling a casual vacancy [Sec. 161(4)]

(C) Appointment of directors by members

1. Appointment of directors to be made in GM [Sec. 152(2)]
2. Separate resolution for appointment of each director (Sec. 162)
3. Rotational and non-rotational directors [Sec. 152(6)]
4. Retirement of directors [Sec. 152(6)]
5. Automatic reappointment [Sec. 152(7)]
6. Right of any person to stand for directorship (Sec. 160 and Rule 13)







Bird's eye-view of the Companies (Appointment and Qualification of Directors) Rules, 2014

Rule No.	Marginal Heading
1	Short title and commencement
2	Definitions
3	Woman director on the Board
4	Number of Independent directors

5	Qualifications of independent director
6	Compliances required by a person eligible and willing to be appointed as an independent director
7	Small shareholders' director
8	Consent to act as director
9	Application for allotment of Director Identification Number before appointment in an existing company
10	Allotment of DIN
10A	Director's intimation of DIN to companies
11	Cancellation or surrender or Deactivation of DIN
12	Intimation of changes in particulars specified in DIN application
12A	Directors KYC
12B	Directors of company required to file e-form ACTIVE
13	Notice of candidature of a person for directorship
14	Disqualification of directors under sub-section (2) of section 164
15	Notice of resignation of director
16	Copy of resignation of director to be forwarded by him
17	Register of directors and key managerial personnel
18	Return containing the particulars of directors and the key managerial personnel

Bird's eye-view of the Companies (Creation and Maintenance of databank of Independent Directors) Rules, 2019

Rule No.	Marginal Heading
1	Short Title and Commencement
2	Definitions
3	Creation and maintenance of data bank
4	Duties of the Institute
5	Panel

Bird's eye-view of the Forms used in this Chapter

Form No.	Description of E-Form (Purpose of E-Form)	Relevant Section	Relevant Rule
DIR-1	Omitted	–	–
DIR-2	Consent to act as a director of a company	152(5)	8
DIR-3	Application for allotment of DIN	153	9
DIR-3A	Declaration, where a person does not have a last name	–	9

DIR-3B	Intimation of allotment of DIN to the company by the Director	156	10A
DIR-3C	Intimation of DIN by the company to the Registrar	157	10A
DIR-3 KYC-WEB	KYC of Directors	–	12A
DIR- 4	Omitted	–	–
DIR-5	Application for surrender of DIN	153	11
DIR-6	Intimation of change in particulars of Director to be given to the Central Government	–	12
DIR-7	Omitted	–	12
DIR-8	Intimation by Director	164 and 152(4)	14
DIR-9	Report by the company to Registrar	164(2)	14
DIR-10	Form of application for removal of disqualification of directors	164(2)	14
DIR-11	Notice of resignation of a director to the Registrar	168	16
DIR-12	Particulars of appointment of directors and the Key Managerial Personnel and the changes among them	168 and 170	8, 15 and 18

Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, –
   (a) any reference to any section means reference to the sections of the Companies Act, 2013; and
   (b) any reference to any rule means reference to the Rules contained in the Companies (Appointment and Qualification of Directors) Rules, 2014.

1.1 Need for directors

1. Company is an artificial person incapable of acting by itself

On incorporation, a company becomes a legal person, *i.e.* it has an identity of its own, it is empowered to hold properties in its own name and it can sue others in its own name. Also, a company is an artificial person, *i.e.* it is invisible, intangible and exists only in contemplation of law.

However, a company is not a natural person, *i.e.* it has no mind or body of its own, it has no eyes to see, no ears to hear, no hands to sign and no brain to think and take decisions. Therefore, a company cannot act by itself and consequently it has to depend upon some human agency to act in its name.

The two human agencies, through which a company acts, are the members of the company and the Board of directors. *In other words*, the decision-making powers of a company are vested in its two organs, *viz.* the members of the company and the Board of directors. The Board is the managerial body to whom is entrusted the whole of the management of the company. It is constituted by the members. Directors are accountable to the members in as much as members are empowered to appoint them and remove them. Directors owe a duty to the members to exercise care, skill and diligence in discharge of their functions. The directors must act as a body without improper exclusion of any of the directors.

2. Separation of ownership from management

The members have no inherent right to participate in the management of the company. They generally lack the expertise to manage the affairs of a company. Further, a large sized company may have its members running into lakhs, who are dispersed all over the length and breadth of the country, which makes it impossible to give the management of the company in their hands. Therefore, a specialised body of persons, called as directors are appointed by the members to manage the affairs of the company.

3. Statutory requirement to have directors

The Act has recognised the need for directors and their vital position in a company. It requires every company to have its Board of directors. As per section 149(1), every public company shall have a minimum of 3 directors, every private company shall have a minimum of 2 directors and every One Person Company shall have a minimum of 1 director.

Delegation by the Board is permissible

The Board of directors may manage the company either by itself or where it is overburdened with the day-to-day affairs of the company, it may delegate its functions to a managing director, whole time director or any other director, or to the manager, or to a committee of directors or to any officer or employee of the company.

1.2 Meaning of 'director' and 'Board of directors' [Section 2(34) and Section 2(10)] *

1. Definition of 'director'

As per Clause (34) of Section 2 of the Companies Act, 2013, 'director' means a director appointed to the Board of a company.

Exhaustive definition

The definition of 'director' is exhaustive. It means that a person shall be regarded as a director only if he is appointed as a director by the company. *In other words*, if a person occupies the position of a director (*i.e.* he functions as a director), but is not designated (*i.e.* named) as a director, he shall not be regarded as a director.

2. Definition of 'Board of directors'

As per Clause (10) of Section 2 of the Companies Act, 2013, 'Board of Directors' or 'Board', in relation to a company, means the collective body of the directors of the company.

Simply speaking, the term 'Board of directors' means a body duly constituted to direct, control and supervise the affairs of a company. *In other words*, the Board of directors is the 'directing mind and will' of the company.

3. Board has the management and control of the company

The 'Board of directors' is the supreme authority having the management and control of the affairs of a company. It is entitled to exercise all such powers as the company is authorised to exercise. However, certain powers are required to be exercised in general meeting by the members, and therefore such powers shall not be exercised by the Board.

4. Functions of the Board

The Board directs, controls, manages and superintends the affairs of a company. It formulates the general policy of the company, establishes organisational set up for implementing these policies, and directs its affairs to achieve the objectives laid down by it. The success of the company depends on the efficient functioning of its Board of directors. Therefore, Board is generally referred to as the eyes, ears, brains, nerves and essential limbs of the company.

1. The terms 'Board of directors', 'Board' and 'directors' are synonymous

The directors collectively are referred to as the 'Board of directors' or the 'Board'. In practice, the expression 'directors' is also used to mean the 'Board of directors'.

2. Directors can exercise powers only when they act collectively

All the powers vested in the Board of directors are exercisable by the directors collectively, *i.e.* by the Board. An individual director has no authority to act on behalf of the company, unless he is so authorised by the Act, articles, a resolution of the Board of directors or a resolution of the members.

1.3 Meaning of 'executive directors' and 'non-executive directors'

The expressions 'executive director' and 'non-executive director' have not been used in the Companies Act, 2013. Generally, these terms are used as follows:

* In the Companies Act, 2013, the definitions are contained in various clauses of section 2. For example, the definition of 'director' is contained in section 2(34), which is to be read / written as 'clause (34) of section 2'; reading / writing it as 'sub-section (34) of section 2' is incorrect.

1. **Executive directors**

   The directors who are in the employment of the company are called as executive directors or inside directors. A whole time director and managing director are covered in this category of directors. The inside directors possess in-depth knowledge about the affairs of the company. They are generally connected with the policy formulation of the company and take active interest in the day-to-day affairs of the company. They have personal involvement with the company since their remuneration depends on the successful operations of the company.

2. **Non-executive directors**

   Directors who are not in the employment of the company are called as non-executive directors or part time directors or outside directors. This category includes professional directors and nominee directors. These directors have generally diverse experience and backgrounds. They provide independent thinking, wider knowledge and perspective to the company. They are appointed not to work full time under a contract of service. They are not intimately connected with the company except through attending the Board meetings. They have an unbiased attitude towards the working of the company.

1.4 Only individuals to be directors and prohibition of assignment of office (Sections 149 and 166)

1. **Only individuals to be directors (Section 149)**

   The Board of directors of every company shall consist of individuals only. Thus, no body corporate, association, firm or Limited Liability Partnership (LLP) shall be appointed as a director.

   The reason behind the provision is that the office of a director is similar to a trust. So, there should be somebody readily available who can be held responsible for the failure to carry out obligations of such an office. It will be difficult to fix the responsibility if a body corporate, association or firm is a director **[*Oriental Metal Pressing Pvt. Ltd.* v *B.K. Thakoor* (1961) 31 Comp Cas 143]**.

2. **Prohibition of assignment of office (Section 166)**

   (a) No director shall assign his office to any other person. Any assignment of office made by a director shall be void.

   (b) If a director of the company contravenes the provisions of section 166, he shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh.

1. As per section 152(3), an individual may be appointed as a director only if he has been allotted Director Identification Number (DIN) or such other number as may be prescribed under section 153.
2. Any person may be appointed as a director in a company (provided he is not disqualified as per section 164), whether or not he is an Indian citizen, and whether or not he is a resident of India.
3. There is no upper or lower age limit for appointment as a director. However, a minor is not eligible to obtain DIN, and so a minor cannot be appointed as a director.

Practical Problems from CA Examinations

Appointment of a director by way of will – Does it amount to assignment of office?

P 1.4A. 'X' was appointed as a director for life by the articles of association of a private company incorporated on 1st June, 2014. The articles also empowered 'X' to appoint a successor. 'X' appointed, by will, 'G' to succeed him after his death. Can 'G' succeed 'X' as a director after the death of 'X'? **[CA (Final) Nov. 1995]**

Ans. No director shall assign his office to any other person. If he does, the assignment shall be void (Section 166).

In the given case, the articles of a company empowered its director to appoint a successor. The director appointed, by his will, Mr. G to succeed him as a director after his death. The Court observed that a director is prohibited from assigning *his* office. The word 'his' used in section 166 indicates that the prohibition applies only when an office held by a director is assigned to any other person. Where a director dies, the office held by him becomes vacant and therefore, such office cannot be assigned to any other person. Therefore, appointment of a new person in such office does not amount to an assignment within the meaning of section 166 **[*Oriental Metal Pressing Pvt. Ltd.* v *B.K. Thakoor* (1961) 31 Comp Cas 143]**.

The facts of the given case are identical to the facts discussed in the above case. Accordingly, it can be said that appointment of 'G' is valid and it does not amount to an assignment of office by 'X'.

1.5 Duties of directors (Section 166)

1. **Duty to act as per the articles**

   Subject to the provisions of this Act, a director of a company shall act in accordance with the articles of the company.

2. Duty to act in good faith

A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

3. Duty to exercise due care

A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

4. Duty to avoid conflict of interest

A director of a company shall not get involved in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

5. Duty not to make any undue gain

A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates. If any director is found guilty of making any undue gain, he shall be liable to pay to the company an amount equal to that gain.

6. Duty not to assign his office

A director of a company shall not assign his office. Any assignment of office made by a director shall be void.

7. Punishment for contravention

If a director of the company contravenes the provisions of section 166, he shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh.

1.6 Director Identification Number (DIN) (Section 152(3) and Sections 153 to 159 and Rules 9, 10, 10A, 11, 12, 12A and 12B)

(A) Provisions contained in the Act

1. Mandatory to have DIN [Section 152(3)]

No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number under section 154 or such other number as may be prescribed under section 153.

2. Application for DIN (Section 153)

(a) Application by whom? Every individual intending to be appointed as a director of any company shall make an application for allotment of DIN.

(b) Manner of making application.

- The application for DIN shall be made to the Central Government.
- The application for DIN shall be made in such form and manner, and shall be accompanied with such fees as may be prescribed.

The Central Government may prescribe any identification number which shall be treated as Director Identification Number for the purposes of this Act, and in case any individual holds or acquires such identification number, the requirement of this section shall not apply or apply in such manner as may be prescribed.

3. Allotment of DIN (Section 154)

The Central Government shall allot DIN to an applicant in such manner as may be prescribed. DIN shall be allotted within 1 month of receipt of application for allotment of DIN.

4. Prohibition to obtain more than one DIN (Section 155)

No individual who has already been allotted a DIN, shall apply or obtain or possess another DIN.

Director Identification Number (DIN) is individual specific, *i.e.* for one individual, there shall be one DIN even if he is a director in more than one company. Once issued, DIN remains valid for lifetime unless it is cancelled, surrendered or deactivated.

5. Intimation of DIN by the director to the company (Section 156)

- Every person who is already a director, shall intimate his DIN to the company or companies in which he is already a director.
- Such intimation must be given by him within 1 month of receipt of DIN.

6. Intimation of DIN by the company to the Registrar (Section 157)

- Every company shall intimate the DIN of all its directors to the Registrar or any other officer or authority as may be specified by the Central Government.
- Such intimation shall be given by the company within 15 days of receipt of intimation of DIN by it under section 156.
- The intimation shall be furnished in such form and manner as may be prescribed.
- If a company fails to intimate DIN in accordance with the provisions of section 157, the punishment shall be as follows:
  (a) The company shall be liable to a penalty of Rs. 25,000 and in case of continuing failure, with a further penalty of Rs. 100 for each day after the first during which such failure continues, subject to a maximum of Rs. 1 lakh.
  (b) Every officer of the company who is in default shall be liable to a penalty of not less than Rs. 25,000 and in case of continuing failure, with a further penalty of Rs. 100 for each day after the first during which such failure continues, subject to a maximum of Rs. 1 lakh.

7. Obligation to indicate DIN (Section 158)

If any return, information or particulars required to be furnished under the Act relates to a director or contains any reference to a director, every person or company shall mention the DIN in such return, information or particulars.

8. Penalty for default of certain provisions (Section 159)

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 Rs. 50,000 and where the default is a continuing one, with a further penalty which may extend to Rs. 500 for each day after the first during which such default continues.

(B) Provisions contained in the Rules

1. Definition of "Director Identification Number" (DIN) [Rule 2(d)]

- 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.
- The DIN obtained by the individuals prior to the notification of these rules shall be the DIN for the purpose of the Companies Act, 2013.
- DIN includes the Designated Partnership Identification Number (DPIN) issued under section 7 of the Limited Liability Partnership Act, 2008 and rules made thereunder.

DIN is a unique Identification Number. For filing various forms with the Registrar, DIN is a pre-requisite, *i.e.* the electronic system of the Ministry of Corporate Affairs does not allow filing of various forms unless DIN of the signatory director is filled in the form.

2. Application for allotment of DIN before appointment in an existing company (Rule 9)

(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 3 directors shall be mentioned in Form No. INC-32 (SPICe) and DIN may be allotted to maximum 3 proposed directors through Form INC-32 (SPICe).

Form INC-32 (SPICe) has been substituted by a new Form, *viz.* Form SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC-32) [Rule 38 of the Companies (Incorporation) Rules, 2014, as amended by the Companies (Incorporation) Amendment Rules, 2020, w.e.f. 15-2-2020]. Rule 9 of the Companies (Appointment and Qualification of Directors) Rules, 2014 should have been amended by the Central Government to provide that the application shall be filed in Form SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC-32) instead of Form INC-32 (SPICe).

(b) The Central Government shall provide an electronic system to facilitate submission of application for the allotment of DIN through the portal on the website of the Ministry of Corporate Affairs.

(c) The applicant shall download Form DIR-3 from the portal, fill in the required particulars sought therein, verify and sign the form and after attaching copies of the following documents, scan and file the entire set of documents electronically –

(i) photograph;

(ii) proof of identity;

(iii) proof of residence;

(iv) Board resolution proposing his appointment as director in an existing company; and

(v) specimen signature duly verified.

(d) Form DIR-3 shall be signed and submitted electronically by the applicant using his or her own Digital Signature Certificate and shall be verified digitally by 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.

(e) In case the name of a person does not have a last name, then his or her father's or grandfather's surname shall be mentioned in the last name along with the declaration in Form No. DIR-3A.

3. Allotment of DIN (Rule 10)

(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 the application number, the Central Government shall process the applications received for allotment of DIN, 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 1 month from the receipt of such application.

(c) If the Central Government, on examination, finds such application to be defective or incomplete in any respect, it shall give intimation of such defect or incompleteness, by placing it on the website and by email to the applicant who has filed such application, directing the applicant to rectify such defects or incompleteness by resubmitting the application within a period of 15 days of such placing on the website and email. In such a case, the Central Government shall –

(i) 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;

(ii) treat and label such application as invalid in the electronic record in case the defects are not removed within the given time; and

(iii) inform the applicant either by way of letter by post or electronically or in any other mode.

(d) 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.

(e) All DINs 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.

(f) The DIN so allotted under these rules is valid for the life-time of the applicant and shall not be allotted to any other person.

The powers and functions of the Central Government in respect of allotment of Director Identification Number have been delegated to the Regional Director, Joint Director, Deputy Director or Assistant Director posted in the office of Regional Director at Noida [Notification No. S.O. 1354(E) dated 21st May, 2014].

4. Intimation of DIN by existing directors (Rule 10A)

(a) 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 1 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.

(b) 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.

5. Cancellation or surrender or Deactivation of DIN [Rule 11(1)]

The Central Government or Regional Director (Northern Region), Noida or any officer authorised by the Regional Director may, upon being satisfied on verification of particulars or documentary proof attached with the application received alongwith fee from any person, cancel or deactivate the DIN in the following cases:

(a) Where DIN is found to be duplicated in respect of the same person provided the data related to both the DIN shall be merged with the validly retained number.

(b) Where DIN was obtained in a wrongful manner or by fraudulent means.
- Before cancellation or deactivation of DIN pursuant to clause (b), an opportunity of being heard shall be given to the concerned individual.
- The term 'wrongful manner' means any case where DIN is obtained on the strength of documents which are not legally valid or incomplete documents are furnished or on suppression of material information or on the basis of wrong certification or by making misleading or false information or by misrepresentation.
- The term 'fraudulent means' means obtaining DIN with an intent to deceive any other person or any authority including the Central Government.

(c) In case of the death of the concerned individual.

(d) Where the concerned individual has been declared as a person of unsound mind by a competent Court.

(e) Where the concerned individual has been adjudicated an insolvent.

(f) Where 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. Before deactivation of any DIN in such case, the Central Government shall verify e-records.

6. Intimation of changes in particulars specified in DIN application (Rule 12)

(a) Every individual who has been allotted a DIN 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:

(i) 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.

(ii) The form shall be digitally signed by a chartered accountant in practice or a company secretary in practice or a cost accountant in practice.

(iii) 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 or companies 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.

7. Directors KYC (Rule 12A)

(a) Every individual who holds DIN as at 31st March of any financial year, shall submit e-form DIR-3 KYC for the said financial year to the Central Government on or before 30th September of immediately next financial year.

(b) Every individual who holds DIN as at 31st March, 2018, shall submit e-form DIR-3 KYC on or before 5th October, 2018.

(c) Every individual who holds DIN as at 31st March, 2019, shall submit e-form DIR-3 KYC or web form DIR-3 KYC-WEB, as the case may be, on or before 14th October, 2019.

(d) If an individual has already submitted e-form DIR-3 KYC in relation to any previous financial year, then, it shall be deemed to be a sufficient compliance of the provisions of Rule 12A, if such individual submits web-form DIR-3 KYC-WEB through the web service in relation to any subsequent financial year.

(e) In case an individual desires to update his personal mobile number or the e-mail address, he shall update the same by submitting e-form DIR-3 KYC only.

(f) For submitting e-form DIR-3 KYC or web-form DIR-3 KYC-WEB through the web service, such fees shall be payable as is provided in the Companies (Registration Offices and Fees) Rules, 2014.

8. Consequences of default in filing e-form DIR-3 KYC [Rule 11(2) and (3)]

(a) If an individual does not intimate his particulars in e-form DIR-3-KYC or the web form DIR-3 KYC-WEB, as the case may be, within stipulated time in accordance with Rule 12A, his DIN shall be deactivated by –

(i) The Central Government; or

(ii) Regional Director (Northern Region); or

(iii) Any officer authorised by the Central Government or Regional Director (Northern Region) [Rule 11(2)].

(b) The de-activated DIN shall be re-activated only after e-form DIR-3-KYC or the web form DIR-3 KYC-WEB, as the case may be, is submitted along with the fee as prescribed under Companies (Registration Offices and Fees) Rules, 2014 [Rule 11(3)].

9. Requirement of filing e-form ACTIVE (Rule 12B)

(a) If a company governed by Rule 25A of the Companies (Incorporation) Rules, 2014 fails to file the e-form ACTIVE till 15th June, 2019, then, the DIN of all the directors of such company shall be marked as "Director of ACTIVE non-compliant company".

Provisions contained in Rule 25A of the Companies (Incorporation) Rules, 2014

1. Every company incorporated on or before 31st December, 2017 shall file the particulars of the company and its registered office, in e-Form ACTIVE (Active Company Tagging Identities and Verification) on or before 15.06.2019.
2. Any company which has not filed its due financial statements under section 137 or due annual returns under section 92 or both with the Registrar shall be restricted from filing e-Form ACTIVE, unless such company is under management dispute and the Registrar has recorded the same on the register.
3. The companies which have been struck off or are under process of striking off or under liquidation or amalgamation or dissolution, as recorded in the register, shall not be required to file e-Form ACTIVE.
4. If a company does not file e-Form ACTIVE till 15.06.2019, the company shall be marked as "ACTIVE non-compliant" on or after 16th June, 2019.

(b) Where the DIN of a director has been marked as "Director of ACTIVE non-compliant company", such director shall take all necessary steps to ensure that all companies governed by rule 25A of the Companies (Incorporation) Rules, 2014, in which such director is a director, file e-form ACTIVE.

(c) After all the companies in which such director is a director, file the e-form ACTIVE, the DIN of such director shall be marked as "Director of ACTIVE compliant company".

Theoretical Questions from CA Examinations

Q 1.6A. Mr. X applied to the Central Government for allotment of Director Identification Number. What are the obligations of Mr. X and the companies in which he is appointed as a director, after "DIN" is allotted to him, under the Companies Act, 2013 and the rules made hereunder? [CA (Final) Nov. 2008]

Q 1.6B. What do you understand by the term 'Director Identification Number' (DIN)? Describe the procedure to obtain the same as enumerated under the Companies Act, 2013 read with the relevant rules. [CA (Final) May 2008, June 2009]

Q 1.6C. What is Director Identification Number (DIN)? Mr. Mohan, a newly appointed director of RST Limited applied for DIN. Advise him about the documents to be submitted for this purpose. [CA (Final) Nov. 2013 (Modified)]

Q 1.6D. Mr. Thangavel is a director in 7 companies with a DIN (Director Identification Number) allotted to him. Again, another DIN was inadvertently allotted to him which was never used for fling any document with any Authority. He desires to surrender the second DIN and keep all his directorship with the first DIN. Advise him the procedure to be followed under the provisions of the Companies Act, 2013 and the Rules made thereunder for surrendering the second DIN inadvertently obtained by him. [CA (Final) Nov. 2019]

Practical Problems from CA Examinations

Course of action required where status of DIN application is marked as 'Put Under Resubmission'

P 1.6A. Mr. Vinay kumar, applied for the first time for allotment of a Directors Identification Number (DIN) on 1st November, 2016 as he is planning to incorporate a private limited company in Form No. DIN-3 under the Companies Act, 2013. The status of his DIN applications presently is showing as "Put Under Resubmission". He seeks your guidance as to whether his application has been rejected and is he required to obtain a fresh DIN. Advise. [CA (Final) Nov. 2017]

Ans. The given problem relates to sections 153 and 154 of the Companies Act, 2013 and Rules 9 and 10 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

As per section 153 read with Rule 9 of the Companies (Appointment and Qualification of Directors) Rules, 2014, every individual intending to be appointed as a director of any company shall make an application for allotment of DIN in Form No. DIR-3. As per section 154, the Central Government shall allot DIN to an applicant within 1 month of receipt of application for allotment of DIN.

As per Rule 10, if the Central Government, on examination, finds that the application for allotment of DIN made by the applicant is defective or incomplete in any respect, it shall give intimation of such defect or incompleteness, by placing it on the website and by email to the applicant who has filed such application, directing the applicant to rectify such defects or incompleteness by resubmitting the application within a period of 15 days of such placing on the website and email. In such a case, the Central Government shall –

(i) 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;

(ii) treat and label such application as invalid in the electronic record in case the defects are not removed within the given time; and

(iii) inform the applicant either by way of letter by post or electronically or in any other mode.

The Ministry of Corporate Affairs has, on its website, displayed Frequently Asked Questions (FAQs) with respect to DIN. One of the FAQs reads as under:

"My DIN application has been put under Resubmission. Am I required to obtain a fresh DIN application?"

The answer to the aforesaid FAQ is as follows:

"No. If the DIN application is put under Resubmission, for example due to following reasons, you can submit additional documents for rectifying your DIN application, within a period of 15 days from the date on which it is marked for resubmission:

- Proof of Identity / residence is not enclosed or expired.
- Proof of Date of Birth is not enclosed.
- Supporting documents are not properly attested.
- Non-submission of affidavit (if required).

On resubmitting the additional documents, same DIN will be approved, if documents are found in correct order as per marked in resubmission."

Thus, based on the above FAQ and its answer and Rule 10, it can be concluded that the application for DIN made by Mr. Vinay Kumar has not been rejected, and he is not required to obtain a fresh DIN. He is required to rectify his earlier application within 15 days from the date his application is marked for resubmission.

Changes in the particulars of a director– How to be incorporated in DIN?

P 1.6B. Some changes in the particulars of a Director, who has already obtained a Director Identification Number have taken Place. Now the Director wants to incorporate the changes in his DIN in the database maintained by the Central Government in this regard. Describe the procedure to be followed by the Director. [CA (Final) May, 2015]

OR

Surya, a director in New Age Limited holding Directors Identification Number (DIN) wants to make certain changes in the particulars of his DIN. What procedure would you follow to get changes incorporated in the DIN already allotted to Surya? [CA (Final) May, 2017]

Ans. The given problem relates to Rule 12 of the Companies (Appointment and Qualification of Directors) Rules, 2014, as explained below:

(a) Every individual who has been allotted a DIN 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:

  (i) 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 it electronically.

  (ii) The form shall be digitally signed by a chartered accountant in practice or a company secretary in practice or a cost accountant in practice.

  (iii) 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 or companies 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.

1.7 Qualifications and disqualifications of directors (Section 164 and Rule 14)

Section 164 read with Rule 14 of the Companies (Appointment and Qualification of Directors) Rules, 2014 negatively stipulates the eligibility requirements for becoming a director by providing certain disqualifications. These disqualifications are explained as follows:

1. Grounds of disqualification [Section 164(1)]

The following persons are disqualified to become a director:

(a) A person who is declared to be of unsound mind by a Court of competent jurisdiction.

Where a person is declared to be of unsound mind, but afterwards he is declared to be of sound mind, the disqualification comes to an end.

(b) A person who is an undischarged insolvent.

A person is termed as 'undischarged insolvent' when he has been adjudged as an insolvent (*i.e.* declared to be an insolvent), but he has not been discharged.

(c) A person who has applied to be adjudicated as an insolvent and his application is pending.

(d) A person who has been convicted by a Court of any offence (whether involving moral turpitude or otherwise) and sentenced to imprisonment for 6 months or more, and 5 years have not elapsed from the date of expiry of the sentence.

1. The director shall continue to be disqualified even if any appeal or petition is filed against the order of conviction or disqualification.
2. The term 'Court' shall include 'Indian Courts' as well as 'Courts outside India'.
3. The expression 'or otherwise' means any offence in respect of which a person has been convicted by a Court under the Companies Act, 2013 or under the Companies Act, 1956 [As per Rule 2(1)(k) of the Companies (Appointment and Qualification of Directors) Rules, 2014].
4. Generally, the disqualification comes to an end on expiry of 5 years from the date of expiry of the sentence. However, if a person is convicted of any offence and sentenced to imprisonment for a period of 7 years or more, he shall be disqualified for lifetime, *i.e.* he is not eligible to be appointed as a director in any company during his entire life.

(e) A person against whom an order disqualifying him for appointment as a director has been passed by a Court or Tribunal and the order is in force.

1. The director shall continue to be disqualified even if any appeal or petition is filed against the order of conviction or disqualification.
2. Where an order of Court or Tribunal disqualifies a person for directorship for certain period, and such period expires, it is termed as 'the order is not in force'.

(f) A person who has not paid any call on shares of the company held by him and 6 months have elapsed from the last day fixed for the payment of the call.

This ground of disqualification shall apply even where the shares are held by a person jointly with any other person(s).

(g) A person who has been convicted of an offence dealing with related party transactions under section 188 at any time during the preceding 5 years.

The director shall continue to be disqualified even if any appeal or petition is filed against the order of conviction or disqualification.

(h) A person who has not complied with section 152(3), *i.e.* he has not been allotted DIN or such other number as may be prescribed under section 153.

(i) A person who has not complied with the provisions of sub-section (1) of section 165, *i.e.* he holds office as a director (including alternate directorships) in more than 20 companies, whether public or private or he holds office as a director (including alternate directorships) in more than 10 public companies (including any private company which is either a holding company or a subsidiary company of a public company).

2. Disqualification by reason of a default made by a company [Section 164(2)]

A person who is or has been a director of a company shall be disqualified from being reappointed as a director of that company or appointed in any other company for a period of 5 years, if the company of which he is or has been a director –

(a) has not filed financial statements or annual returns for any continuous period of 3 financial years; or

(b) has failed to ⇨
- repay the deposits accepted by it or pay interest thereon; or
- redeem any debentures on the due date or pay interest due thereon; or
- pay the declared dividend,

⇨ and such failure continues for 1 year or more.

1. If after the disqualification under section 164(2) is attracted, the default is made good by the company, the directors who got disqualified by reason of section 164(2) shall continue to be disqualified.
2. Where a person is appointed as a director of a company which has committed any of the defaults specified in section 164(2), he shall not incur the disqualification for a period of 6 months from the date of his appointment.
3. Provisions contained in Rule 14 of the Companies (Appointment and Qualification of Directors) Rules, 2014 are as follows:
   (a) Every person who is proposed to be appointed or reappointed as a director shall inform the company about his disqualification under section 164(2). Such intimation shall be filed by him with the company in Form DIR-8 before he is appointed or reappointed as a director.

(b) Whenever a company commits any of the defaults specified under section 164(2), the company shall immediately (but not later than 30 days from the date of default) file with the Registrar Form DIR-9 furnishing therein the names and addresses of all the directors of the company during the relevant financial years.

(c) Upon receipt of Form DIR-9, the Registrar shall immediately register such Form and place it in the document file for public inspection.

(d) Any application for removal of disqualification of directors shall be made in Form DIR-10.

4. The report of the auditor shall state as to whether any director is disqualified from being appointed as a director under sub-section (2) of section 164 [Section 143(3)(g)].

5. The provisions of section 164(2) shall not apply to a Government Company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

3. Freedom to prescribe additional grounds of disqualification [Section 164(3)]

Articles of a private company may provide additional grounds of disqualification of a director. *For example*, the articles of private company may provide that a person shall not be capable of being appointed as a director unless he is a Chartered Accountant. But, a public company is prohibited from providing any additional disqualifications.

No educational qualification or minimum experience is required in order to become a director of a company, whether public or private. Thus, even an illiterate person may be appointed as a director. Similarly, the Companies Act, 2013 does not prescribe any requirement as to age for becoming a director. Likewise, a person who does not hold any shares in the company is not disqualified for directorship. Thus, no person shall be disqualified for directorship on the ground that he does not hold any shares in the company at the time of his appointment as a director.

However, a private company may provide any additional ground of disqualification in its articles (say, with respect to age or educational qualifications or holding any shares in the company at the time of his appointment as a director or otherwise).

1.8 Vacation of office by directors (Section 167)

The provisions relating to vacation of office of a director are contained in section 167 of the Companies Act, 2013. These provisions are explained as follows:

1. Grounds of vacation of office of a director [Section 167(1)]

The office of a director shall become vacant in the following cases:

(a) Where he incurs any of the disqualifications specified in section 164.

In case a company makes a default specified in section 164(2), all the directors of such defaulting company shall be disqualified for appointment or reappointment as director for a period of 5 years [Section 164(2)]. As per section 167, if a director who becomes disqualified under section 164(2), is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant.

(b) Where he absents himself from all the Board meetings held during a period of 12 months.

Where a director participates in a Board meeting by video conferencing or other audio visual means, it amounts to 'attending the Board meeting', and not 'absence from Board meeting'.

The office of the director shall be vacated even if leave of absence is granted to him by the Board.

(c) Where he acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested.

(d) Where he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of section 184.

(e) Where he becomes disqualified by an order of a Court or the Tribunal.

(f) Where 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.

The expression 'or otherwise' means any offence in respect of which a person has been convicted by a Court under the Companies Act, 2013 or under the Companies Act, 1956 [As per Rule 2(1)(k) of the Companies (Appointment and Qualification of Directors) Rules, 2014].

(g) Where he is removed in pursuance of the provisions of this Act.

Any director (whether rotational or non-rotational, whether a managing director or whole time director or ordinary director, whether an additional director or director filling a casual vacancy or alternate director, or a nominee director, or small shareholders' director or independent director, or any other director) may be removed by passing an ordinary resolution and complying with other conditions contained in section 169.

(h) Where 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.

Vacation of office is automatic

(a) A director *ipso facto* ceases to be a director on happening of any of the events specified under section 167.

(b) No opportunity of being heard is required to be given to the director.

(c) The Board is not required to pass a resolution to the effect that the office of a director has been vacated.

(d) The Board has no power to waive any ground of vacation of office.

2. Postponement of certain grounds of vacation of office

The grounds of vacation of office referred to in clauses (e) and (f) of section 167(1) shall not take effect –

(a) for the first 30 days;

(b) where any appeal is preferred within 30 days, until the expiry of 7 days from the date on which such appeal is disposed of;

(c) where any further appeal is preferred within 7 days, until such further appeal is disposed of.

3. Punishment for contravention [Section 167(2)]

If a person functions as a director even when he knows that the office of director held by him has become vacant, he shall be punishable with imprisonment upto 1 year or with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh, or with both.

4. Consequences of vacation of office of all the directors [Section 167(3)]

Where all the directors of a company vacate their offices under any of the grounds specified under section 167, the promoter or, in his absence, the Central Government shall appoint the required number of directors.

All such directors shall hold office till the directors are appointed by the company in the general meeting.

5. Freedom to prescribe additional grounds of vacation of office [Section 167(4)]

The articles of a private company may provide additional grounds of vacation of office of a director. But, a public company cannot provide any additional grounds of vacation of office in its articles.

No requirement of holding qualification shares

Neither section 167 nor any other section requires holding of any shares by a director in order to continue as a director. Thus, no director of a company shall have to vacate his office on the ground that he did not acquire the shares in the company within such time as may be specified by the company in the articles. *In other words*, there is no concept or requirement of holding any qualification shares by the directors.

However, a private company may provide any additional ground of vacation of office in its articles. Thus, a private company may provide in its articles that if a person fails to obtain certain shares as specified in the articles within such time as may be specified in the articles, then, the office of director shall become vacant.

Practical Problems from CA Examinations

Failure to repay matured deposits – Implications

P 1.8A. Mr. A is a director of ABC Limited which failed to repay matured deposits from 1st April, 2018 onwards and the default continues. But ABC Limited is regular in filing annual accounts and annual returns. Mr. A is also a director of PQR Limited and XYZ Limited.

Answer the following questions with reference to the relevant provisions of the Companies Act, 2013:

(i) Whether Mr. A is disqualified and if so, whether he is required to vacate his office of director in PQR Limited and XYZ Limited.

(ii) Is it possible for Board of directors of DEF Limited to appoint Mr. A as an additional director at the Board meeting to be held on 15th May, 2019? Would your answer be different if Mr. A ceased to be a director of ABC Limited by resignation on 1st March, 2019?

State also the auditor's liability with regard to reporting of disqualification under section 164(2). [CA (Final) May 2002 (Modified)]

Ans. As per section 164(2), a director of a company shall be disqualified from being reappointed as a director in that company or appointed as a director in any other company, if the company of which he is already a director fails to repay its deposits or interest thereon on the due date and such failure continues for 1 year or more. Such disqualification shall remain in force for a period of 5 years.

As per section 167, if a director who becomes disqualified under section 164(2) is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant.

In the given case ABC Limited has failed to repay its deposits on the due date (*i.e.* 1.4.2018) and such default has continued for more than 1 year (*i.e.* beyond 31.3.2019). Therefore –

- Mr. A is disqualified for appointment or reappointment as a director for a period of 5 years. Accordingly, DEF Limited cannot appoint Mr. A as an additional director on 15.5.2019.
- Mr. A cannot continue as a director in PQR Limited and XYZ Limited after 31.3.2019. However, he is entitled to continue as a director in ABC Limited.
- Disqualification contained in section 164(2) can apply to a person only if such person was a director as on the date when such disqualification was first attracted. Therefore, if Mr. A had ceased to be a director of ABC Limited by resignation on 1st March, 2019, he would have escaped the disqualification specified under section 164(2), and accordingly DEF Limited could appoint Mr. A as an additional director on 15.5.2019 and the office of director of Mr. A in PQR Limited and XYZ Limited would not have become vacant.
- As per section 143(3)(g), the auditor of the company shall state in his report as to whether any of the directors of the company are disqualified from being appointed as a director under section 164(2).

Note: Section 164 and section 167 have been amended by the Companies (Amendment) Act, 2017. The answer to the practical problem given above is as per the amended provisions. However, the answers given in the Suggested Answers issued by ICAI are not updated by ICAI to give effect to any amendment made in the Act or the Rules. So, students may find that some of the answers given in this Book do not match with the answers given in the Suggested Answers issued by ICAI.

Failure to file annual returns, pay interest on loans and repay matured deposits – Implications

P 1.8B. Mr. Kishore is a director of AB Limited and PQ Limited. AB Limited was regular in filing the annual returns but did not file annual accounts for the years ended 31st March, 2016, 2017 and 2018. AB Limited did not pay interest on loans taken from a public financial institution from 1st April, 2017 and also failed to repay matured deposits taken from public on due dates from 1st April, 2017 and the default continues.

Answer the following in the light of relevant provisions of the Companies Act, 2013:

(i) Whether Mr. Kishore is disqualified under section 164 of the Companies Act, 2013?

(ii) Whether Mr. Kishore can continue as a director in AB Limited and PQ Limited?

(iii) Whether Mr. Kishore can seek reappointment when he retires by rotation at the Annual General Meeting of AB Limited to be held in September, 2018?

(iv) Mr. Kishore is proposed to be appointed as additional director of XY Limited in June, 2018. Is he eligible to be appointed as additional director in XY Limited? **[CA (Final) May 2013 (Modified)]**

Ans. As per section 164(2), a person who has been a director of a company shall be disqualified from being appointed or reappointed as a director in any company for a period of 5 years, if the company of which he has been a director –

(a) has not filed the financial statements or annual returns for any continuous 3 financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon on due date or redeem its debentures on due date or pay interest due thereon or pay the declared dividend, and such failure continues for 1 year or more.

As per section 167, if a director who becomes disqualified under section 164(2) is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant.

In the present case, ABC Limited has committed the following defaults:

(a) Failure to file the financial statements for continuous 3 financial years, *i.e.* 2015-16, 2016-17 and 2017-18.

Because of such failure, all the persons who have been the directors of AB Limited shall be disqualified for 5 years.

(b) Failure to pay interest on loans taken from a Public financial institution from 1st April, 2017 onwards.

However, such failure does not attract the disqualification under section 164(2), since the disqualification is incurred only if the default relates to payment of 'deposits', and not because of non-payment of loans taken from any public financial institution or interest thereon.

(c) Failure to repay the matured deposits on due date from 1st April, 2017 till 31st March, 2018.

The default in payment of matured deposits has continued for a period of 1 year. Accordingly, all the directors of AB Limited shall be disqualified under section 164(2) with effect from 1st April, 2018.

The answer to the given problem is given as follows:

(i) Mr. Kishore is disqualified under section 164(2) w.e.f. 1st April, 2018 for a period of 5 years.

(ii) Mr. Kishore can continue as a director in AB Limited, but his office of director in PQ Limited shall become vacant.

(iii) Since Mr. Kishore is disqualified under section 164(2), he cannot be reappointed as a director in AB Limited or appointed as a director in any other company for a period of 5 years, *i.e.* from 1st April, 2018 to 31st March, 2023. Accordingly, Mr. Kishore cannot be reappointed as a director when he retires by rotation at the Annual General Meeting of AB Limited to be held in September, 2018.

(iv) With effect from 1st April, 2018, Mr. Kishore is disqualified under section 164(2) for a period of 5 years. So, he is not eligible to be appointed as an additional director of XY Limited in June, 2018.

Note: Section 164 and section 167 have been amended by the Companies (Amendment) Act, 2017. The answer to the practical problem given above is as per the amended provisions. However, the answers given in the Suggested Answers issued by ICAI are not updated by ICAI to give effect to any amendment made in the Act or the Rules. So, students may find that some of the answers given in this Book do not match with the answers given in the Suggested Answers issued by ICAI.

Failure to file annual returns, pay interest on loans and repay matured deposits – Implications

P 1.8C. Mr. Dhruv is a director of M/s LT Limited and XT Limited respectively. M/s LT Limited did not file its financial statements for the year ended 31st March 2016, 2017 & 2018 respectively with the Registrar of Companies (ROC) as mandated under the Companies Act, 2013. M/s LT Limited also did not pay interest on loans taken from a public financial institution from 1st April, 2017 and also failed to repay matured deposits taken from public on due dates from 1st April, 2017 onwards.

Answer the legality of the following in the light of the relevant provision of the Companies Act, 2013:

(i) Whether Mr. Dhruv is disqualified under Companies Act, 2013 and if so, whether he can continue as a director in M/s LT Limited? Further can he also seek reappointment when he retires by rotation at the AGM of M/s XT limited scheduled to be held in September 2019?

(ii) Mr. Dhruv is proposed to be appointed as an additional director of M/s MN Limited in June 2019. Is he eligible to be appointed as an additional director in M/s MN Limited? Decide. [CA (Final) May 2019]

Ans. As per section 164(2), a person who has been a director of a company shall be disqualified from being appointed or reappointed as a director in any company for a period of 5 years, if the company of which he has been a director –

(a) has not filed the financial statements or annual returns for any continuous 3 financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon on due date or redeem its debentures on due date or pay interest due thereon or pay the declared dividend, and such failure continues for 1 year or more.

As per section 167, if a director who becomes disqualified under section 164(2) is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant.

In the present case, M/s LT Limited has committed the following defaults:

(a) Failure to file the financial statements for continuous 3 financial years, *i.e.* 2015-16, 2016-17 and 2017-18.

Because of such failure, all the persons who have been the directors of M/s LT Limited shall be disqualified under section 164(2) for a period of 5 years.

(b) Failure to pay interest on loans taken from a public financial institution from 1st April, 2017 onwards.

However, such failure does not attract the disqualification under section 164(2), since the disqualification is incurred only if the default relates to payment of 'deposits', and not because of non-payment of loans taken from any public financial institution or interest thereon.

(c) Failure to repay the matured deposits on due date from 1st April, 2017.

If the default in payment of matured deposits has continued for a period of 1 year, all the directors of M/s LT Limited shall be disqualified under section 164(2) with effect from 1st April, 2018.

The answer to the given problem is given as follows:

(i) Mr. Dhruv is disqualified under section 164(2) w.e.f. 1st April, 2018 for a period of 5 years, assuming that the default in payment of matured deposits has continued upto 31st March, 2018.

Mr. Dhruv can continue as a director in M/s LT Limited, but his office of director in M/s XT Limited shall become vacant on 1st April, 2018.

Since the office of director of Mr. Dhruv in M/s XT Limited has become vacant on 1st April, 2018, and he is disqualified for appointment as a director in any company for a period of 5 years with effect from 1st April, 2018, it is not possible that Mr. Dhruv holds the position of director in M/s XT Limited in September, 2019. Accordingly, there is no question of retirement or reappointment of Mr. Dhruv in the AGM of M/s XT Limited in September, 2019.

(ii) Since Mr. Dhruv is disqualified under section 164(2), he cannot be appointed as a director in any company for a period of 5 years, *i.e.* from 1st April, 2018 to 31st March, 2023. So, he is not eligible to be appointed as an additional director of M/s MN Limited in June, 2019.

Failure to repay matured deposits – Implications

P 1.8D. Mr. John is a director of MNC Ltd., which accepted deposits from public. The financial position of MNC Ltd. turned very bad and it failed to repay the deposits which fell due for payment on 10th April 2017 and such repayment has not been made till 5th May 2018. Another company JKL Ltd. wants to appoint the said Mr. John as its director at its annual general meeting to be held on 6th May, 2018. You are required to state with reference to the provisions of the Companies Act, 2013 whether Mr. John can be appointed as a director of JKL Ltd. [CA (Final) May 2008 (Modified)]

Ans. As per section 164(2), a person who has been a director of a company shall be disqualified from being appointed or reappointed as a director in any company for a period of 5 years, if the company of which he has been a director –

(a) has not filed the financial statements or annual returns for any continuous 3 financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon on due date or redeem its debentures on due date or pay interest due thereon or pay the declared dividend, and such failure continues for 1 year or more.

In the given case MNC Ltd. has failed to repay its deposits on the due date (*i.e.* 10.4.2017) and such default has continued for 1 year (*i.e.* from 11.04.2017 to 10.4.2018). Therefore, –

- Mr. John, the director of MNC Ltd., is disqualified for appointment or reappointment as a director in any company for a period of 5 years. The period of disqualification shall be from 11.4.2018 to 10.04.2023. Accordingly, JKL Ltd. cannot appoint Mr. John as a director on 06.05.2018.
- As per section 167, if a director who becomes disqualified under section 164(2) is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant. Accordingly, Mr. John can continue as a director in MNC Ltd., but if he is a director in any other company also, his office of director in all such other companies shall become vacant.

Note: Section 164 and section 167 have been amended by the Companies (Amendment) Act, 2017. The answer to the practical problem given above is as per the amended provisions. However, the answers given in the Suggested Answers issued by ICAI are not updated by ICAI to give effect to any amendment made in the Act or the Rules. So, students may find that some of the answers given in this Book do not match with the answers given in the Suggested Answers issued by ICAI.

Whether disqualification u/s 164(2) is attracted for failure to file financial statement and failure to pay interest on loans taken from a financial institution?

P 1.8E. Mr. Ramanathan is a director of Fraudulent Ltd., Honest Ltd. and Regular Ltd. For the financial year ended on 31st March, 2014 two irregularities were discovered against Fraudulent Ltd. Fraudulent Ltd. did not file its financial statement for the year ended 31.3.2014 and failed to pay interest on loans taken from a financial institution for the last three years.

On 1st June, 2015 Mr. Ramanathan is proposed to be appointed as additional director of Goodwill Ltd., which company has sought a declaration from Mr. Ramanathan and he also submitted the declaration stating that the disqualification specified in Section 164 of the Companies Act, 2013 is not attracted in his case. Decide under the provisions of the Companies Act, 2013:

(i) Whether the declaration submitted by Mr. Ramanathan to Goodwill Ltd. is in order?

(ii) Whether Mr. Ramanathan can continue as a director in Honest Ltd. and Regular Ltd.? [CA (Final) June 2009 (Modified)]

Ans. As per section 164(2), a person who has been a director of a company shall be disqualified from being appointed or reappointed as a director in any company for a period of 5 years, if the company of which he has been a director –

(a) has not filed the financial statements or annual returns for any continuous 3 financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon on due date or redeem its debentures on due date or pay interest due thereon or pay the declared dividend, and such failure continues for 1 year or more.

In the present case, Fraudulent Limited has committed the following defaults:

(a) Failure to file annual accounts for the year ended 31st March, 2014.

As per section 164(2), disqualification applies only if the default is in filing of *financial statements or annual returns* for 3 continuous financial years.

However, in the present case, the failure to file the financial statement has not been for 3 continuous financial years as contemplated under section 164(2). Therefore, in the given case, failure to file the financial statement does not result in disqualification under section 164(2).

(b) Failure to pay interest on loans taken from a financial institution for last 3 years

Such failure does not result in disqualification under section 164(2), since the disqualification is incurred only if the default relates to payment of 'deposits' or 'interest on deposits', and not because of non-payment of 'loans' obtained from any financial institution.

Accordingly, -

(i) the declaration submitted by Mr. Ramnathan to Goodwill Ltd. is in order and valid.

(ii) Mr. Ramnathan can continue as a director in all the companies in which he is a director including Fraudulent Ltd., Honest Ltd. and Regular Ltd.

Failure to pay interest on loans obtained from a financial institution and repay matured deposits – Implications

P 1.8F. Mr. Ravindranathan is holding the post of director in three companies out of which Goodluck Colours Limited is one. For the financial year ended on 31st March, 2014, Goodluck Colours Limited failed to pay interest on loans taken from a financial institution and also failed to repay the matured deposits. On 1st June, 2014, Mr. Ravindranathan accepting the post of additional director in Soma Footwear Limited, submitted a declaration that the disqualification specified in section 164 of the Companies Act, 2013 is not applicable in his case. Decide whether the declaration submitted by Mr. Ravindranathan to Soma Footwear Limited is in order. [CA (Final) May 2010 (Modified)]

Ans. As per section 164(2), a person who has been a director of a company shall be disqualified from being appointed or reappointed as a director in any company for a period of 5 years, if the company of which he has been a director –

(a) has not filed the financial statements or annual returns for any continuous 3 financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon on due date or redeem its debentures on due date or pay interest due thereon or pay the declared dividend, and such failure continues for 1 year or more.

In the present case, Goodluck Colours Limited has committed the following defaults:

(a) Failure to pay interest on loans taken from a financial institution for the financial year ended on 31st March, 2014.

However, such failure does not attract the disqualification under section 164(2), since the disqualification is incurred only if the default relates to payment of 'deposits', and not because of non-payment of interest on 'loans' obtained from a financial institution.

(b) Failure to repay the matured deposits on due date for the financial year ended on 31st March, 2014.

Default in payment of matured deposits or interest thereon would result in applicability of section 164(2) only if such default continues for 1 year or more. However, the question is silent with respect to the date when such default occurred for the first time.

As on 1st June, 2014, if 1 year has not elapsed from the date the default had first occurred, the disqualification under section 164(2) shall not be attracted to Mr. Ravindranathan, and so he may be appointed as an additional director of Soma Footwear Limited, and therefore, the declaration given by Mr. Ravindranathan is in order.

However, if as on 1st June, 2014, 1 year has elapsed from the date the default had first occurred, Mr. Ravindranathan shall be disqualified under section 164(2), and so he cannot be appointed as an additional director of Soma Footwear Limited, and therefore, the declaration given by Mr. Ravindranathan is not in order.

Difference in answer as compared to the answer given by ICAI

The Author's answer as given above differs from the answer given in the Practice Manual issued by the Board of Studies, ICAI for May, 2015 Exams. The answer in the Practice Manual issued for May, 2015 Exams is as under:

"... As Goodluck Colours Limited has failed to repay its deposits on due date and the said failure continues for more than one year, Mr. Ravindranathan is disqualified under the said section.

The declaration submitted by him therefore, is not in order and he is not eligible to the appointment as Additional Director in Soma Footwear Limited."

In the Practice Manual issued for November, 2016 and onwards Exams, this question has been omitted.

In the opinion of the Author, there is nothing in the question by which it can be made out that the default in repayment of matured deposits has continued for 1 year or more or not, and so the question can be answered either by taking the assumption that the default has continued for 1 year or more or by taking the assumption that the default has not continued for 1 year or more. However, ICAI had answered this question as if it was a fact (rather than an assumption) that the default has continued for 1 year or more.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Failure to file annual accounts and annual returns for 3 financial years – Implications

P 1.8G. Mr. Vikram, a director of M/s Tubelight Limited has made default in filing of annual accounts and annual returns with Registrar of Companies for continuous period of 3 financial years ending on 31st March 2018. Examine the validity of the following under the Companies Act, 2013:

(i) Whether Mr. Vikram can continue to be a director of M/s Tubelight Limited (defaulting company) and also M/s Green Light Limited, where he is also a director? Also state whether he can be re-appointed as director in M/s Tubelight Limited.

(ii) What would be your answer in case Mr. Vikram is a nominee director of a Public Financial Institution?

(iii) What would be your answer in case the defaulting company (*i.e.* M/s. Tubelight Limited) is a private limited company?

[CA (Final) Nov. 2017 (Modified)]

Ans. As per section 164(2), a person who has been a director of a company shall be disqualified from being appointed or reappointed as a director in any company for a period of 5 years, if the company of which he has been a director –

(a) has not filed the financial statements or annual returns for any continuous 3 financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon on due date or redeem its debentures on due date or pay interest due thereon or pay the declared dividend, and such failure continues for 1 year or more.

In the present case, M/s Tubelight Limited has committed the default as specified under section 164(2)(a). Accordingly, all the directors of M/s Tubelight Limited shall be disqualified under section 164(2).

As per section 167, if a director who becomes disqualified under section 164(2) is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant.

The answer to the given problem is given as follows:

(i) Mr. Vikram can continue as a director of M/s Tubelight Limited since as per section 167, his office of director in the defaulting company (*i.e.* M/s Tublelight Limited) shall not be vacated.

However, Mr. Vikram cannot continue as a director in M/s Green Light Limited since as per section 167, the office of director of Mr. Vikram in all companies, other than the defaulting company, shall become vacant.

As per section 164(2), Mr. Vikram shall be disqualified for reappointment in the defaulting company for a period of 5 years from the date of incurring disqualification. Accordingly, Mr. Vikram cannot be reappointed as a director in M/s Tubelight Limited for a period of 5 years.

(ii) The answers would remain same even if Mr. Vikram were a nominee director of a Public Financial Institution, since the provisions contained in sections 164(2) and 167 apply to nominee directors of Public Financial Institutions also, and no exemption has been provided to them under the Companies Act, 2013 or the Rules prescribed thereunder.

Under the Companies Act, 1956, the disqualification by reason of non-filing of annual accounts and annual returns (as contained in section 274(1)(g) of the Companies Act, 1956) did not apply to the nominee directors of Public Financial Institutions as per Circular No. 11/2001, dated 25.5.2001. However, this Circular does not have any application under the Companies Act, 2013.

Difference in answer as compared to the answer given by ICAI

The Author's answer as given above differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. The answer in the Suggested Answers is as under:

"In case Mr. Vikram is a nominee director of a Public Financial Institution, then in such case section 164 is not applicable."

The Author does not agree with the answer given in the Suggested Answers since the MCA Clarification on which this answer is based, has no application under the Companies Act, 2013.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

(iii) The provisions contained in sections 164(2) and 167 equally apply to the private companies. Accordingly, the answers would remain same even if the defaulting company, i.e. M/s Tubelight Limited were a private company.

Failure to file financial statements for 1 year, pay interest on loans to PFI and repay matured deposits – Implications

P 1.8H. Mr. Ram is a Director of ABC Limited, XYZ Limited and PQR Limited. ABC Limited was regular in filing annual returns, but did not file financial statements for the year ended 31st March, 2017. Further ABC Limited failed to pay interest on loans taken from a public financial institution from 1st January, 2017 onwards and also failed to repay the matured deposits on due date from 1st April, 2017 onwards.

Mr. Ram is proposed to be appointed as additional director of MN Limited on 1st June, 2018. MN Limited has sought a declaration from Mr. Ram to the effect that the disqualification specified in section 164(2) of the Companies Act, 2013 is not applicable in his case. Mr. Ram seeks your advice on the following:

(i) Whether it is in order for him to give the declaration sought by MN Limited in view of the defaults committed by ABC Limited.

(ii) Whether he can continue as a director in ABC Limited, XYZ Limited and PQR Limited.

(iii) Whether he can seek reappointment when he retires by rotation at the annual general meeting of ABC Limited to be held in September, 2018.

(iv) What would be your answer, if Mr. Ram had resigned from his office of director in ABC Limited on 31st December, 2017?

Advise explaining the relevant provisions of the Companies Act, 2013. [CA (Final) May 2003 (Modified)]

Ans. As per section 164(2), a person who has been a director of a company shall be disqualified from being appointed or reappointed as a director in any company for a period of 5 years, if the company of which he has been a director –

(a) has not filed the financial statements or annual returns for any continuous 3 financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon on due date or redeem its debentures on due date or pay interest due thereon or pay the declared dividend, and such failure continues for 1 year or more.

As per section 167, if a director who becomes disqualified under section 164(2) is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant.

In the present case, ABC Limited has committed the following defaults:

(a) Failure to file the financial statements for the financial year 2016-17.

Because of such failure, Mr. Ram and no other director of ABC Limited shall be disqualified since such failure has not occurred for 3 continuous financial years.

(b) Failure to pay interest on loans taken from a Public financial institution from 1st January, 2017 onwards.

However, such failure does not attract the disqualification under section 164(2), since the disqualification is incurred only if the default relates to payment of 'deposits', and not because of non-payment of loans taken from any public financial institution or interest thereon.

(c) Failure to repay the matured deposits on due date from 1st April, 2017 and such default is continuing till 1st June, 2018.

The default in payment of matured deposits has continued for a period of 1 year. Accordingly, all the directors of ABC Limited shall be disqualified under section 164(2) with effect from 1st April, 2018.

The answer to the given problem is given as follows:

(i) Mr. Ram is disqualified under section 164(2) w.e.f. 1st April, 2018 for a period of 5 years, and so he cannot be appointed as an additional director of MN Limited on 1st June, 2018. Accordingly, it is not in order for Mr. Ram to give a declaration to MN Limited that he is not disqualified under section 164(2).

(ii) Mr. Ram can continue as a director of ABC Limited since as per section 167, his office of director in the defaulting company (i.e. M/s ABC Limited) shall not be vacated.

However, Mr. Ram cannot continue as a director in XYZ Limited and PQR Limited since as per section 167, the office of director of Mr. Ram in all companies, other than the defaulting company, shall become vacant.

(iii) Since Mr. Ram is disqualified under section 164(2), he cannot be reappointed as a director in the defaulting company for a period of 5 years. Accordingly, Mr. Ram shall be disqualified for reappointment as a director when he retires by rotation at the Annual General Meeting of ABC Limited to be held in September, 2018.

(iv) Had Mr. Ram resigned from the position of director on 31st December, 2017, the disqualification under section 164(2) would not have become attracted to him. Accordingly, the answers would have been as follows:

(a) He would not have become disqualified for appointment as additional director in MN Limited on 1st June, 2018.

(b) His office of director in ABC Limited, XYZ Limited and PQR Limited would not have become vacant.

(c) He would not have become disqualified for reappointment as a director at the Annual General Meetings of ABC Limited to be held in September, 2018.

Note: Section 164 and section 167 have been amended by the Companies (Amendment) Act, 2017. The answer to the practical problem given above is as per the amended provisions. However, the answers given in the Suggested Answers issued by ICAI are not updated by ICAI to give effect to any amendment made in the Act or the Rules. So, students may find that some of the answers given in this Book do not match with the answers given in the Suggested Answers issued by ICAI.

Whether a director is required to hold the qualification shares as specified in the articles

P 1.81. In the general meeting of X Ltd., held on 2.5.2018, Mr. A was appointed as a director. On that day, he was not holding any equity shares in X Ltd. As per the articles of association of X Ltd., the share qualification is the holding of 500 equity shares. On 15.6.2018 Mr. A applied for 1,000 equity shares in X Ltd. and the shares were allotted on 10.7.2018. Discuss as to whether Mr. A's office of director shall be vacated. [CA (Final) Nov. 2000 (Modified)]

OR

Mr. Busybody has been appointed as a director of ACE Automobiles Ltd. on 2nd April, 2017. The articles of association of the company provides that the qualification of a director shall be holding of at least 10 shares in the company. Mr. Busybody applied for 10 equity shares of the company on 31st May, 2017. But the shares were allotted only at the Board meeting held on 19th August, 2017. Examine with reference to the relevant provisions of the Companies Act, 2013 whether Mr. Busybody's office of director shall become vacant. [CA (Final) May 2003 (Modified)]

OR

The Articles of Association of Sunrise Ltd. provide that the qualification of a director shall be holding of at least 10 shares in the company. Mr. Rao has been appointed as a director in the said meeting on 1st May, 2016. Mr. Rao applied for 10 equity shares of the company on 30th July, 2016. The said shares were allotted to him on 20th August, 2016 when the Board meeting was held.

Whether office of director of Mr. Rao shall become vacant? [CA (Final) Nov. 2008 (Modified)]

Ans. The grounds of disqualification of a director are contained in section 164 and the grounds of vacation of office of a director are contained in section 167. None of these sections requires holding of any shares in order to become a director, or to continue as a director. Thus, no person shall be disqualified for directorship on the ground that he does not hold any shares in the company. Similarly, no director of a company shall have to vacate his office of director on the ground that he did not acquire certain shares in the company.

Even where the articles of a company require holding of certain shares within such time as may be specified in the articles, such a provision has no legal effect, since it is contrary to the provisions contained in sections 164 and 167.

Thus, there is no concept or requirement of holding any qualification shares by the directors.

Accordingly, the office of director of Mr. A / Mr. Busybody / Mr. Rao shall not become vacant.

Consequences of non-payment of a call on shares-

P 1.8J. M/s. Iqbal Sons Ltd. issued shares of the nominal value of Rs. 10 per share, out of which Rs. 5 was payable on application and balance Rs. 5 was payable on call. The call money was invited by the Board of directors but some shareholders, including a non-executive director, failed to pay the same within the prescribed period. Explain the status of director who defaulted in paying call money. [CA (Final) May 2005]

Ans. As per section 167, the office of director shall be vacated if the director fails to pay a call on the shares of the company within 6 months from the last day fixed for the payment of the call. Similarly, a person shall be disqualified from becoming a director if he fails to pay a call on the shares of the company within 6 months from the last day fixed for the payment of the call (Section 164).

In the given case, a non-executive director has failed to pay a call on the shares of the company. If the non-payment of call continues for 6 months from the due date of payment of call, the office of director held by him shall become vacant. The vacation of office shall be automatic, *i.e.* the non-executive director shall forthwith (*i.e.* immediately on expiry of 6 months from due date of payment of call) vacate the office of director held by him. Also, in such a case, he shall be disqualified from being appointed as a director in M/s Iqbal Sons Ltd.

Disqualifications of directors – A few cases

P 1.8K. State with reference to the relevant provisions of the Companies Act, 2013 whether the following persons can be appointed as directors of a public company:

(i) Mr. A, who has huge personal liabilities far in excess of his assets and properties, has applied to the court for adjudicating him as an insolvent and such application is pending.

(ii) Mr. B, who was caught red-handed in a shop lifting case two years ago, was convicted by a Court and sentenced to imprisonment for a period of eight weeks.

(iii) Mr. C, a former bank executive, was convicted by a Court eight years ago for embezzlement of funds and sentenced to imprisonment for a period of one year.

(iv) Mr. D is a director of DLT Limited, which has not filed its annual returns for 3 continuous financial years. [CA (Final) May 2004]

Ans. The given problem relates to section 164 of the Companies Act, 2013. Section 164 contains various grounds of disqualification for appointment as a director.

The given problem is discussed as under:

(i) A person is disqualified if he himself applies to the Court for adjudicating him as an insolvent [Section 164(1)(c)]. Since, Mr. A has himself applied to the court for adjudicating him as an insolvent, he is disqualified for directorship even if his application is pending.

(ii) A person is disqualified only if he is convicted by a Court of any offence (whether involving moral turpitude or otherwise) and sentenced to imprisonment for 6 months or more [Section 164(1)(d)]. In the present case Mr. B was caught red-handed in a shop lifting case and was sentenced to imprisonment for a period of 8 weeks, i.e. less than 6 months. Since section 164(1)(d) is not attracted, Mr. B is not disqualified for directorship.

(iii) A person is disqualified if he is convicted by a Court of any offence (whether involving moral turpitude or otherwise) and sentenced to imprisonment for 6 months or more. However, such disqualification shall remain in force for a period of 5 years only [Section 164(1)(d)]. In the present case Mr. C was convicted 8 years ago. Therefore, as on date, the disqualification of Mr. C has come to an end, and so, he is not disqualified for directorship.

(iv) Disqualification specified under section 164(2) applies if a company makes a default in filing financial statements or annual returns for 3 continuous financial years. Such disqualification shall remain in force for 5 years. In the present case, DLT Limited, in which Mr. D is a director, has not filed its annual returns for 3 continuous financial years. Since the conditions for attracting disqualification given under section 164(2) are satisfied, Mr. D is disqualified for directorship for a period of 5 years, i.e. he cannot be reappointed as a director in DLT Limited or appointed as a director in any other company.

As per section 167, if a director who becomes disqualified under section 164(2) is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant. Accordingly, Mr. D can continue as a director in DLT Limited, but if he is a director in any other company also, his office of director in all such other companies shall become vacant.

Comment: The articles of a private company may provide additional grounds of disqualification of a director. Therefore, in cases (ii) and (iii) above, the concerned person shall be disqualified for directorship if –

(a) the company is a private company; *and*

(b) it has included in its articles, additional grounds of disqualification of a director, and such additional ground covers the situation given in case (ii) and (iii) above.

Disqualifications of directors – A few cases

P 1.8L. State with reference to the provisions of the Companies Act, 2013, whether the following persons can be appointed as directors of a company.

(i) Mr. L, who has not paid calls in respect of shares of the company held by him and five months have passed from the last day fixed for the payment of calls.

(ii) Mr. G is Director of LDT Limited, which has not filed the annual return pertaining to the annual general meeting held for the financial years 2015-2016, 2016-2017 and 2017-2018. [CA (Final) Nov. 2016 (Modified)]

Ans. The given problem relates to section 164 of the Companies Act, 2013. Section 164 contains various grounds of disqualification for appointment as a director.

The given problem is discussed as under:

(i) As per section 164, a person shall be disqualified for appointment as a director if he has not paid any calls due on the shares held by him, and a period of 6 months have elapsed from the last day fixed for the payment of such call.

In the given case, the default in the payment of calls is for a period of 5 months. Since, the period of default is less than 6 month, the disqualification specified under section 164 is not attracted to Mr. L. Accordingly, Mr. L is not disqualified for appointment as a director.

(ii) Disqualification specified under section 164(2) applies if a company makes a default in filing financial statements or annual returns for 3 continuous financial years. Such disqualification shall remain in force for 5 years.

In the present case, LDT Limited, in which Mr. G is a director, has not filed its annual returns for three continuous financial years. Since the conditions for attracting disqualification given under section 164(2) are satisfied, Mr. G is disqualified for directorship for a period of 5 years, i.e. he cannot be appointed or reappointed as a director for a period of 5 years in LDT Limited or in any other company.

As per section 167, if a director who becomes disqualified under section 164(2) is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant. Accordingly, Mr. G can continue as a director in LDT Limited, but if he is a director in any other company also, his office of director in all such other companies shall become vacant.

Note: Section 164 and section 167 have been amended by the Companies (Amendment) Act, 2017. The answer to the practical problem given above is as per the amended provisions. However, the answers given in the Suggested Answers issued by ICAI are not updated by ICAI to give effect to any amendment made in the Act or the Rules. So, students may find that some of the answers given in this Book do not match with the answers given in the Suggested Answers issued by ICAI.

1.9 Number of directors [Section 149(1) and (2)]

Section 149 of the Companies Act, 2013 provides for the constitution of the Board of directors. The purpose of the section is to prevent the company from going into the hands of a single person. The provisions relating to minimum and maximum number of directors are explained as follows:

1. Minimum number of directors [Section 149(1)(a)]

- Every public company shall have a minimum of 3 directors.
- Every private company shall have a minimum of 2 directors.
- Every One Person Company shall have a minimum of 1 director.

A company may, by its articles, provide a higher number as the minimum strength of the Board of directors. However, if the articles provide a number lower than the statutory minimum number of directors, such a provision shall be void, and of no legal effect.

2. Maximum number of directors [Section 149(1)(b)]

- A company shall have a maximum of 15 directors.
- However, a company may appoint more than 15 directors by passing a special resolution. No approval of the Central Government is required for this purpose.

1. A company may, by its articles, provide that the maximum number of directors shall be less than 15.
2. Any increase in number of directors beyond the number specified in the articles, shall require alteration of articles by a special resolution by complying with the provisions contained in section 14.

3. Legal requirements for existing companies [Section 149(2)]

Every company existing on or before the date of commencement of this Act shall, within 1 year from such commencement, comply with the requirements relating to minimum and maximum number of directors.

4. Exemptions

(a) The provisions relating to maximum number of directors, and requirement of passing special resolution for increasing the number of directors beyond 15, do not apply to a Government company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

(b) The provisions relating to maximum number of directors, and requirement of passing special resolution for increasing the number of directors beyond 15, do not apply to a company licenced under section 8 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 584(E) dated 13th June, 2017].

Conclusion:

A Government company and a company licenced under section 8 may have more than 15 directors without passing a special resolution if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

Practical Problems from CA Examinations

Increase in number of directors beyond 15

P 1.9A. The number of directors appointed by each of the following companies is 9:

(i) ABS Company Ltd.

(ii) DSP Trading Private Ltd.

(iii) Traders Association (a company registered under section 8 of the Companies Act, 2013)

(iv) Hindustan Paper Ltd. (a Government company under Clause (45) of section 2 of the Companies Act, 2013)

The Board of directors of the company wants to increase the number of directors to 15. State with reference to the provisions of the Companies Act, 2013 whether the directors can do so. What would be your answer if the number of directors is proposed to be increased to 16 instead of 15? [CA (Final) Nov. 2003 (Modified)]

OR

The number of directors appointed by each of the following companies is 9:

(i) Goodheart Company Limited.

(ii) Frontline Trading Private Limited

(iii) Hindustan Zink Limited (a Government company under Clause (45) of Section 2 of the Companies Act, 2013).

The Board of Directors of the aforesaid companies propose to increase the number of Directors to 15. Advise, whether under the provisions of the Companies Act, 2013, the Board of Directors can do so? What would be your answer if the number of directors is proposed to be increased to 16 instead of 15? [CA (Final) June 2009 (Modified)]

Ans. As per section 149(1), a company shall have a maximum of 15 directors. However, a company may appoint more than 15 directors by passing a special resolution.

The provisions relating to maximum number of directors, and requirement of passing special resolution for increasing the number of directors beyond 15, do not apply to a Government company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92. Thus, a Government company may have more than 15 directors without passing a special resolution if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

The provisions relating to maximum number of directors, and requirement of passing special resolution for increasing the number of directors beyond 15, do not apply to a company licenced under section 8 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92. Thus, a company licenced under section 8 may have more than 15 directors without passing a special resolution if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 584(E) dated 13th June, 2017].

In the given case, if the number of directors is proposed to be increased to 15, all the above companies may appoint 6 directors, without requiring any approval of the members by way of a special resolution.

However, if the number of directors is to be increased to 16, –

(i) ABS Company Ltd. shall have to obtain the approval of members by passing a special resolution;

(ii) DSP Trading Pvt. Ltd. shall have to obtain the approval of members by passing a special resolution;

(iii) Traders Association (a company registered under section 8) does not require the approval of members by passing a special resolution;

(iv) Hindustan Paper Ltd. (a Government company under Clause (45) of section 2) does not require the approval of members by passing a special resolution.

In case, the maximum number of directors as per the articles of association of any of these companies is less than 16, such company shall have to alter its articles of association by passing a special resolution and complying with other legal requirements for alteration of articles as contained in section 14.

Legal requirements for increasing the number of directors to 16, where the articles provide for maximum of 10 directors

P 1.9B. The articles of association of Rajasthan Toys Private Limited provide that the maximum number of directors in the company shall be 10. Presently, the company is having 8 directors. The Board of directors of the said company desire to increase the number of directors to 16. Advise whether under the provisions of the Companies Act, 2013 the Board of directors can do so. **[CA (Final) May, 2010 (Modified); ICAI Study Material]**

OR

The articles of association of Surya Private Co. provided that the maximum number of directors in the company shall be 15. Presently, the company is having 12 directors. The Board of directors of the said company desired to increase the number of directors to 16. Advise whether under the provisions of the Companies Act, 2013 the Board of directors can do so.

[ICAI, RTP, Nov. 2015]

Ans. As per section 149(1), a company shall have a maximum of 15 directors. However, a company may appoint more than 15 directors by passing a special resolution.

Rajasthan Toys Private Limited can increase the number of directors to 16 by complying with the following 2 requirements:

1. Pass a special resolution approving the appointment of more than 15 directors, *i.e.* 16 directors in this case [Section 149(1)].
2. Pass a special resolution for alteration of articles of association of the company [Section 14]. The amended articles shall provide for the maximum number of directors as 16 or more than 16.

Thus, it is evident that the Board is not empowered to increase the number of directors to 16. The Board can get the same done by calling a general meeting of members and getting the two special resolutions passed in the general meeting, as explained above.

Legal requirements for increasing the number of directors to 18, where the articles provide for maximum of 10 directors

P 1.9C. KMR Limited, a listed public company, has 15 directors on its Board. The articles of association of the said company provide for the maximum number of directors in the company to be 15. Due to diversification and expansion of activities, the Board of directors of the said company desire to increase the number of directors to 18. Decide with reference to the applicable provisions of the Companies Act, 2013:

(i) Whether the Board of directors can do so?

(ii) Will your answer differ if the said company would have been a Government Company? **[CA (Final) May, 2019]**

Ans. The given problem relates to section 149(1) of the Companies Act, 2013.

(i) As per section 149(1), a company shall have a maximum of 15 directors. However, a company may appoint more than 15 directors by passing a special resolution.

KMR Limited can increase the number of directors to 18 by complying with the following 2 requirements:

(a) Pass a special resolution approving the appointment of more than 15 directors, *i.e.* 18 directors in this case [Section 149(1)].

(b) Pass a special resolution for alteration of articles of association of the company (Section 14). The amended articles shall provide for the maximum number of directors as 18 or more than 18.

Thus, it is evident that the Board is not empowered to increase the number of directors to 18. The Board can get the same done by calling a general meeting of members and getting the two special resolutions passed in the general meeting, as explained above.

(ii) A Government company may have more than 15 directors without passing a special resolution if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

Accordingly, if KMR Limited were a Government company, the increase in number of directors from 15 to 18 shall not require special resolution for appointing more than 15 directors. However, since the maximum number of directors as per the articles of association of KMR Limited is only 15, KMR Limited shall have to increase this limit to 18 by altering its articles by passing a special resolution and complying with other legal requirements for alteration of articles as contained in section 14.

1.10 Number of directorships (Section 165)

1. Maximum number of directorships [Section 165(1)]

(a) No person shall hold office as a director (including alternate directorships) in more than 20 companies, whether public or private.

(b) No person shall hold office as a director (including alternate directorships) in more than 10 public companies (including any private company which is either a holding company or a subsidiary company of a public company).

Directorships excluded for the purpose of section 165(1)

1. For reckoning the limit of directorships of 20 companies, directorship of a Dormant company shall be excluded [Explanation II to Sec. 165(1)]; and
2. For reckoning the limit of directorships of 20 companies or 10 companies, as the case may be, directorship of a company licenced under section 8 shall be excluded, if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015].

2. Directorships exceeding the maximum limit held before the commencement of this Act [Section 165(3)]

If the number of directorships held by a person immediately before the commencement of this Act exceeds the maximum number of directorships specified under section 165, then, he shall, within 1 year from such commencement, –

(a) choose the companies in which he wishes to continue to hold the office of director, such that the number of companies so chosen does not exceed the maximum number of directorships specified under section 165;

(b) resign his office as director in the other remaining companies; and

(c) intimate the choice made by him, to –

(i) each of the companies in which he was holding the office of director before the commencement of this Act; and

(ii) the Registrar having jurisdiction in respect of each such company.

3. Effect of resignation made under section 165(3) [Section 165(4) and (5)]

(i) Any resignation made in pursuance of section 165(3) shall become effective immediately on the despatch of the resignation to the company concerned.

(ii) No such person shall act as director in more than the specified number of companies, –

(a) after despatching his resignation; or

(b) after the expiry of 1 year from the commencement of this Act,

whichever is earlier.

4. Punishment for contravention [Section 165(6)]

If a person accepts an appointment as a director which results in exceeding the maximum number of directorships, he shall be liable to a penalty of Rs. 5,000 for each day after the first during which such contravention continues.

1. Restrictions on maximum number of directorships may be imposed by the members

The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as director.

2. Restrictions on being a Small Shareholders' Director

A person cannot be a Small Shareholders' Director in more than 2 companies at the same time [Rule 7(8) of the Companies (Appointment and Qualification of Directors) Rules, 2014.

Practical Problems from CA Examinations

Can an individual holding directorships in 10 public companies and 9 private companies accept directorship in a public company?

P 1.10A. Mr. Influential is already a director of 19 companies. Out of these 19 companies, 10 are public companies and 9 are private companies. Mr. Influential is being appointed as a director of another company named Expensive Remedies Ltd. Advise Mr. Influential in regard to the following:

(i) Restrictions on the number of directorships to be held by an individual and whether he can accept the new appointment in view thereof. What would be your answer if Mr. Influential was appointed as a director in ABC Pvt. Ltd. instead of Expensive Remedies Ltd.

(ii) What are the companies to be excluded for the purpose of calculating the ceiling on the appointment of directors?

[CA (Final) Nov. 2001 (Modified)]

Ans.

(i) The provisions relating to restrictions on number of directorships are contained in section 165, as explained hereunder:

1. A person shall not hold office as a director in more than 20 companies.
2. The number of public companies in which a person may be appointed as a director shall not exceed 10.
3. For the purpose of section 165, a private company which is either a subsidiary company or a holding company of a public company shall be considered to be a public company.

In the present case, the Mr. Influential is proposed to be appointed as a director in Expensive Remedies Ltd. which is a public company. If Mr. Influential accepts this directorship, the directorships held by him in public companies shall be 11, which will exceed the maximum permissible number (*i.e.* 10). Accordingly, Mr. Influential cannot accept the directorship in Expensive Remedies Limited.

However, if Mr. Influential was appointed as a director in ABC Pvt. Ltd. instead of Expensive Remedies Ltd., it would have been permissible for him to accept such directorship since accepting such directorship would not result in any contravention of section 165 as his directorships in public companies would have been 10 and his directorships in all companies, whether public or private, would have been 20.

(ii) Any directorship held by a person in a company licenced under section 8 shall be excluded while computing the ceiling of 20 companies and 10 public companies if such private company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92. Further, directorship held in a Dormant company shall be excluded while computing the ceiling of 20 companies.

Also, any directorship in a private company which is neither a holding company nor a subsidiary company of a public company, shall be excluded while computing the ceiling of 10 public companies.

Can an individual holding directorships in 10 public companies accept directorship in 2 public companies, one private company and one non-profit company?

P 1.10B. Mr. Raj is director in 10 public limited companies as on 30th July, 2014 and continues to be so till 24th September, 2014. The following companies appoint Mr. Raj as a director at their respective Annual General Meetings held on dates mentioned against their names:

(1) MLP Ltd. (AGM held on 27th September, 2014)

(2) PAT Private Ltd. (AGM held on 25th September, 2014)

(3) Retail Traders Association (a company registered under Section 8 of the Companies Act, 2013 (AGM held on 26th September, 2014)

(4) KMC Ltd. (AGM held on 29th September, 2014)

You are required to state with reference to the relevant provisions of the Companies Act, 2013 the options available to Mr. Raj in respect of accepting or not accepting the appointment of the above companies. [CA (Final) Nov. 2003, May 2008 (Modified)]

Ans. The provisions relating to restrictions on number of directorships are contained in section 165, as explained hereunder:

1. A person shall not hold office as a director in more than 20 companies.
2. The number of public companies in which a person may be appointed as a director shall not exceed 10.
3. For the purpose of section 165, a private company which is either a subsidiary company or a holding company of a public company shall be considered to be a public company.

In the present case, the two public companies *viz.* MLP Ltd. and KMC Ltd. have appointed Mr. Raj as director. If Mr. Raj accepts the directorship in one or both of these two public companies, the directorships held by him in public companies shall be 11 or 12, as the case may be, which will exceed the maximum permissible number (*i.e.* 10). Accordingly, Mr. Raj cannot accept the directorship in MLP Ltd. as well as KMC Ltd. Alternatively, Mr. Raj may resign from his existing directorships in 2 public companies and accept the directorships in MLP Ltd. as well as KMC Ltd., or he may resign from his existing directorship in 1 public company and accept the directorship in either MLP Ltd. or KMC Ltd.

PAT Private Ltd. is a private company, and it is neither a holding company nor a subsidiary company of any public company. If Mr. Raj accepts the directorship in PAT Private Ltd., the total number of directorships held by him shall be 11, which is within the maximum permissible limit of 20 companies. Therefore, Mr. Raj may accept the directorship in PAT Private Ltd. without any restriction.

Retail Traders Association is a non-profit company incorporated under section 8. The provisions of section 165(1) do not apply to a company licenced under section 8 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015]. Accordingly, Mr. Raj may accept the directorship in Retail Traders Association without any restriction, if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

Tutorial Note:

The first line of the question read as follows:

"Mr. Raj is director in 10 public limited companies as on 30th July, 2014 and continues to be so till 24th September, 2014."

Some students interpret this line to mean that Mr. Raj was a director in 10 public limited companies only till 24th September, 2014, and so as on 25th September, 2014, he is not a director in any company. Going by this interpretation, their answer would be different from the answer given by the Author.

If the first line of the question is reasonable interpreted, it doesn't mean that Mr. Raj ceased to be a director of all the 10 public limited companies as on 25th September, 2014. Therefore, while giving the answer to this question, the Author has assumed that Mr. Raj was a director of 10 public limited companies as on 25th September, 2014.

A person holding 16 directorships receives offers of directorships from 15 other companies – Which directorships can he accept?

P 1.10C. Mr. Fortune is holding directorship in the following types of companies:

(i) 4 Public companies

(ii) 10 private companies

(iii) 2 companies registered under section 8 of the Companies Act, 2013.

Mr. Fortune further received offer from 7 public companies, 6 private companies and 2 companies registered under section 8 of the Companies Act, 2013. He wants to take up maximum permissible directorship.

His order of preference is as follows:

(1) Public companies

(2) Private companies (not being holding or subsidiary of any public company) and

(3) Companies registered under section 8 of the Companies Act, 2013

Advice Mr. Fortune referring to the restriction provisions imposed in the Companies Act, 2013.

[CA (Final) Revision Test Paper, Nov. 2017]

Ans. The provisions relating to restrictions on number of directorships are contained in section 165, as explained hereunder:

The legal position

1. A person shall not hold office as a director in more than 20 companies.
2. The number of public companies in which a person may be appointed as a director shall not exceed 10.
3. For the purpose of section 165, a private company which is either a subsidiary company or a holding company of a public company shall be considered to be a public company.
4. For reckoning the limit of directorships of 20 companies or 10 companies, as the case may be, directorship of a company licenced under section 8 shall be excluded, if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015].

The given case and analysis of the case

5. Mr. Fortune is already a director in 16 companies. However, for the purpose of section 165, his directorships shall be counted as 14, since 2 directorships held by him in section 8 companies shall be excluded.
6. If Mr. Fortune decides to accept offers of directorship in all 7 public companies, the total directorships held by him for the purpose of section 165 would be 21 (*i.e.* in excess of the limit of 20 directorships), and directorships in public companies held by him for the purpose of section 165 would be 11. As is evident, accepting offers of directorships in all 7 public companies would result in contravention of provisions of section 165, and so Mr. Fortune can accept a maximum of 6 directorships in public companies.
7. Mr. Fortune can accept the offers of directorship in two section 8 companies, since these directorships are not considered for the purpose of section 165.

Conclusion

8. Mr. Fortune can accept a maximum of 6 directorships in public companies. He cannot accept directorship offered to him in any of the private companies. However, he can accept directorships in two section 8 companies.

Appointments held by a person in 10 public companies and 11 private companies, including directorship in a dormant company and a private company which is a subsidiary of a public company – Validity of appointments

P 1.10D. Mr 'R' holds directorship in 10 public companies and 11 private companies as on 31.05.2019. One of the above private companies is a dormant company. Apart from the dormant company, on 30.06.2019, a private company (in which Mr. R is holding directorship) has become a subsidiary of a public company.

In the light of the provisions of the Companies Act, 2013 examine and decide:

(i) The validity of holding directorship of Mr 'R' with reference to number of directorship as on 31.05.2019 and as on 30.06.2019.

(ii) Whether a company has power to specify any lesser number of companies in which a director of the company may act as a director?

[CA (Final) Nov. 2019]

Ans. The provisions relating to restrictions on number of directorships are contained in section 165, as explained hereunder:

The legal position

1. A person shall not hold office as a director in more than 20 companies.
2. The number of public companies in which a person may be appointed as a director shall not exceed 10.
3. For the purpose of section 165, a private company which is either a subsidiary company or a holding company of a public company shall be considered to be a public company.
4. For reckoning the limit of directorships of 20 companies, directorship of a dormant company shall be excluded.

The given case and analysis of the case

5. Mr. R holds directorship in 10 public companies and 11 private companies. Out of these 11 private companies, one private company is a dormant company, and one private company has become a subsidiary of a public company on 30.06.2019.
6. The private company which is a dormant company shall be excluded while counting the limit of 20 directorships (in public companies as well as private companies). Since such dormant company is a private company, there is no question of considering it while counting the limit of 10 directorships (in public companies).
7. The private company which has become a subsidiary of a public company on 30.06.2019 shall be considered as a public company with effect from 30.06.2019, and therefore, with effect from 30.06.2019, such private company shall be considered while determining the limit of 10 directorships (in public companies) as well as for determining the limit of 20 directorships (in public companies as well as private companies). However, before 30.06.2019, such private company shall not be considered while determining the limit of 10 directorships (in public companies), but shall be considered for determining the limit of 20 directorships (in public companies as well as private companies).

Conclusions

8. **Validity of directorships held by Mr. R as on 31.05.2019**

   As per the provisions of section 165, the number of directorships held in public companies by Mr. R. is 10. The number of directorships held in public companies as well as private companies, as per the provisions of section 165, is 20 (since the private company which is a dormant company, shall not be considered). Accordingly, there is no contravention of section 165, and therefore, Mr. R has validly held all the directorships, as on 31.05.2019.

9. **Validity of directorships held by Mr. R as on 30.06.2019**

   As per the provisions of section 165, the number of directorships held in public companies by Mr. R. is 11 (since the private company which has become subsidiary of a public company, shall be considered as a public company). The number of directorships held in public companies as well as private companies, as per the provisions of section 165, is 20. Since directorships held in public companies by Mr. R exceed the maximum limit of 10 directorships, Mr. R has contravened the provisions of section 165.

10. **Whether a company has power to specify lesser number of companies in which a director may act as a director?**

    As per section 165, the members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as director.

Advanced Practical Problems

Which directorships shall be included and excluded for the purpose of section 165?

P 1.10E. State whether the following directorships shall be considered while counting the limit of 10 companies and 20 companies, under section 165 of the Companies Act, 2013.

(i) Directorship in a Government company incorporated as a public company
(ii) Directorship in a Public Sector Undertaking (not being a Government company)
(iii) Directorship in a foreign company
(iv) Directorship in a foreign company which is a subsidiary or holding company of a company incorporated in India
(v) Directorship in a foreign body corporate, not being a foreign company
(vi) Directorship in a company licenced under section 8 of the Companies Act, 2013
(vii) Small Shareholder Directorship in a listed public company
(viii) Holding directorship in a public company as a nominee director
(ix) Holding directorship in a public company as an alternate director
(xi) Holding directorship in a public company as a managing director or whole-time director
(xii) Holding directorship in a private company
(xiii) Directorship in a private company which is a subsidiary of a public company
(xiv) Directorship in a private company which is a holding company of a public company
(xv) Directorship in a dormant company which is a public company

Ans. The provisions relating to restrictions on number of directorships are contained in section 165 read with Notification No. G.S.R. 466(E) dated 5th June, 2015, discussed as under:

1. No person shall hold office as a director (including alternate directorships) in more than 20 companies, whether public or private.
2. No person shall hold office as a director (including alternate directorships) in more than 10 public companies (including any private company which is either a holding company or a subsidiary company of a public company).
3. For reckoning the limit of directorships of 20 companies, directorship of a Dormant company shall be excluded [Explanation II to Sec. 165(1)].
4. For reckoning the limit of directorships of 20 companies or 10 companies, as the case may be, directorship of a company licenced under section 8 shall be excluded, if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015].

Applying the above provisions, the given questions are answered as under:

	Case	Whether the directorship shall be counted in the limit of 10 directorships in public companies?	Whether the directorship shall be counted in the limit of 20 directorships in public as well as private companies?
(i)	Directorship in a Government company incorporated as a public company	Yes	Yes
(ii)	Directorship in a Public Sector Undertaking (not being a Government company)	No (Since it is not a 'company')	No (Since it is not a 'company')
(iii)	Directorship in a foreign company	No (Since it is not a 'company')	No (Since it is not a 'company')
(iv)	Directorship in a foreign company which is a subsidiary or holding company of a company incorporated in India	No (Since it is not a 'company')	No (Since it is not a 'company')
(v)	Directorship in a foreign body corporate, not being a foreign company	No (Since it is not a 'company')	No (Since it is not a 'company')
(vi)	Directorship in a company licenced under section 8 of the Companies Act, 2013	No (Since excluded by Notification No. G.S.R. 466(E) dated 5th June, 2015)	No (Since excluded by Notification No. G.S.R. 466(E) dated 5th June, 2015)
(vii)	Small Shareholder Directorship in a listed public company	Yes	Yes
(viii)	Holding directorship in a company as a nominee director in a public company	Yes	Yes
(ix)	Holding directorship in a company as an alternate director in a public company	Yes	Yes
(xi)	Holding directorship in a company as a managing director or whole-time director in a public company	Yes	Yes
(xii)	Directorship in a private company	No	Yes
(xiii)	Directorship in a private company which is a subsidiary of a public company	Yes	Yes
(xiv)	Directorship in a private company which is a holding company of a public company	Yes	Yes
(xv)	Directorship in a dormant company which is a public company	Yes [As per Explanation II to Sec. 165(1)]	No [As per Explanation II to Sec. 165(1)]

1.11 Resignation of directors (Section 168 and Rules 15 and 16)

1. Legal requirements for making resignation by a director [Section 168(1)]

(a) A director may resign from his office by giving a notice in writing to the company. It means that the resignation shall be valid only if it is addressed to the company. Any resignation addressed to a third party shall not have any effect.

Under the Companies Act, 1956, there was no requirement that the resignation of a director had to be in writing. Accordingly, under the Companies Act, 1956, even an oral resignation was held to be valid. However, as per section 168 of the Companies Act, 2013, an oral resignation shall not have any legal effect.

(b) The director may, within 30 days of resignation, forward to the Registrar –

(i) a copy of his resignation; and

(ii) detailed reasons for the resignation.

Rule 16 of the Companies (Appointment and Qualification of Directors) Rules, 2014

(a) The notice of resignation may be filed by the director with the Registrar in Form No. DIR-11.

(b) However, where a company has already filed Form No. DIR-12 with the Registrar under Rule 15, a foreign director of such company resigning from his office may authorise in writing a practising chartered accountant or cost accountant in practice or company secretary in practice or any other resident director of the company to sign Form DIR-11 and file the same on his behalf intimating the reasons for the resignation.

(c) On receipt of resignation, the Board shall take note of the same.

2. Legal requirements to be complied with by a company on receipt of resignation [Section 168(1) read with Rule 15 of the Companies (Appointment and Qualification of Directors) Rules, 2014]

(a) The company shall intimate the Registrar –

(i) within 30 days of receipt of notice of resignation;

(ii) by filing Form No. DIR-12.

(b) The company shall post on its website (if any) the information regarding the resignation made by the director.

(c) The company shall also include the fact of resignation in the report of directors (*i.e.* the Board's report prepared under section 134) to be laid in the next general meeting.

3. Effect of resignation made under section 168(1) [Section 168(2)]

The resignation made under section 168(1) shall take effect from –

(i) the date on which the notice is received by the company; or

(ii) the date, if any, specified by the director in the notice,

whichever is later.

Section 168 does not state any requirement of acceptance of resignation of a director by the Board or members. Thus, any resignation made by a director shall take effect as per the provisions contained in section 168(2), without requiring any acceptance.

4. No extinguishment of liability even after resignation [Proviso to Section 168(2)]

Even after a director has resigned, he shall continue to be liable for the offences committed during his tenure.

5. Consequences of resignation of all the directors [Section 168(3)]

Where all the directors of a company resign from their offices, or vacate their offices under section 167, 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.

Where all the directors of a company resign and as a consequence the Digital Signature Certificates (DSC) of all the directors are deactivated, DIR-12 cannot be filed by the company due to lack of an authorized signatory director.

In order to enable the filing of DIR-12 in such a case, the Registrar of Companies are authorised, on request from the stakeholders, and after due examination, to allow any one of the resigned director who was an authorised signatory director for the purpose of filing DIR-12 only (MCA General Circular No. 03/2015 dated 03.03.2015).

Practical Problems from CA Examinations

Can the resignation of a director be refused?

P 1.11A. Due to internal problems in the working of M/s. Infighting Detergents Ltd., Mr. Satyam, the executive director, and Mr. Shivam, a director, have submitted their resignations and decided to disassociate themselves with the working of the company. Mr. Sundaram, the managing director, decides to refuse their resignations. Examine whether the managing director can compel Mr. Satyam and Mr. Shivam to continue as per the provisions of the Companies Act, 2013. [CA (Final) May 2001]

Ans. Section 168 of the Companies Act, 2013 lays down the provisions with respect to resignation of directors. Section 168 does not grant any right to the managing director or to the Board of directors to refuse the resignation of a director. Section 168 expressly provides that the resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later.

In the present case, Mr. Sundaram, the managing director, cannot compel Mr. Satyam or Mr. Shivam to continue in office. Mr. Satyam and Mr. Shivam shall have to vacate their offices from the dates specified in their respective notices or the respective dates of receipt of their notices of resignation by the company, whichever is later.

Resignation submitted by a director but not accepted by the Board and no form filed by the company – When does directorship cease?

P 1.11B. Mr. Raj, a director of PQR Ltd., submitted his resignation from the post of director to the Board of directors on 30th June, 2014 and obtained a receipt therefor on the same day. The Board of directors of PQR Ltd. neither accepted the resignation nor did it file any form with the registrar of companies. You are required to state whether Mr. Raj ceases to be the director of PQR Ltd. and if yes, since when? [CA (Final) Nov 2004 (Modified)]

Ans. Section 168 of the Companies Act, 2013 lays down the provisions with respect to resignation of directors. As per section 168, a director who resigns may, within 30 days of resignation, forward to the Registrar, a copy of his resignation in Form No. DIR-11 along with detailed reasons for the resignation.

Also, section 168 casts a duty on the company to intimate the Registrar regarding the resignation by a director. Such intimation shall be given by the company to the registrar in Form No. DIR-12 within 30 days of receipt of resignation from the director.

Section 168 does not require that the resignation of a director is to be accepted by the Board of directors or any other person or authority. Also, section 168 does not grant any right to the managing director or to the Board of directors to refuse the resignation of a director. Section 168 expressly provides that the resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later.

The effective date of resignation is not related to the date of filing of Form No. DIR-11 or Form No. DIR-12. Filing of Form No. DIR-11 or DIR-12 are only consequential acts; filing is not an act to be complied with in order to make a resignation effective. Even if no form is filed with the registrar, the resignation shall take effect from –

(a) the date on which the notice of resignation is received by the company; or

(b) the date, if any, specified in the notice of resignation,

whichever is later.

Assuming that the notice of resignation of Mr. Raj did not specify any date with effect from which the resignation shall take effect, Mr. Raj shall cease to be a director with effect from 30th June, 2014, *i.e.* the date on which the notice of resignation is received by the company.

Status of director where company does not intimate the resignation to the Registrar

P 1.11C. Vijay, a director resigns after giving due notice to the company and he forwards a copy of resignation in e-form DIR-11 to the Registrar of Companies (ROC) within the prescribed time. What would be the status of Vijay if the company fails to intimate about the resignation of Vijay to ROC? [CA (Final) May 2017]

Ans. Section 168 of the Companies Act, 2013 lays down the provisions with respect to resignation of directors, as explained below:

The legal position

1. A director may resign from his office by giving a notice in writing to the company. As per section 168, a director who resigns, may, within 30 days of resignation, forward to the Registrar, a copy of his resignation in Form No. DIR-11 along with detailed reasons for the resignation.
2. On receipt of resignation of a director, the company shall intimate the Registrar –
   (i) within 30 days of receipt of notice of resignation;
   (ii) by filing Form No. DIR-12.
3. The resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later.

The given case and analysis of the case

4. Mr. Vijay has filed Form DIR-11 with the Registrar.
5. The company has failed to file Form DIR-12 with the Registrar.
6. Non-filing of Form DIR-12 does not invalidate the resignation of Vijay. In fact, filing of Form DIR-12 is a consequence of resignation, and so non-filing of the same cannot affect the validity of resignation.

Conclusion

7. Mr. Vijay shall cease to be a director with effect from the date on which his resignation is received by the company or the date, if any, specified by Mr. Vijay in his resignation, whichever is later.

1.12 Appointment of directors to be voted on individually (Section 162)

Section 162 prohibits the placing of a single resolution for the election of two or more directors before the members. The purpose of prohibiting single resolution is to enable the members to accept or reject a particular individual standing for directorship without being compelled to accept or reject all of them. Accordingly, section 162 prohibits putting forward a list of candidates to be elected and thereby forcing the meeting to vote for the candidates in a batch.

The provisions of section 162 are explained below:

1. **Separate resolution for each appointment**

   At a general meeting, two or more persons cannot be appointed as directors by a single resolution, *i.e.* every director must be appointed by passing a separate resolution.

2. **Single resolution for two or more appointments permitted subject to conditions**

   Two or more persons may be appointed as directors by a single resolution, if a resolution that the appointments shall be so made (*i.e.* appointments of two or more directors by a single resolution) has first been agreed to by the meeting without any vote being cast against it. *In other words*, two or more directors may be appointed by a single resolution as per the following procedure:

   - Firstly, pass a resolution authorising the appointment of two or more directors by a single resolution. Such resolution shall be passed without even a single vote being cast against the resolution.
   - Then, pass a resolution appointing such directors (*i.e.* two or more directors) by a single resolution. Such resolution shall be passed as an ordinary resolution.

   Example 1. In a general meeting, 80 members were present. All the 80 members passed a single resolution appointing 2 directors A and B. The single resolution appointing the 2 directors is void since a resolution was not first been agreed to by the meeting that appointment of 2 directors shall be made by a single resolution.

   Example 2. In a general meeting, 10 members were present. A resolution to the effect that X and Y shall be appointed by a single resolution was passed with the consent of 8 members, but the other 2 members abstained from voting. At the time of voting on the single resolution for the appointment of both X and Y, 7 members voted in favour of the resolution and 3 members voted against the resolution. The single resolution appointing the 2 directors is valid.

1. **Restricted application of section 162**

   Section 162 shall not apply to any appointment made by a company otherwise than in general meeting (*i.e.* Section 162 shall apply only when the appointment or reappointment of 2 or more directors is made in general meeting). *For example*, if 2 or more additional directors are appointed in a Board meeting, section 162 is not attracted.

2. **Consequences of contravention of Section 162**

   If appointment of 2 or more directors is made by a single resolution (passed in contravention of section 162), the consequences shall be as follows:

   (a) All such appointments shall be void (it is immaterial as to whether any objection against the single resolution was raised in the meeting or not).

   (b) The provisions relating to automatic appointment of directors shall not apply [Section 152(7)(b)(v)].

   (c) The acts of such directors shall be valid until the defect in appointment is noticed by the company (Section 176).

3. **Non-applicability of section 162**

   (a) The provisions of section 162 shall not apply to a private company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92. [Notification No. G.S.R. 464(E) dated 5th June, 2015].

   (b) As per Notification No. G.S.R. 463(E) dated 5th June, 2015, the provisions of section 162 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; or

   (ii) a subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by that Government company,

   if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

Theoretical Questions from CS Examinations

Q 1.12A. The notice of annual general meeting of XYZ Ltd. includes an item of business for appointment of A and B as its directors by a single resolution. Is this legally valid? [CS (Final) Dec. 2001]

Practical Problems from CA Examinations

Appointment of all the directors by a single resolution – Consequences

P 1.12A. XYZ Company Ltd. in its annual general meeting appointed all its directors by passing one single resolution. No objection was made to the resolution. Examine the validity of appointment of directors explaining the relevant provisions of the Companies Act, 2013. Will it make any difference, if XYZ Company Ltd. were a private company? [CA (Final) May 2003]

OR

In case of appointment of directors of a company, all the directors were not voted on individually, but were appointed by one resolution and no shareholder objected to it. Discuss the position under the provision of the Companies Act, 2013.

[CA (Final) Nov. 1998]

Ans. At a general meeting, two or more persons cannot be appointed as directors by a single resolution unless a resolution that appointment shall be so made has first been agreed to by the meeting without any vote being cast against it. A resolution moved in contravention of this provision shall be void, whether or not objection was raised at the time when such resolution was passed (Section 162).

In the present case, all the members passed a single resolution appointing all the directors. Before moving the resolution for appointment of all the directors by a single resolution, no resolution was passed to the effect that all the directors shall be appointed by a single resolution. Therefore, the resolution appointing all the directors by a single resolution is void, and consequently the appointment of all the directors is also void. It is immaterial that no member objected to the appointment of all the directors by a single resolution.

As per section 176, the acts of these directors shall not be invalid till the defect in their appointment is noticed by the company.

The provisions of section 162 do not apply to a private company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 464(E) dated 5th June, 2015]. Therefore, if the company in the present case is a private company and it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the appointment of all the directors by a single resolution shall be valid.

Appointment of 3 directors by single resolution – Consequences

P 1.12B. In ABC Ltd. three directors were to be appointed. The item was included in agenda for the Annual General Meeting scheduled on 30th September, 2014, under the category of 'Ordinary Business'. All the three persons as proposed by the Board of directors were elected as Directors of the company by passing a 'single resolution' avoiding the repetition (multiplicity) of resolution. After the three directors joined the Board, certain members objected to their appointment and the resolution. Examine the provisions of Companies Act, 2013 and decide

Whether the contention of the members shall be tenable and whether both the appointment of directors and the 'single resolution' passed at the company's Annual General Meeting shall be void. [CA (Final) Nov. 2010 (Modified)]

Ans. At a general meeting, two or more persons cannot be appointed as directors by a single resolution unless a resolution that appointment shall be so made has first been agreed to by the meeting without any vote being cast against it. A resolution moved in contravention of this provision shall be void, whether or not objection was raised at the time when such resolution was passed (Section 162).

In the present case, appointment of 3 directors has been made by passing a single resolution. Before moving the resolution for appointment of 3 directors by a single resolution, no resolution was passed to the effect that the appointment of 3 directors shall be made by a single resolution. Therefore, the resolution appointing the three directors by a single resolution is void, and consequently the appointment of all the three directors is also void. It is immaterial that no member objected to such appointments.

Thus, the contention of the members that the appointment of the 3 directors is void, is correct. Also, the single resolution passed for appointments, is void.

Whether 2 directors can be appointed in the AGM by a single resolution?

P 1.12C. Mr. Bond and Mr. James were appointed as Directors of Jamesbond Ltd. at the AGM held on 30th September, 2017 by a single resolution. State the relevant provisions of the Companies Act, 2013 and identify is it possible to appoint the above directors by a single resolution? [CA (Final) May 2018]

Ans. The given problem relates to section 162 of the Companies Act, 2013.

Relevant provisions of the Companies Act, 2013

As per section 162, at a general meeting, two or more persons cannot be appointed as directors by a single resolution unless a resolution that appointment shall be so made has first been agreed to by the meeting without any vote being cast against it. A resolution moved in contravention of this provision shall be void, whether or not objection was raised at the time when such resolution was passed.

Whether it is possible to appoint Mr. James and Mr. Bond as directors by a single resolution?

In the present case, appointments of 2 directors, *viz.* Mr. James and Mr. Bond, have been made at the AGM by passing a single resolution.

Applying the provisions contained in section 162, Mr. James as well as Mr. Bond can be appointed by a single resolution at the AGM, provided –

(a) before moving such single resolution, a resolution that the appointments of these 2 directors shall be made by a single resolution, has been passed at the meeting; and

(b) no vote has been cast against such resolution.

Thus, it is possible to appoint Mr. James and Mr. Bond as directors by a single resolution by complying with the above requirements.

Advanced Practical Problems

Whether appointment of 2 or more directors by a single resolution can be made at a general meeting only if unanimous resolution is passed?

P 1.12D. Comment on the validity of the following statement, by giving some illustrations:

"Appointment of 2 or more directors can be made by a single resolution only if before making such appointments, a unanimous resolution is passed."

Ans. The given statement is based upon the provisions of section 162 of the Companies Act, 2013.

As per section 162, at a general meeting, two or more persons cannot be appointed as directors by a single resolution unless a resolution that appointments shall be so made has first been agreed to by the meeting without any vote being cast against it. A resolution moved in contravention of this provision shall be void, whether or not objection was raised at the time when such resolution was passed.

Illustration No. 1: It is proposed to appoint Mr. A and Mr. B as directors at the AGM by passing a single resolution. 20 members are present in the AGM. Before appointing Mr. A and Mr. B as directors, a resolution was proposed before the members as to whether such appointments be made by a single resolution. All the 20 members voted in favour of such resolution. Then, a single resolution proposing the appointments of Mr. A and Mr. B was proposed before the members and it was passed as an ordinary resolution. Since the provisions of section 162 have been complied with, the appointments of Mr. A and Mr. B are valid.

Illustration No. 2: It is proposed to appoint Mr. C and Mr. D as directors at the AGM by passing a single resolution. 30 members are present in the AGM. Before appointing Mr. C and Mr. D as directors, a resolution was proposed before the members as to whether such appointments be made by a single resolution. Out of the 30 members present, 25 members voted in favour of such resolution, but no member voted against such resolution (*i.e.* 5 members abstained from voting). Then, a single resolution proposing the appointments of Mr. C and Mr. D was proposed before the members and it was passed as an ordinary resolution. Since the provisions of section 162 have been complied with, the appointments of Mr. A and Mr. B are valid.

From illustration No. 2, it is evident that the requirement stipulated under section 162 that a resolution is first passed with no vote being cast against it, has been satisfied, though unanimous resolution has not been passed.

Conclusion: The statement "appointment of 2 or more directors can be made by a single resolution only if before making such appointments, a unanimous resolution is passed." is not correct.

1.13 First directors [Section 152(1)]

1. First directors as per the articles

Section 152(1) permits a company to make such provision with respect to first directors as it may deem fit. However, such provision has to be contained in the articles of the company filed with the Registrar at the time of incorporation of the company. Following points are worth noting in this regard:

(a) Generally, the names of the first directors are specified in the articles at the time of incorporation of the company. In such a case, the persons so named as first directors in the registered articles of the company act as first directors.

(b) If the registered articles of a company are silent with respect to first directors, but Regulation No. 60 contained in Table F is applicable to such company, then, as per the said Regulation No. 60, the number and names of the first directors shall be determined in writing by the majority of the subscribers to memorandum.

(c) If the registered articles of a company are silent with respect to first directors, and Regulation No. 60 contained in Table F is not applicable to such company, then, all the subscribers to memorandum, who are individuals, shall be deemed to be the first directors.

A situation may arise where the registered articles of a company are silent with respect to first directors, Regulation No. 60 contained in Table F is not applicable to such company, and all the subscribers to memorandum are body corporates. In such a case, the company shall not have any first director, until the appointment of directors is made in accordance with the provisions contained in the Act.

2. Tenure of first directors

The first directors shall hold their offices until the directors are duly appointed by the company as per the provisions contained in the Act.

1. Applicability of section 152(1)

Section 152(1) applies to all companies, whether public or private.

2. First directors in case of One Person Company

The individual (being the sole member of the company) shall be deemed to be the first director of One Person Company until the director or directors are duly appointed by the member as per the provisions contained in the Act.

1.14 General provisions relating to appointment of directors [Section 152(2) to (5) and Rule 8]

1. Appointment of directors to be made in the general meeting [Section 152(2)]

(a) As a general rule, every director shall be appointed by the company in general meeting.

(b) However, where any provision contained in the Act requires or specifies any other manner of appointment of directors, the appointment may be made in such manner.

Some examples where the Act requires or specifies appointment of directors otherwise than in general meeting

(i) Appointment of an additional director [Section 161(1)]

(ii) Appointment of an alternate director [Section 161(2)]

(iii) Appointment of a nominee director [Section 161(3)]

(iv) Appointment of a director filling a casual vacancy [Section 161(4)]

2. Mandatory to have DIN [Section 152(3)]

No person shall be appointed as a director of a company unless he has been allotted –

(a) the Director Identification Number under section 154; or

(b) such other number as may be prescribed under section 153.

3. Duty to furnish DIN and declaration before appointment [Section 152(4)]

Every person proposed to be appointed as a director (whether in general meeting or otherwise), shall furnish to the company –

(i) his DIN or such other number as may be prescribed under section 153; and

(ii) a declaration that he is not disqualified to become a director under this Act.

Can a minor become a director?

There is no express provision in the Companies Act, 2013 disqualifying a minor from becoming a director.

However, an individual may be appointed as a director only if he has been allotted DIN or such other number as may be prescribed under section 153 [Section 152(3)]. A minor is not eligible to obtain DIN.

Also, every person proposed as a director has to file his written consent to act as a director [Section 152(5)]. A minor cannot file a valid consent as required under section 152(5).

Therefore, a minor cannot become a director in any company, whether public or private.

4. Consent to act as a director [Section 152(5) and Rule 8]

(i) Every person shall furnish to the company his consent in writing (in Form DIR-2) to act as a director. The consent shall be filed on or before his appointment as a director.

(ii) The consent filed by the director with the company, shall be filed by the company with the Registrar –

  (a) within 30 days of such appointment;

  (b) in Form DIR-12;

  (c) along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014.

Applicability of provisions with respect to filing of consent

(a) The provisions of section 152(5) read with Rule 8 apply to all companies, whether public or private.

(b) However, the provisions of section 152(5) shall not apply in case of a Government company where appointment of such director is made by the Central Government or State Government, as the case may be, if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015]. Accordingly, no person appointed as a director in a Government company by the Central Government or State Government is required to file his consent, and the Government company is also not required to file any consent with the Registrar if such Government company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

(c) The Companies Act, 1956 provided some relaxations with respect to filing of consent in certain cases. However, such relaxations have not been provided under the Companies Act, 2013. *For example*, as per the Companies Act, 2013 –

(i) persons named in the articles as first directors are required to file their consents with the company;

(ii) a director who retires (whether by rotation or by reason of expiry of his term) and is reappointed, is required to file his consent with the company;

(iii) a director appointed by the Tribunal is required to file his consent with the company.

In all the above cases, the company is also required to file the consent of the director with the Registrar.

5. Requirements of explanatory statement for appointing an independent director [Proviso to Section 152(5)]

In the case of appointment of an independent director in the general meeting, an explanatory statement for such appointment, annexed to the notice of the general meeting, shall include a statement that in the opinion of the Board, he fulfils the conditions specified in this Act for such an appointment.

The Proviso to section 152(5) shall not apply to a company licenced under section 8 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No G.S.R. 466(E) dated 5th June, 2015].

Advanced Practical Problems

Notice of AGM is short by 1 day – Whether appointment of a director made in the AGM is valid?

P 1.14A. Late Latif Ltd. called its eighth AGM by serving a notice which was short by 1 day. In the AGM, a resolution was passed appointing Mr. Lazy as a director. Is the appointment of Mr. Lazy valid?

Ans. The given problem relates to section 101 of the Companies Act, 2013.

As per section 101, any general meeting may be called by serving not less than 21 clear days' notice. However, section 101 is silent as to the consequences where a general meeting is called by serving a shorter notice. This issue was raised before the Court in ***Shailesh Harilal Shah and Others v Matushree Textiles Ltd. and Other.*** The Court held that the provisions of section 101 are directory and not mandatory. In case of a directory provision, it is sufficient if the requirement contained in such provision is obeyed or fulfilled substantially. So, even if a notice of general meeting is short by few days, the notice, the general meeting and the resolutions passed at the general meeting shall not be invalid provided no prejudice is caused to any member of the company.

In the given case, the notice of 8th AGM is short by 1 day only. It is very unlikely that such shorter notice would have caused any prejudice to any member of the company. Therefore, the 8th AGM and all the resolutions passed thereat including the appointment of Mr. Lazy as a director shall remain valid.

1.15 Rotational and non-rotational directors, and retirement of directors [Section 152(6) and (7)]

(A) Directors liable to retire by rotation, i.e. rotational directors [Section 152(6)(a)].

Section 152(6)(a) provides as under:

"Unless the articles provide for the retirement of all directors at every annual general meeting, not less than two-thirds of the total number of directors of a public company shall –

(i) be persons whose period of office is liable to determination by retirement of directors by rotation; and

(ii) save as otherwise expressly provided in this Act, be appointed by the company in general meeting."

The provisions relating to rotational directors are analysed as under:

1. Number of rotational directors and requirement of rotation

(a) Not less than 2/3rd of total number of directors shall be the rotational directors.

(b) However, the articles of a company may provide that all the directors shall retire at every annual general meeting.

2. Appointment of rotational directors

The rotational directors shall be appointed by the company in general meeting (whether annual general meeting or extraordinary general meeting).

3. Meaning of 'total number of directors' [Explanation to Section 152(6)]

(a) 'Total number of directors' shall not include the independent directors (whether such independent director is appointed under the Companies Act, 2013 or under any other law for the time being in force). Thus, an independent director shall not retire by rotation, and shall not be included in 'total number of directors' for the purpose of computation of rotational directors.

(b) Nominee directors appointed by a financial institution established under a separate Act of the Parliament and containing provisions overriding the Companies Act, 2013, shall not be included in the 'total number of directors' for the purpose of section 152(6).

(B) Directors not liable to retire by rotation, i.e. non-rotational directors [Section 152(6)(b)].

In the case of a public company, the directors, other than rotational directors shall, in default of, and subject to any regulations in the articles of the company, also be appointed by the company in general meeting.

Simply speaking, the directors other than rotational directors are called as non-rotational directors. The provisions applicable to non-rotational directors are as follows:

1. Appointment

The non-rotational directors shall be appointed in the general meeting. However, the articles of a company may provide otherwise, *i.e.* a company may provide in its articles the manner of appointment of not more than 1/3rd of total number of directors. For example, the articles of a company may empower the Board of directors to appoint the non-rotational directors.

2. Term of office

The non-rotational directors may be appointed for such period as may be determined by the general meeting and there is nothing in the Act which prohibits even an appointment for life. However, the term of office of a non-rotational director may also be determined as per the provisions contained in the articles of a company.

Illustrations on rotational and non-rotational directors.

Sl. No.	*Case*	*Consequences / Implications*
1.	A Ltd. has 6 directors.	Minimum 4 directors must be rotational directors.
2.	B Ltd. has 6 directors, 4 rotational and 2 non-rotational.	There is no contravention of section 152.
3.	C Ltd. has 6 directors, 5 rotational and 1 non-rotational.	There is no contravention of section 152.
4.	D Ltd. has 6 directors. The company has appointed all these directors as rotational directors.	There is no contravention of section 152.
5.	E Ltd. has 6 directors, 3 rotational and 3 non-rotational.	The present composition of Board is not in compliance of section 152.
6.	F Ltd. has 6 directors, 4 rotational and 2 non-rotational. The company intends to appoint a non-rotational director.	The company cannot appoint a director as a non-rotational director since it would result in contravention of section 152.
7.	G Ltd. has 6 directors, 5 rotational and 1 non-rotational. The company intends to appoint a non-rotational director.	The company can appoint a director as non-rotational director since it would not result in contravention of section 152.
8.	H Ltd. has 6 directors, 4 rotational and 2 non-rotational. The company intends to appoint a rotational director.	The company can appoint a director as a rotational director since it would not result in contravention of section 152.

(C) Retirement of directors [Section 152(6)(c) to (e)].

1. Number of directors due to retire at the AGM [Section 152(6)(c)]

At the first annual general meeting and every subsequent annual general meeting, 1/3rd (or nearest to 1/3rd) of directors liable to retire by rotation [determined as per section 152(6)(a)] shall retire from the office.

However, the articles of a company may provide that all the directors shall retire at every annual general meeting.

2. Who shall retire? [Section 152(6)(d)]

(a) The directors liable to retire by rotation shall be those who have been longest in the office.

(b) In case, two or more directors were appointed on the same day, the names of directors liable to retire shall be determined –

(i) as per any agreement between them (*i.e.* mutual consent); *or*

(ii) by lots, in the absence of any such agreement.

3. Vacancy in the place of retiring director [Section 152(6)(e)]

(a) The retiring director may be reappointed at the annual general meeting.

An ordinary resolution is required for reappointing the retiring director. In case, the ordinary resolution for reappointment is lost (*i.e.* the ordinary resolution for reappointment fails), the retiring director ceases to be a director.

(b) However, the company may, instead of reappointing the retiring director, appoint some other person in his place (provided a notice of such person's candidature is given to the company in accordance with the provisions of section 160).

(c) The company may decide not to reappoint the retiring director, and also not to appoint any other person in his place.

Where a company does not hold AGM upto the last due date, the directors liable to retire at the AGM shall have to vacate their offices on the last day AGM ought to have been held **[*B.R. Kundra* v *Motion Pictures Association* (1976) 46 Comp Cas 339].**

Illustrations on retirement of directors.

A, B, C, D, E, F, G, H, I, J, K and L are the 12 directors of AL Ltd. Calculate the number of directors liable to retire in the annual general meeting to be held on 30th September, 2016 in each of the following alternative cases:

Q. No.	***Question***	***Analysis***	***Total number of directors***	***Number of rotational directors***	***Number of retiring directors***
1.	All the directors have been appointed by the shareholders in the general meeting.	In the absence of any information, it has been assumed that 2/3rd of total number of directors (*i.e.* 8) are rotational directors and remaining directors (*i.e.* 4) are non-rotational directors.	12	8	3
2.	A and B are additional directors.	Additional directors are appointed by the Board of directors, and they are, therefore, non-rotational directors. However, they shall be counted while calculating the 'total number of directors' for the purpose of section 152(6) of the Companies Act, 2013. Accordingly, the 'total number of directors' in this case is 12.	12	8	3
3.	A and B are nominees of LIC.	LIC is empowered to appoint the nominee directors in accordance with the provisions of the Life Insurance Corporation of India Act, 1956. As per the Life Insurance Corporation of India Act, 1956, the nominee directors appointed by LIC shall not be counted while calculating the 'total number of directors' for the purpose of section 152(6) of the Companies Act, 2013. The provisions contained in the Life Insurance Corporation of India Act, 1956 override the provisions contained in the Companies Act, 2013. Accordingly, the 'total number of directors' in this case is 10, and not 12.	10	7	2

4.	A and B are nominees of ICICI Bank Ltd.	ICICI Bank Ltd. is a company within the meaning of the Companies Act, 2013. Since there is no special Act empowering ICICI Bank Ltd. to appoint the nominee directors, the nominee directors appointed by ICICI Bank Ltd. shall be counted while calculating the 'total number of directors' for the purpose of section 152(6) of the Companies Act, 2013. Accordingly, the 'total number of directors' in this case is 12.	12	8	3
5.	A and B were appointed by the Board of directors and their appointments were subsequently approved in the next general meeting as per section 161(4) to fill the casual vacancies in the office of Y and Z respectively (both Y and Z were appointed as rotational directors in general meeting). C and D are the non-rotational directors. All other directors (*i.e.* E to L) are rotational directors.	Both A and B shall be non-rotational directors since they have been appointed by the Board of directors. All the directors (*i.e.* A to L) shall be counted while calculating the 'total number of directors' for the purpose of section 152(6) of the Companies Act, 2013. So, the total number of directors in this case is 12. Out of these 12 directors, A, B, C and D are non-rotational directors. Thus, the non-rotational directors shall be 4, and rotational directors shall be 8.	12	8	3
6.	A is a managing director.	A managing director may be a rotational director or a non-rotation director depending upon the terms and conditions of his appointment. Irrespective of the fact that a managing director is a rotational director or non-rotational director, he shall be counted while calculating the 'total number of directors' for the purpose of section 152(6) of the Companies Act, 2013. Same is the case with the whole time director.	12	8	3
7.	A is a whole time director.		12	8	3
8.	A, B, C and D are independent directors.	The independent directors shall not be considered while calculating the 'total number of directors' for the purpose of section 152(6). Accordingly, the 'total number of directors' in this case is 8, and not 12.	8	6	2

4. Position where place of retiring director is not filled up at AGM [Section 152(7)]

(a) Adjournment of AGM [Section 152(7)(a)]. If the vacancy in the place of retiring director is not filled up at the AGM and the meeting has not resolved not to fill the vacancy, the annual general meeting shall adjourn till the next week at the same time and place or if that day is a national holiday, then to next succeeding day which is not a holiday.

(b) ***Automatic reappointment [Section 152(7)(b)].*** If at the adjourned AGM also, the vacancy in the place of retiring director is not filled up and the meeting has not resolved not to fill the vacancy, the retiring director shall be deemed to be reappointed.

(c) ***No automatic reappointment [Section 152(7)(b)].*** At an adjourned AGM, a retiring director shall not be deemed to be automatically reappointed in the following cases:

(i) Where a resolution for the reappointment of such director was put and lost.

(ii) Where the retiring director has, in writing, expressed his unwillingness to be reappointed.

(iii) Where he is not qualified or is disqualified for appointment.

(iv) Where a resolution, whether special or ordinary, is required for his reappointment.

(v) Where appointment of 2 or more directors is made by a single resolution passed in contravention of section 162.

1. **Position in case of private companies**

The provisions of section 152(6) and (7) do not apply to a private company. Accordingly, there is no concept of retirement of directors by rotation in case of private companies. Thus, it is possible for a private company to appoint all the directors for any fixed period (say, 20 years) or even for life. However, the articles of a private company may make provisions with respect to retirement of directors by rotation, but even in such a case, the provisions of section 152(6) and (7) shall not apply to it, and the retirement of directors shall take place in accordance with the provisions contained in the articles.

2. **Non-applicability in case of certain Government companies**

As per Notification No. G.S.R. 463(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 582(E) dated 13th June, 2017, the provisions of section 152(6) and 152(7) shall not apply to –

(a) a Government company, which is not a listed company, in which not less than 51% of 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,

if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

3. **Meaning of 'retiring director'**

For the purpose of section 152 and 160, 'retiring director' means a director retiring by rotation [Explanation to section 152(7)].

4. **Additional director is included in 'total number of directors'**

An additional director appointed as per section 161(1) shall be included in the 'total number of directors' for the purpose of section 152(6), since section 161(1) does not over-ride section 152(6).

Theoretical Questions from CA Examinations

Q 1.15A. Explain the circumstances under which a director retiring at an annual general meeting shall be deemed to have been reappointed even though no such appointment has been made. [CA (Final) May 2003]

Q 1.15B. Annual general meeting of Hero Ltd. has been scheduled in compliance with the requirements of the Companies Act, 2013. In this connection, it has some directors who are rotational and out of which some have been appointed long back, some have been appointed on the same day.

Decide in this connection,

(i) Which of the directors shall be retiring by rotation and be eligible for re-election?

(ii) In case two directors were appointed on the same day, how would you decide their retirement by rotation?

(iii) In case the meeting could not decide how the vacancies caused by retirement to be dealt with, what shall be consequences?

(iv) What will be your answer, assuming that the matter could not be decided even at the adjourned meeting?

[CA (Final) May 2011 (Modified)]

Practical Problems from CA Examinations

A company has 5 directors – How many directors are liable to retire?

P 1.15A. The articles of association of M/s XY Limited provide for five directors and all the five directors are in positions. How many directors are liable to retire at the ensuing annual general meeting? [CA (Final) Nov. 1995]

Ans. Not less than 2/3rd of total number of directors shall be the directors whose period of office is liable to determination by retirement by rotation (any fraction contained in that 2/3rd shall be rounded off as one). These directors are referred to as rotational directors. At every annual general meeting, 1/3rd (or nearest to 1/3rd) of rotational directors shall retire from the office. Directors who are longest in office since their last appointment shall retire first [Section 152(6)].

In the present case, the company has 5 directors in office. As per Section 152(6), the number of rotational directors shall not be less than 4 (*i.e.* not less than 2/3rd of 5, *i.e.* not less than 3.33, *i.e.* either 4 or 5).

Assuming that the company has 4 rotational directors, director(s) liable to retire by rotation at the ensuing annual general meeting shall be 1/3rd (or nearest to 1/3rd) of rotational directors, i.e. 1/3rd of 4, i.e. 1.33. Since nearest to 1.33 is 1, one director shall retire from the office at the ensuing annual general meeting. The director who has been longest in office shall retire first. He shall be eligible for reappointment.

Alternate Answer:

If it is assumed that all the 5 directors are rotational directors, the director(s) liable to retire by rotation at the ensuing annual general meeting shall be 1/3rd (or nearest to 1/3rd) of rotational directors, i.e. 1/3rd of 5, i.e. 1.66. Since nearest to 1.66 is 2, two directors shall retire from the office at the ensuing annual general meeting. The directors who have been longest in office shall retire first. The retiring directors shall be eligible for reappointment.

Tutorial Note:

In exams, the Students should expressly state the assumption chosen by them, whether it be 4 rotational directors or 5 rotational directors. The Author suggests the students to assume rotational directors to be 4.

A company has 6 rotational directors – How many directors are liable to retire?

P 1.15B. ABC Company Ltd. in its first general meeting appointed six directors whose period of office is liable to be determined by rotation. Briefly explain the procedure and rules regarding retirement of these directors. Will it make any difference, if ABC Company Ltd. does not carry on business for profit? [CA (Final) Nov. 2002]

Ans. Not less than 2/3rd of total number of directors shall be the directors whose period of office is liable to determination by retirement by rotation (any fraction contained in that 2/3rd shall be rounded off as 1).

Such directors are referred to as rotational directors. However, the articles of a company may provide for greater number of rotational directors. Further, the articles of a company may provide that all the directors shall be rotational directors [Section 152(6)].

As per 152(6), at the first annual general meeting and every subsequent annual general meeting, 1/3rd (or nearest to 1/3rd) of directors liable to retire by rotation shall retire from the office. The directors liable to retire by rotation shall be those who have been longest in the office. In case, two or more directors were appointed on the same day, the directors liable to retire shall be determined by an agreement between them. In the absence of any such agreement, their names shall be determined by lots.

In the given case, it is given that the first general meeting has appointed 6 directors whose period of office is liable to be determined by rotation. It means that all the 6 directors appointed in the first general meeting shall be the rotational directors. Therefore, 2 directors (1/3rd of 6) shall retire at the ensuing annual general meeting. The two directors liable to retire shall be those who have been longest in office. In case, 2 or more directors were appointed on the same day, the directors liable to retire shall be determined by an agreement between them. In the absence of any such agreement, their names shall be determined by lots. These directors shall be eligible for reappointment.

A separate resolution shall be moved for reappointment of both the directors (Section 162).

Section 152(6) does not make any special provision in case of Non-Profit Companies. Thus, the same provisions, as discussed above, shall apply even where ABC Company Ltd. does not carry on business for profit.

Adjournment of AGM due to disturbances – Implications

P 1.15C. Is it possible for a retiring director to continue in his office beyond the date of the annual general meeting which had to be adjourned due to disturbances at the meeting? Explain. [CA (Final) May 1998]

Ans. The given problem relates to section 152(6), 152(7) of the Companies Act, 2013 and the decision given in ***B R Kundra v Motion Pictures Association***, as discussed below:

The legal position

1. At every annual general meeting, 1/3rd (or nearest to 1/3rd) of rotational directors shall retire from office [Section 152(6)].
2. If the place of retiring director is not filled and the meeting has not resolved not to fill the vacancy, the meeting shall be adjourned automatically to the next week at the same time and place or if that day is a national holiday, then to next succeeding day which is not a holiday. If at the adjourned meeting also, the place of retiring director is not filled and the meeting has not resolved not to fill the vacancy, the retiring directors shall be deemed to be reappointed [Section 152(7)].

3. Where a company does not hold AGM upto the last due date, the directors liable to retire at the AGM shall have to vacate their offices on the last day AGM ought to have been held **[*B.R. Kundra* v *Motion Pictures Association* (1976) 46 Comp Cas 339]**.

The given case

4. The annual general meeting has been duly convened, *i.e.* the directors have fulfilled their obligation of convening the annual general meeting, and so the decision given in ***B.R. Kundra* v *Motion Pictures Association*** shall not apply in this case. Pending the decision in the annual general meeting, a retiring director can continue in office even after the date of annual general meeting. His reappointment depends upon the decision taken in the adjourned annual general meeting and may be discussed as follows:
   (a) If the adjourned meeting resolves to reappoint him, he shall be reappointed.
   (b) If the resolution for the reappointment of retiring director is lost in the adjourned annual general meeting, he shall not be reappointed.
   (c) If no resolution is passed at the adjourned meeting relating to his appointment and the adjourned meeting does not resolve not to fill the vacancy, he shall be automatically reappointed. However, the automatic reappointment shall not apply in the following cases:
      (i) Where a resolution for his appointment was put and lost.
      (ii) Where a resolution is required for his appointment.
      (iii) Where he is disqualified for appointment.
      (iv) Where the retiring director has, in writing, expressed his unwillingness to be reappointed.
      (v) Where appointment of 2 or more directors is made by a single resolution passed in contravention of section 162.

Conclusion

5. The retiring director can continue in office after the date of the annual general meeting. If in the adjourned annual general meeting also, the place of retiring director is not filled up and the meeting has not resolved not to fill the vacancy, he shall be deemed to be reappointed except in five cases, as discussed above.

Computation of number of non-rotational directors and directors liable to retire by rotation

P 1.15D. The promoters of a public company propose to have the strength of the Board of directors as eleven. They also propose to make the managing director and whole time directors as directors not liable to retire by rotation. They seek your advice on the following matters:

(i) Maximum number of persons, who can be appointed as directors not liable to retire by rotation.

(ii) How many of the remaining directors will have to retire by rotation every year at the annual general meeting?

[CA (Final) Nov. 2002]

Ans. As per section 152(6), not less than 2/3rd of total number of directors shall be the directors whose period of office is liable to determination by retirement by rotation (any fraction contained in that 2/3rd shall be rounded off as 1). Such directors are referred to as rotational directors. However, the articles of a company may provide for greater number of rotational directors. In other words, in no case, the number of non-rotational directors shall exceed 1/3rd of total number of directors.

As per section 152(6), at the first annual general meeting and every subsequent annual general meeting, 1/3rd (or nearest to 1/3rd) of directors liable to retire by rotation shall retire from the office.

Applying the provisions of section 152(6) to the given case –

(i) At least 8 directors shall be rotational directors (2/3rd of 11 is 7.33; taken as 8 since *not less than* 2/3rd of total directors shall be rotational directors). Accordingly, only 3 directors can be appointed as non-rotational directors. Therefore, it is permissible to appoint managing director and whole time director as non-rotational directors.

(ii) In case 3 directors are appointed as non-rotational directors, 1/3rd of rotational directors shall retire at the ensuing annual general meeting, i.e. 3 directors (1/3 of 8 is 2.67; *nearest to* 2.67 is 3). These 3 directors shall be eligible for reappointment.

Various issues relating to retirement, reappointment and automatic reappointment

P 1.15E. Annual general meeting of Hero Ltd. has been scheduled in compliance with the requirements of the Companies Act, 2013. In this connection, it has some directors who are rotational and out of which some have been appointed long back, some have been appointed on the same day.

Decide in this connection,

(i) Which of the directors shall be retiring by rotation and be eligible for re-election?

(ii) In case two directors were appointed on the same day, how would you decide their retirement by rotation?

(iii) In case the meeting could not decide how the vacancies caused by retirement to be dealt with, what shall be consequences?

(iv) What will be your answer, assuming that the matter could not be decided even at the adjourned meeting?

[CA (Final) May 2011]

Ans. The provisions relating to rotational directors, retirement of directors, reappointment of directors and automatic reappointment are contained in section 152(6) and (7) of the Companies Act, 2013. Applying these provisions, the given problem is answered as under:

(i) Not less than 2/3rd of total number of directors (any fraction contained in that 2/3rd shall be rounded off as one) shall be rotational directors. Out of these rotational directors, 1/3rd (or nearest to 1/3rd) shall retire from office at every annual general meeting. A director retiring by rotation may be reappointed at the same annual general meeting. However, the company may, instead of reappointing the retiring director, appoint some other person.

(ii) The directors liable to retire by rotation shall be those who have been longest in the office. In case, two or more directors were appointed on the same day, the names of directors liable to retire shall be determined –
  (a) as per any agreement between them; or
  (b) by lots, in the absence of any such agreement.

(iii) If, at the AGM, the vacancy in the place of retiring director is not filled up and the meeting has not resolved not to fill the vacancy, the AGM shall adjourn to the next week at the same time and place or if that day is a national holiday, then to next succeeding day which is not a holiday.

(iv) If at the adjourned AGM also, the vacancy in the place of retiring director is not filled up and the meeting has not resolved not to fill the vacancy, the retiring director shall be deemed to be reappointed. However, at an adjourned AGM, a retiring director shall not be deemed to be automatically reappointed in the following cases:
  - Where a resolution for the reappointment of such director was put and lost.
  - Where the retiring director has, in writing, expressed his unwillingness to be reappointed.
  - Where he is not qualified or is disqualified for appointment.
  - Where a resolution is required for his reappointment.
  - Where appointment of 2 or more directors is made by a single resolution passed in contravention of section 162.

Various issues relating to automatic reappointment and non-holding of AGM

P 1.15F. Two (2) out of Ten (10) directors on the Board of XYZ Limited have retired by rotation at an Annual General Meeting. These two (2) vacancies or place of retiring directors is not filled up and the meeting has also not expressly resolved 'not to fill the vacancy'. Since the AGM could not complete its business, it is adjourned to a later date.

Neither place of retiring directors could be filled up at this adjourned meeting nor did the meeting expressly resolve, 'not to fill the vacancy'. Analyse & apply relevant provisions of the Companies Act, 2013 and decide:

(i) Whether in such a situation the retiring directors shall be deemed to have been reappointed at the adjourned meeting?

(ii) What will be your answer in case at the adjourned meeting, the resolutions for reappointment of these directors were lost?

(iii) Whether such directors can continue in case the directors do not call the Annual General Meeting? [CA (Final) May 2019]

OR

ADJ Company Limited has 10 directors on its board. Two of the directors have retired by rotation at an Annual General Meeting. The place of retiring directors is not so filled up and the meeting has also not expressly resolved 'not to fill the vacancy'. Since the AGM could not complete its business, it is adjourned to a later date. At this adjourned meeting also the place of retiring directors could not be filled up, and the meeting has also not expressly resolved 'not to fill the vacancy'.

(i) Whether in such a situation the retiring directors shall be deemed to have been re-appointed at the adjourned meeting?

(ii) What will be your answer in case at the adjourned meeting, the resolutions for re-appointment of these directors were lost?

(iii) Whether such directors can continue in case the directors do not call the Annual General Meeting? [CA (Final) May 2010]

Ans. The provisions relating to automatic reappointment are contained in section 152(7) of the Companies Act, 2013. Applying these provisions, the given problem is answered as under:

(i) As per Section 152(7), if the vacancy in the place of retiring director is not filled up and the meeting has not resolved not to fill the vacancy, the annual general meeting shall adjourn to the next week at the same time and place or if that day is a national holiday, then to next succeeding day which is not a holiday.

If at the adjourned meeting also, the vacancy in the place of retiring director is not filled up and the meeting has not resolved not to fill the vacancy, the retiring director shall be deemed to be reappointed.

Thus, in the given case, both the retiring directors shall be deemed to have been reappointed at the adjourned annual general meeting.

(ii) In case at the adjourned meeting, the resolutions for reappointment of retiring directors were lost, there is no question of reappointment or deemed reappointment. They shall have to vacate their offices.

(iii) In case the AGM is not called, the directors liable to retire cannot continue beyond the last day the AGM ought to have been held, and so their offices shall be vacated. The reason for this is that, as the calling of the AGM is a duty and responsibility of the directors, the directors by omitting to call the AGM, should not take advantage of their own default and, by that means, extend their own period of office **[*B. R. Kundra* v *Motion Pictures Association*]**.

Difference in answer as compared to the answer given by ICAI

The decision in ***B. R. Kundra* v *Motion Pictures Association*** was given under the provisions of the Companies Act, 1956. In the opinion of the Author, the same decision shall apply under the Companies Act, 2013 since the provisions relating to retirement of directors and deemed reappointment are same under the Companies Act, 1956 (*i.e.* Section 256) and the Companies Act, 2013 [*i.e.* Section 152(7)].

The Author's answer, as given above, differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI for May, 2019 Exams. The answer given in the Suggested Answers for May, 2019 Exams is as under:

"Section 152(6)(c) states that 1/3rd of the rotational directors shall retire at every AGM. They retire at the AGM and at its conclusion. Hence, they will retire as soon as the AGM is held. Further, as per section 96 (dealing with annual General Meeting) of the Companies Act, 2013, every company other than a One Person Company shall in each year hold an Annual General Meeting. Hence, it is necessary for the company to hold the AGM, whereby these directors will be liable to retire by rotation.

Further Section 97 states that, if any default is made in holding the annual general meeting of a company under section 96, the Tribunal may, on the application of any member of the company, call, or direct the calling of, an annual general meeting of the company. Such general Meeting shall be deemed to be an annual general meeting of the company under this Act."

The answer given in the Suggested Answers for May, 2019 Exams does not clearly state as to whether the directors liable to retire can continue beyond the last due date of the AGM or they will have to vacate their offices on the last date AGM was due to be held.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Number of directors due to retire in the AGM, and consequences where no resolution reappointing a director is passed

P 1.15G. A and B were appointed as first directors on 4th April, 2014 in Sun Glass Ltd. Thereafter, C, D and E were appointed as directors on 6th July 2014 and F, G and H were also appointed as directors on 7th August 2014 in the company. In the Annual General meeting (AGM) of the company held after the above appointments, A and B were proposed to be retired by rotation and re-appointed as directors.

At the AGM, resolution for A's retirement and re-appointment was passed. However, before the resolution for 'B' could be taken up for consideration, the meeting was adjourned. In the adjourned meeting also, the said resolution could not be taken up and the meeting was ended without passing the resolution for B's retirement and reappointment.

In the light of above and with reference to relevant provision of the Companies Act, 2013, answer the following:

(i) Whether proposals for retirement by rotation and re-appointment of A and B only were sufficient?

(ii) What will be the status of B as a director in the company? [CA (Final) Nov. 2015]

Ans. The provisions relating to retirement of directors and reappointment of retiring directors are contained in section 152(6) and 152(7) of the Companies Act, 2013. Applying these provisions, the given problem is answered as under:

(i) Calculation of number of directors due to retire in the next AGM:

(a) Total number of directors of the company: 8

(b) Number of rotational directors: Not less than 2/3rd of 8, *i.e.* not less than 5.33, i.e. 6.

(c) Number of directors due to retire in the AGM: 1/3rd of 6, i.e. 2.

(d) Directors who are due to retire: Those directors who have been longest in office, i.e. A and B.

Thus, the proposal to retire and reappoint only 2 directors (*i.e.* Mr. A and Mr. B) is valid.

(ii) If, at the AGM, the vacancy in the place of retiring director is not filled up and the meeting has not resolved not to fill the vacancy, the AGM shall adjourn to the next week at the same time and place or if that day is a national holiday, then to next succeeding day which is not a holiday.

If at the adjourned AGM also, the vacancy in the place of retiring director is not filled up and the meeting has not resolved not to fill the vacancy, the retiring director shall be deemed to be reappointed. However, at an adjourned AGM, a retiring director shall not be deemed to be automatically reappointed in the following cases:

- Where a resolution for the reappointment of such director was put and lost.
- Where the retiring director has, in writing, expressed his unwillingness to be reappointed.
- Where he is not qualified or is disqualified for appointment.
- Where a resolution is required for his reappointment.
- Where appointment of 2 or more directors is made by a single resolution passed in contravention of section 162.

In the given case, the AGM was adjourned without filling the vacancy in place of Mr. B. Also, at the adjourned AGM, the vacancy in the place of Mr. B was not filled up. Neither the AGM nor the adjourned AGM resolved not to fill the vacancy. Since the given case does not fall under any of the 5 exceptional cases as stated above, Mr. B shall be deemed to be reappointed.

Computation of number of non-rotational directors and directors liable to retire by rotation, whether notice received under section 160 is valid if it is received after issue of notice of AGM, and whether Board is empowered to increase the strength of directors to 18 by appointing additional directors by a single resolution?

P 1.15H. The promoters of M/s Frontline Limited a listed public company propose to have the strength of the Board of directors as eleven. They also propose to make the Managing Director and whole time directors as directors not liable to retire by rotation. Advise on the following matters as per the provisions of the Companies Act, 2013:

(i) Maximum number of persons, who can be appointed as directors not liable to retire by rotation.

(ii) How many of the remaining directors will have to retire by rotation every year at the Annual General Meeting (AGM)?

(iii) For the purpose of increasing the strength, certain nominations were received to nominate candidates for contesting elections. One of the nominations was rejected by the directors as it was received after sending the notice of AGM and that too after the working hours of the last day on which nomination should have been received.

(iv) Can the Board of Directors increase the strength of Companies' directors to 18 from 11 by appointing additional directors through passing single resolution? [CA (Final) May 2018]

Ans. The given problem relates to section 152(6), section 160 read with section 101, section 149(1) and section 162 of the Companies Act, 2013, as discussed below:

The legal position

1. As per section 152(6), not less than 2/3rd of total number of directors shall be the directors whose period of office is liable to determination by retirement by rotation (any fraction contained in that 2/3rd shall be rounded off as 1). Such directors are referred to as rotational directors. However, the articles of a company may provide for greater number of rotational directors. In other words, in no case, the number of non-rotational directors shall exceed 1/3rd of total number of directors.
2. As per section 152(6), at the first annual general meeting and every subsequent annual general meeting, 1/3rd (or nearest to 1/3rd) of directors liable to retire by rotation shall retire from the office.
3. Section 160 recognises the right of a person, who is not a retiring director, to stand for directorship. A notice received under section 160 shall be valid, if it complies with the following requirements:
   (a) The notice is given *at least* 14 days before the general meeting.
   (b) It is deposited at the registered office of the company.
   (c) The notice is signed by the person eligible to give notice.
   (d) A sum of Rs. 1 lakh or such higher amount as may be prescribed, is deposited along with the notice.
4. As per section 149(1), a company shall have a maximum of 15 directors. However, a company may appoint more than 15 directors by passing a special resolution.
5. As per section 162, at a general meeting, two or more persons cannot be appointed as directors by a single resolution unless a resolution that appointment shall be so made has first been agreed to by the meeting without any vote being cast against it.

The given case, analysis of the case and conclusion

(i) At least 8 directors shall be rotational directors (2/3rd of 11 is 7.33; taken as 8 since not less than 2/3rd of total directors shall be rotational directors). Accordingly, maximum 3 directors can be appointed as non-rotational directors. Therefore, it is permissible to appoint managing director and whole time director as non-rotational directors.

(ii) 1/3rd of rotational directors shall retire at the ensuing annual general meeting. In case 8 directors are appointed as rotational directors, the directors liable to retire by rotation at the annual general meeting shall be 3 (1/3 of 8 is 2.67; nearest to 2.67 is 3). These 3 directors shall be eligible for reappointment.

(iii) As per section 101, the notice of every general meeting shall be sent by the company to the members at least 21 clear days before the meeting. However, section 160 does not require that the notice to be given to the company under section 160 must be received by the company before issue of notice of the general meeting by the company.

In the present case, one of the nominations under section 160 has been received by the company after the notice of AGM was issued by the company. Further, such nomination was received after the working hours of the last day on which nomination should have been received. Such nomination has been rejected by the directors, as the directors consider that such nomination is not valid as per section 160.

An analysis of the provisions of section 160 and section 101 shows that the nomination under section 160 need not be received by the company before issue of notice of AGM by the company. The nomination received by the company shall be valid if it is received by the company at least 14 days before the date of the general meeting. Further, there is no such requirement that the nomination has to be received within the working hours of the last day for receipt of nominations.

Thus, the decision to reject such nomination is not valid.

Difference in answer as compared to the answer given by ICAI

The Author's answer to this question differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. The relevant portion of the answer given in the Suggested Answers is as under:

"In the instant case, one nomination was rejected by the directors as it was received after sending the notice of AGM and that too after the working hours of the last day on which nomination should have been received *i.e.* 14th day. Hence, the contention of the directors are valid."

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

(iv) The Board is not empowered to increase the strength of directors to 18, since any increase in number of directors beyond 15 requires the approval of the members by a special resolution.

Thus, the Board can increase the strength of directors to 18, only after a special resolution authorising the number of directors to 18 or more, is passed in the general meeting.

Once a special resolution has been passed permitting the number of directors to 18 or more, the Board may increase the strength of directors to 18 by appointing the additional directors. Further such additional directors may be appointed by passing a single resolution, since the appointment of additional directors is made by the Board, and not in general meeting, and so the provisions of section 162 shall not be attracted as section 162 applies only in case of appointment of directors in general meeting.

Difference in answer as compared to the answer given by ICAI

The Author's answer to this question differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. The relevant portion of the answer given in the Suggested Answers is as under:

"According to Section 149(1) of the Companies Act, 2013, if the company wants to appoint more than 15 directors, it can do so after passing a special resolution. Hence, the Board of directors of Frontline Limited, before increasing the strength of directors from 11 to 18 by appointing additional directors, have to pass a special resolution.

But, these appointments cannot be done through single resolution. Each director shall be appointed by a separate resolution unless the meeting first agreed that the appointment shall be made by a single resolution and no vote has been cast against such agreement. A resolution moved in contravention of this provision shall be void, whether or not objection thereto was raised at the time it was so moved. [Section 162 of the Act]."

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Practical Problems from CS Examinations

AGM not held – Can retiring directors continue in office?

P 1.15I. The annual general meeting of a company for the financial year 2014-2015 was held on 30th September, 2015. Till 30th September, 2016, the company does not hold any annual general meeting for the financial year 2015-2016. R, S and T are the directors liable to retire at the annual general meeting. Can they continue in office? [CS (Final) Dec. 1997; Dec. 1999 (Modified)]

Ans. At every annual general meeting, 1/3rd (or nearest to 1/3rd) of rotational directors shall retire from office [Section 152(6)]. As a general rule, the directors who are liable to retire at an annual general meeting cannot continue in office after the last day on which the annual general meeting should have been held. This is because the calling of annual general meeting is a duty and responsibility of the directors. They cannot, by omitting to call the annual general meeting, take advantage of their own default and by that means extend their tenure of office **[*B.R. Kundra* v *Motion Pictures Association* (1976) 46 Comp Cas 339]**. Also, the rule of automatic reappointment does not apply to a case where annual general meeting is not held.

As per section 96, the annual general meeting of a company must be held –

(a) within 6 months of close of the financial year; and

(b) not later than 15 months from the date of its previous annual general meeting.

However, the Registrar has the power to grant extension of time for holding the annual general meeting by a period not exceeding 3 months.

The answer to the given problem is as under:

(a) For the financial year 2015-2016, the annual general meeting must be held on or before 30th September, 2016. If it is not so held, the directors, R, S and T shall cease to hold their offices on 30th September, 2016. Their continuance beyond this date shall be invalid.

(b) However, if the Registrar grants extension of time for holding the annual general meeting, the annual general meeting may be held upto 31.12.2016, and so the directors can continue in office till that date. However, if the annual general meeting is not held upto 31.12.2016 (where extension is granted), the directors, R, S and T shall cease to hold their offices on 31.12.2016.

1.16 Right of persons other than retiring directors to stand for directorship (Section 160 and Rule 13)

Section 160 recognises the right of a person, who is not a retiring director, to stand for directorship. 'Retiring director' means a director retiring by rotation [Explanation to section 152(7)]. In other words, any person (other than a director retiring by rotation) may stand for directorship by complying with the provisions of section 160.

1. Person eligible to give notice for directorship

(a) A person (whether or not he is a member of the company) may give a notice of his own candidature, *i.e.* he may, by serving a notice in accordance with the provisions of section 160, propose his own appointment as a director.

(b) A member may give a notice of the candidature of any other person.

2. Requirements of notice

(a) The notice shall be given at least 14 days before the general meeting.

(b) The notice shall be deposited at the registered office of the company.

(c) The notice shall be signed.

(d) A sum of Rs. 1 lakh or such higher amount as may be prescribed, shall be deposited along with the notice.

1. Refund of deposit

The amount deposited with the company shall be refunded, if the person proposed as a director –

(i) gets elected as a director (*i.e.* if an ordinary resolution is passed for his appointment); or

(ii) gets more than 25% of the total valid votes cast (whether on a show of hands or on poll).

2. Forfeiture of deposit in case of Section 8 Companies

As per General Circular No. 38/2014 dated 14th October, 2014, where a person fails to secure more than 25% of the valid votes, the Board of directors of a section 8 company may decide as to whether the deposit made by such person is to be forfeited or refunded.

3. No requirement of deposit in certain cases

The requirement of deposit of Rs. 1 lakh shall not apply –

(a) in case of appointment of an independent director; or

(b) to a director recommended by the Nomination and Remuneration Committee constituted under section 178; or

(c) to a director recommended by the Board of directors of the company, in the case of a company not required to constitute Nomination and Remuneration Committee.

3. Duty of the company to inform its members

The company shall inform its members about the candidature of the person proposed as a director in such manner as may be prescribed.

Rule 13 of the Companies (Appointment and Qualification of Directors) Rules, 2014, prescribes the following procedure in this regard:

(a) Time limit for informing the members. The company shall inform its members about the candidature of the person proposed as a director at least 7 days before the general meeting.

(b) Manner of informing the members. The company shall inform its members by –

(i) 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

(ii) by placing notice of such candidature on the website of the company, if any.

(c) Exemption from serving individual notices. The company shall not be required to serve individual notices on the members (through electronic mode as well as by writing), if the company advertises the candidature of the proposed director at least 7 days before the general meeting, –

(i) 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

(ii) at least once in English language in an English newspaper circulating in the district in which the registered office of the company is situated.

4. Non-applicability of sections 101 and 102

Seven days' notice given by the company to its members in accordance with the provisions of section 160 shall be valid notwithstanding the fact that it does not comply with the requirement of *at least 21 days'* notice as specified under section 101, and does not contain the explanatory statement as required under section 102.

1. Scope of section 160

'Retiring director' means a director retiring by rotation [Explanation to section 152(7)]. Therefore, following implications may be drawn:

(a) An additional director, a director filling a casual vacancy, an alternate director or a nominee director is not a 'retiring director'. Thus, appointment of any such director as a regular director (*i.e.* appointment as a director by the members at a general meeting) requires compliance with section 160.

(b) Where a director retires by rotation and the company, instead of reappointing the retiring director, intends to appoint any other person in his place, compliance with section 160 is required.

(c) Section 160 empowers a company to make fresh appointment of directors, *i.e.* the strength of the Board may be increased by making use of section 160.

2. **Applicability of section 160 at any general meeting**
   Section 160 enables a person to stand for directorship at any general meeting, and not necessarily at an annual general meeting only **[*Re, Motion Pictures Association* (1974) 44 Comp Cas 298]**.
3. **Articles cannot take statutory right given under section 160**
   A company cannot, by its articles, take away the statutory right given under section 160. *In other words*, a person's right to give notice to stand for directorship is not affected by any contrary provision contained in the articles.
4. **Effect of non-compliance**
   The provisions of section 160 are mandatory. Non-compliance of procedure prescribed under section 160 would render the appointment invalid. Where the company failed to inform to its members about the candidature of the person proposed as a director, the appointment of director was held to be invalid **[*Namita Gupta* v *Cachar Native Joint Stock Co. Ltd.* (1999) 34 CLA 287]**
5. **Non-applicability of section 160**
   (a) The provisions of section 160 shall not apply to a private company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 464(E) dated 5th June, 2015].
   (b) As per Notification No. G.S.R. 463(E) dated 5th June, 2015, the provisions of section 160 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 that Government company,

      if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92
   (c) The provisions of section 160 shall not apply to a company licenced under section 8 whose articles provide for election of directors by ballot if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015].

Theoretical Questions from CA Examinations

Q 1.16A. The management of ATP Ltd., a company listed with The Stock Exchange, Mumbai wants to appoint Mr. BDF as a director of the company at the Annual General Meeting of the company to be held on 24th May, 2014. It may be noted that Mr. BDF is not a retiring director. The management seeks your guidance regarding the procedure to be adopted for the purpose. You are required to state the procedure to be followed for giving effect to such proposal and formalities to be observed after appointment of Mr. BDF as director, by the management of ATP Ltd., as per the provisions of the Companies Act, 2013. [CA (Final) May 2007 (Modified)]

Practical Problems from CA Examinations

Notice u/s 160 received after issue of notice of AGM – Whether valid?

P 1.16A. Notice has been received from a member proposing himself for appointment as a director after the issue of notice convening the annual general meeting. As a secretary of a public company, how will you deal with the above situation?

[CA (Final) Nov. 1999]

Ans. Section 160 recognises the right of a person, who is not a retiring director, to stand for directorship. A notice received under section 160 shall be valid, if it complies with the following requirements:

- The notice is given at least 14 days before the general meeting.
- It is deposited at the registered office of the company.
- The notice is signed by the person eligible to give notice.
- A sum of Rs. 1 lakh or such higher amount as may be prescribed, is deposited along with the notice.

As per section 101, the notice of every general meeting shall be sent by the company to the members at least 21 clear days before the meeting. However, section 160 does not require that the notice to be given to the company under section 160 must be received by the company before issue of notice of the general meeting by the company.

In the present case, the notice under section 160 has been received by the company from a member after the company has issued the notice of the annual general meeting. The notice given by the member shall be in accordance with the provisions of section 160 if it is received by the company at least 14 days before the general meeting and the notice complies with other requirements of section 160. In case, the notice given by the member is in accordance with the provisions of section 160, the company shall inform its members about the candidature of the proposed director by serving individual notices or by advertisement in accordance with the provisions of section 160 read with Rule 13 of the Companies (Appointment and Qualification of ...) Rules, 2014.

Person proposed as director fails to get elected as a director, but receives 30% of total votes cast – Is he entitled to receive deposit of Rs. 1 lakh?

P 1.16B. Mr. D, proposes his candidature as a director in X Ltd. along with the deposit of 1 lac rupees. Later Mr. D failed to be appointed but received 30% of total votes. Mr. D asked X Ltd. to refund the deposit but the company denied to pay as he failed to be elected. [ICAI, Mock Test Paper, October 2018]

Ans. The given problem relates to section 160 of the Companies Act, 2013. Where a person who is not a retiring director serves on the company a notice of his candidature proposing himself as a director, he is required to deposit a sum of Rs. 1 lakh with the company along with such notice.

The amount deposited with the company shall be refunded, if the person proposed as a director –

(i) gets elected as a director (*i.e.* if an ordinary resolution is passed for his appointment); or

(ii) gets more than 25% of the total valid votes cast (whether on a show of hands or on poll).

In the given case, Mr. D has deposited a sum of Rs. 1 lakh with the company, but he failed to get elected as a director. However, Mr. D secured 30% of total valid votes, *i.e.* the condition of securing more than 25% of total valid votes cast, has been satisfied.

Therefore, Mr. D is entitled to refund of Rs. 1 lakh deposited with the company. Accordingly, the decision of the company not to refund Rs. 1 lakh to Mr. D is not valid.

1.17 Appointment of directors by proportional representation (Section 163)

1. Need for proportional representation

Generally, the appointment of directors is made by the simple majority of shareholders. Thus, it may result in appointment of all the directors by a majority of shareholders and a substantial minority may not be able to place even a single director on the Board. Consequently, this is a major handicap in the exercise of rights of minority shareholders. To overcome this handicap, section 163 provides for appointment of directors by way of proportional representation which enables a minority of respectable strength to elect its representatives and at the same time the majority shareholders retain their right to appoint the directors in proportion to their voting strength.

2. Condition for making appointments by proportional representation

Specific provision in the articles is required for appointment of directors by proportional representation. The articles must contain the detailed provisions prescribing the procedure for appointment of directors by this method.

3. Number of directors

Where a company adopts this method, not less than 2/3rd of the total number of directors shall be appointed by proportional representation.

4. Periodicity of appointments

The appointment of directors by proportional representation shall be made once in every 3 years.

5. Modes of voting

Any of the following modes of voting may be adopted for appointing the directors by proportional representation:

(a) Voting by single transferable vote

(b) Cumulative voting

(c) Any other method.

The terms 'single transferable vote' and 'cumulative voting' have not been defined in any provision of the Companies Act, 2013. However, as per the practices adopted in the corporate world, these terms are generally understood as under:

1. **Single transferable vote**

   In 'single transferable vote', the names of all the candidates contesting the elections are entered in a ballot paper. Irrespective of his shareholding, every member is entitled to cast his vote in favour of one or more candidates in the order of his preference, *i.e.* first preference vote, second preference vote, third preference vote, etc. A candidate who secures votes equal to 'quota' gets elected, and his surplus / unused votes are transferred to other candidate in accordance with the preference stated by the voting member.

2. **Cumulative voting**

   In this system, the number of votes to which each member is entitled to, is arrived at by multiplying the number of shares held by him by the number of directors to be elected. A member may cast all his votes in favour of one candidate only, or may distribute his votes among 2 or more candidates.

   Example: A company decides to elect 8 directors by proportional representation out of 15 candidates contesting the elections. Mr. A, a member has 1,000 shares. Mr. A shall be entitled to cast 8,000 votes. Mr. A may cast all his 8,000 votes in favour of any one candidate, or may distribute his 8,000 votes among 2 or more than 2 candidates.

6. Mode of filling casual vacancies

In case of any casual vacancy, the provisions of section 161(4) shall apply, *i.e.* any casual vacancy may be filled in accordance with the provisions contained in the articles, and in the absence of any provision in the articles, the casual vacancy may be filled by the Board by passing a resolution at a Board meeting, and the appointment made by the Board shall be subsequently approved by the members in the immediately next general meeting.

1. Non-applicability

As per Notification No. G.S.R. 463(E) dated 5th June, 2015, the provisions of section 163 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 that Government company,

if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

2. Provisions contained in Table F

Table F does not contain any provision for appointment of directors by proportional representation.

3. Over-riding effect of Section 163

Section 163 overrides the entire Companies Act, 2013.

Theoretical Questions from CS Examinations

Q 1.17A. A company has in its articles of association provided for appointment of not less than two-thirds of the total number of its directors according to the principle of proportional representation. Can the directors so appointed be removed by the company in general meeting? [CS (Final) Dec. 1995]

1.18 Appointment of woman director (Second proviso to sub-section (1) of section 149 and Rule 3)

1. Applicability

Such class(es) of companies as may be prescribed, shall have at least 1 woman director.

Prescribed classes of companies (Rule 3)

(i) Every listed company; and

(ii) Every public company having paid up share capital of Rs. 100 crore or more; and

(iii) Every public company having turnover of Rs. 300 crore or more.

For this purpose, the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

2. Time within which appointment shall be made (Rule 3)

Every company which is incorporated under the Companies Act, 2013 and is covered in the prescribed class(es) of companies, shall appoint at least 1 woman director within 6 months of its incorporation.

3. Filling of vacancies (Rule 3)

Any vacancy in the office of a woman director shall be filled-up by the Board at the earliest but not later than –

(i) immediately next Board meeting; or

(ii) 3 months from the date of such vacancy,

whichever is later.

Where a company has two or more woman directors, and vacancy arises in the office of one or more woman directors such that at least one woman director continues to be in office, the company may decide not to fill such vacancy or vacancies, and in case the company decides to fill such vacancy or vacancies, such vacancy or vacancies may be filled up by appointing a woman director or a person other than a woman director.

However, if there is only one woman director, and the vacancy arises in the office of such woman director, the company shall have to fill such vacancy by appointing a woman director only.

4. Legal requirements for existing companies

Every company existing on or before the date of commencement of the Companies Act, 2013 (which falls under the prescribed class(es) of companies as per Rule 3), shall appoint at least 1 woman director within 1 year from such commencement, *i.e.* such appointment shall be made on or before 31.03.2015.

Practical Problems from CA Examinations

Whether vacancy in the office of woman director has been validly filled up?

P 1.18A. Examine the validity of the following appointment with reference to the provisions of the Companies Act, 2013:

The Board of Directors of MNP Limited appointed Ms. Neha as a Women Director in the Board Meeting held on 10th September, 2014. The said appointment was made to fill the vacancy of the woman director, which had occurred as a result of resignation of Ms. Sheela on 30th June, 2014.

Will your answer differ if the Board Meeting of the company was held on 8th November, 2014? [CA (Final) May, 2015]

Ans. The provisions relating to woman director are contained in second proviso to sub-section (1) of section 149 of the Companies Act, 2013 read with Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014. As per these provisions, any vacancy in the office of a woman director shall be filled-up by the Board at the earliest but not later than –

(i) immediately next Board meeting; or

(ii) 3 months from the date of such vacancy,

whichever is later.

In the given case, vacancy in the office of Ms. Sheela arose on 30th June, 2014. The period of 3 months (from the date of vacancy) shall expire on 30th September, 2014 (the date on which the vacancy arose *i.e.* 30th June, 2014 shall be excluded, and therefore, the period of 3 months shall start from 1st July, 2014 and end on 30th September, 2014).

The vacancy in the office of Ms. Sheela has been filled by the Board by appointing Ms. Neha in the Board meeting held on 10th September, 2014. The said appointment has been made within a period of 3 months from the date of the vacancy, and so the said appointment has been validly made. Even if the Board meeting held on 10th September, 2014 is not the first Board meeting held after the vacancy arose (*i.e.* 30th June, 2014), the said appointment is valid, since the vacancy has been filled up within 3 months.

If the vacancy is filled up on 8th November, 2014 instead of 10th September, 2014, the said appointment shall be valid only if the Board meeting held on 8th November, 2014 is the first Board meeting held after 30th June, 2014.

Author's Note:

Section 173(1) requires a company to hold at least 4 Board meetings in every calendar year, and the gap between any 2 consecutive Board meetings shall not be more than 120 days.

In the given question, if the vacancy is filled up in a Board meeting held on 8th November, 2014, and such Board meeting is the first Board meeting held after 30th June, 2014, in such case there would be a contravention of the provisions of section 173(1). However, since the question asked in the exam required the students to answer only with respect to validity of appointment of Ms. Neha, the students need not mention contravention of section 173(1).

Difference in answer as compared to the answer given by ICAI

The Author's answer to this question differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. As per the answer given in the Suggested Answers, the 3 months' period from the date of creation of vacancy ends on 29th September, 2014.

The Author does not agree with the Answer given in the Suggested Answers. Since, there is no provision in the Companies Act, 2013 or in the Rules made thereunder with respect to calculation of time limits, the Author has applied the provisions contained in section 9 of the General Clauses Act, 1897 for calculating the period of 3 months from 30th June, 2014.

Section 9 of the General Clauses Act, 1897 reads as under:

"In any Central Act or Regulation made after the commencement of this Act, it shall be sufficient, for the purpose of excluding the first in a series of days or any other period of time, to use the word 'from', and for the purpose of including the last in a series of days or any other period of time, to use the word 'to'."

Applying section 9 of the General Clauses Act, 1897, it is clear that the date of creation of vacancy (*i.e.* 30th June, 2014) shall be excluded, and so the period of 3 months shall start from 1st July, 2015 and end on 30th September, 2014.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Time limit for filling vacancy in the office of woman director

P 1.18B. Sky Limited, a listed company has been incorporated under the Companies Act, 2013. An intermittent vacancy of a woman director has arisen on 15th June, 2016. Advise the company to fill the vacancy as per the provisions of the Companies Act, 2013. The Board meeting was held on 14th August, 2016. [CA (Final) Nov. 2016]

Ans. The provisions relating to woman director are contained in second proviso to sub-section (1) of section 149 of the Companies Act, 2013 read with Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014. As per these provisions, any vacancy in the office of a woman director shall be filled-up by the Board at the earliest but not later than–

(i) immediately next Board meeting; or

(ii) 3 months from the date of such vacancy,

whichever is later.

In the given case, vacancy in the office of a woman director arose on 15th June, 2016. The period of 3 months (from the date of vacancy) shall expire on 15th September, 2016 (the date on which the vacancy arose *i.e.* 15th June, 2016 shall be excluded, and therefore, the period of 3 months shall start from 16th June, 2016 and end on 15th September, 2016).

After the creation of vacancy in the office of woman director, the next Board meeting was held on 14th August, 2016.

Out of these two dates, *i.e.* 15th September, 2016 and 14th August, 2016, the later date is 15th September, 2016. So, if the vacancy in the office of woman director is filled on or before 15th September, 2016, it would be a sufficient compliance of second proviso to sub-section (1) of section 149 read with Rule 3.

Thus, the company may fill the vacancy in the office of woman director in the Board meeting held on 14th August, 2016 or any subsequent Board meeting to be held on or before 15th September, 2016.

Difference in answer as compared to the answer given by ICAI

The Author's answer to this question differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. As per the answer given in the Suggested Answers, the 3 months' period from the date of creation of vacancy ends on 14th September, 2016.

The Author does not agree with the Answer given in the Suggested Answers. Since, there is no provision in the Companies Act, 2013 or in the Rules made thereunder with respect to calculation of time limits, the Author has applied the provisions contained in section 9 of the General Clauses Act, 1897 for calculating the period of 3 months from 15th June, 2016.

Section 9 of the General Clauses Act, 1897 reads as under:

"In any Central Act or Regulation made after the commencement of this Act, it shall be sufficient, for the purpose of excluding the first in a series of days or any other period of time, to use the word 'from', and for the purpose of including the last in a series of days or any other period of time, to use the word 'to'."

Applying section 9 of the General Clauses Act, 1897, it is clear that the date of creation of vacancy (*i.e.* 15th June, 2016) shall be excluded, and so the period of 3 months shall start from 16th June, 2016 and end on 15th September, 2016.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Appointment of a practicing cost accountant as a woman director – Implications

P 1.18C. Referring to the provisions of the Companies Act, 2013, examine the validity of the following appointment of directors:

(a) Brown Limited, having a turnover of Rs. 60 crores in the financial yec 2016-17 appoints Ms. Rose as the woman director on 1st March 2017. Ms. Rose already holds directorship in twelve companies including ten public companies. She is whole time Cost Accountant in practice.

(b) Ms. Jasmine holds directorship in eight public companies including managing directorship in two companies and directorship in six companies. In addition, she also holds alternate directorship in three companies and independent directorship in three subsidiary companies of Brown Limited. [CA (Final) Nov. 2017]

OR

Excel Limited is a listed company with a turnover of Rs. 60 crore in the financial year 2017-2018. The company appoints Ms. W as the woman director on 1st March, 2018. Ms. W is already a director in 12 companies including 10 public companies. Also, Ms. W is a chartered accountant in practice. Evaluate in the light of the given facts, the validity of appointment of Ms. W in Excel Limited. [ICAI, RTP, May 2018; Mock Test Paper, April 2018]

Ans. The given problem relates to section 165(1) and second proviso to sub-section (1) of section 149 of the Companies Act, 2013 and Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

As per second proviso to sub-section (1) of section 149 read with Rule 3, it is mandatory for the following classes of companies to appoint one or more woman director:

(i) Every listed company; and

(ii) Every public company having paid up share capital of Rs. 100 crore or more; and

(iii) Every public company having turnover of Rs. 300 crore or more.

For this purpose, the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

As per section 165(1), –

(a) no person shall hold office as a director (including alternate directorships) in more than 20 companies, whether public or private.

(b) no person shall hold office as a director (including alternate directorships) in more than 10 public companies (including any private company which is either a holding company or a subsidiary company of a public company).

The provisions of section 165(1) shall not apply to a company licenced under section 8 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015].

The given problems are answered as under:

(a) The provisions relating to woman director are not applicable to Brown Limited since Brown Limited is not covered under second proviso to sub-section (1) of section 149 read with Rule 3. In the absence of adequate information, it has been assumed that Brown Limited is not a listed company, its turnover during the financial year 2015-16 (as per the audited financial statement) was less than Rs. 300 crore and its paid up capital as on 31.03.2016 (as per the audited financial statement) was less than Rs. 100 crore. The turnover of Brown Limited during the financial year is Rs. 60 crore, which is irrelevant for determining the applicability of provisions of woman director.

However, there is nothing in section 149 or any other provision of the Companies Act, 2013 which prevents a company from appointing a woman director, even if the provisions relating to woman director are not applicable to it.

Neither section 164 nor any other provision contained in the Companies Act, 2013 disqualifies for directorship any cost accountant in practice. Thus, for examining the validity of appointment of Ms. Rose as a director of Brown Limited, it is immaterial that Ms. Rose is a practicing cost accountant.

The number of directorships already held by Ms. Rose is 12, out of which directorships held in public companies are 10. As per section 165(1), it is not permissible for any person to hold more than 10 directorships of public companies. However, any directorship in a company licenced under section 8 is not counted for the purpose of section 165(1).

The appointment of Ms. Rose as a director of Brown Limited would result in holding of 11 directorships of public companies, which is in contravention of section 165(1). However, there would be no contravention if out of these 11 public companies, any public company is a company licenced under section 8 if such section 8 company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

Also there would be no contravention, if Ms. Rose resigns from directorship of any of the 10 public companies and afterwards accepts the directorship in Brown Limited.

(b) The directorships held by Ms. Jasmine are as under:

Nature of directorship	***Counted as directorships of public companies, as per section 165***
Managing directorship in public companies	2
Directorships in public companies	6
Alternate directorship in companies	0 or 1 or 2 or 3 depending upon the fact as to whether these 3 alternate directorships are in public companies or not
Independent directorship in subsidiary companies of Brown Limited [Directorships in 3 subsidiary companies of Brown Limited shall be considered while reckoning directorships in public companies, as per section 165(1)]	3
Total number of directorships held in public companies	11 or 12 or 13 or 14

It is evident that the number of directorships held in public companies by Ms. Jasmine exceeds 10, which is the maximum permissible directorships as per section 165(1). Thus, Ms. Jasmine has contravened the provisions of section 165(1), and therefore, she is punishable with fine as specified under section 165(6), *i.e.* she shall be liable to a penalty of Rs. 5,000 for each day after the first during which such contravention continues.

Whether appointments of woman director, Indian Resident Director and independent directors are mandatory?

P 1.18D.

Case I. Royal Limited is a company listed at Madras Stock Exchange, incorporated on 1st January, 2015. The Board of directors of the company decides to appoint in its Board 'woman director' and the 'Resident Director'.

(i) Explaining the provisions of the Companies Act, 2013, state whether it is mandatory for the company to appoint such directors in its Board.

(ii) What would be your answer in case the company is a non-listed company and the Board of directors decided not to have the woman director on the company's Board?

(iii) What shall be your answer in case the company in question is not listed at any of the exchanges the paid-up share capital of the company is Rs. 50 crore and the turnover of the company is Rs. 200 crore. Decide whether the company is mandatorily required to appoint the woman director. [ICAI, Revision Test Paper, Nov. 2016]

Case II. M Ltd. is an unlisted company engaged in FMCG sector having 11 directors on its Board.

The company has paid-up share capital of Rs. 300 crore and a turnover of Rs. 500 crore. The provisions contained in the Companies Act, 2013 require the companies to have the following categories of directors on their Board:

(a) Woman director

(b) Independent director.

Keeping in view of the provisions of the Companies Act, 2013, M Ltd. appointed the directors as required by the Act. State the relevant provisions. [ICAI, Revision Test Paper, May 2017]

Ans. The given problem relates to second proviso to sub-section (1) of section 149, section 149(3) and section 149(4) of the Companies Act, 2013 and Rule 3 and Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

The legal position

As per second proviso to sub-section (1) of section 149 read with Rule 3, it is mandatory for the following classes of companies to appoint one or more woman directors:

(a) Every listed company; and

(b) Every public company having paid up share capital of Rs. 100 crore or more; and

(c) Every public company having turnover of Rs. 300 crore or more.

For this purpose, the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

As per section 149(3), every company shall have at least 1 director who stays in India for a total period of not less than 182 days during the financial year.

As per section 149(4), every listed public company shall have at least 1/3rd of the total number of directors as independent directors. For this purpose, any fraction contained in such 1/3rd shall be rounded off as one.

Further, section 149(4) read with Rule 4 provides that there shall be at least 2 directors as independent directors, if –

(i) the company is a public company having a paid up share capital of Rs. 10 crore or more; or

(ii) the company is a public company having a turnover of Rs. 100 crore or more; or

(iii) the company is a public company having in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 crore.

Answer to Case I.

(i) It is mandatory for Royal Limited to appoint at least one woman director since it is a listed company. It is also mandatory for Royal Limited to appoint at least one Indian Resident Director since every company is required to appoint such director.

(ii) In case Royal Limited is not a listed company, it would still be required to appoint a woman director if it satisfies one or more of the following conditions:

  (a) The paid up share capital of Royal Limited is Rs. 100 crore or more as on the last day of the preceding financial year.

  (b) The turnover of Royal Limited is Rs. 300 crore or more during the preceding financial year.

(iii) In case Royal Limited is not a listed company, its paid up share capital is Rs. 50 crore and its turnover is Rs. 200 crore, it is not mandatory for Royal Limited to appoint any woman director since none of the requirements contained in second proviso to sub-section (1) of section 149 read with Rule 3 is satisfied in such a case.

Answer to Case II.

(i) Though M Ltd. is not a listed company, it is required to appoint at least one woman director since its paid up share capital is Rs. 300 crore (*i.e.* the criterion of paid up share capital of Rs. 100 crore or more is satisfied) and its turnover is Rs. 500 crore (*i.e.* the criterion of turnover of Rs. 300 crore or more is satisfied).

(ii) Though M Ltd. is not a listed company, it is required to appoint at least 2 directors as independent directors since its paid up share capital is Rs. 300 crore (*i.e.* the criterion of paid up share capital of Rs. 10 crore or more is satisfied) and its turnover is Rs. 500 crore (*i.e.* the criterion of turnover of Rs. 100 crore or more is satisfied).

1.19 Indian resident director [Section 149(3)]

1. Applicability

The provisions relating to Indian resident director, apply to all companies.

2. Legal requirement

(a) Every company shall have at least 1 director who stays in India for a total period of not less than 182 days during the financial year.

(b) In case of a newly incorporated company, this requirement shall apply proportionately at the end of the financial year in which the company is incorporated.

1. In order to support and enable companies to focus on taking necessary measures to address the COVID-19 threat, including the economic disruptions caused by COVID-19, MCA has provided a relaxation with respect to Indian resident director. As per this relaxation, even if no director of a company has stayed in India for a total period of 182 days or more during the financial year 2019-20, it shall not be deemed to be a contravention (MCA General Circular No. 11/2020 dated 24th March, 2020).
2. Section 149(3) of the Companies Act, 2013 has been amended by the Companies (Amendment) Act, 2017 with effect from 7th May, 2018. As a consequence, the clarification issued by MCA with respect to Indian resident director vide General Circular No. 25/2014 dated 26th June, 2014, has lost its relevance, *i.e.* such clarification shall not have any effect. Accordingly, such clarification has not been given in this Book.

1.20 Independent directors (Section 149 and Rules 4 and 5)

1. Independent directors in case of a listed public company [Section 149(4)]

Every listed public company shall have at least 1/3rd of the total number of directors as independent directors.

For this purpose, any fraction contained in such 1/3rd shall be rounded off as one.

2. Independent directors in case of prescribed class(es) of companies [Section 149(4) read with Rule 4]

(a) Prescribed class(es) of companies and number of independent directors. The Central Government may prescribe the minimum number of independent directors in case of any class(es) of public companies.

As per Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, there shall be at least 2 directors as independent directors, if –

(i) the company is a public company having a paid up share capital of Rs. 10 crore or more; or

(ii) the company is a public company having a turnover of Rs. 100 crore or more; or

(iii) the company is a public company having in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 crore.

However, the following classes of unlisted public companies shall not be required to have any independent director:

(a) A joint venture

(b) A wholly owned subsidiary

(c) A dormant company as defined under section 455 of the Act.

The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

A joint venture would mean a joint arrangement, entered into in writing, whereby the parties that have joint control of the arrangement, have rights to the net assets of the arrangement. The usage of the term 'joint venture' is similar to that under the Accounting Standards (General Circular No. 09/2017, dated 5th September, 2017).

(b) Filling of intermittent vacancies. Any intermittent vacancy of an independent director shall be filled-up by the Board at the earliest but not later than immediately next Board meeting or 3 months from the date of such vacancy, whichever is later.

(c) Effects, where a company ceases to fulfil the prescribed criteria. Where a company ceases to fulfil the criteria prescribed under Rule 4 for 3 consecutive years, it shall not be required to comply with these provisions until such time as it meets any of such conditions.

(d) Higher number of independent directors due to composition of audit committee. If the company covered in any of the prescribed class(es) of companies, 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.

Example 1: A Ltd. is an unlisted public company having paid up share capital of Rs. 10 crore. It has 4 directors. As per section 149(4), A Ltd. shall have a minimum of 2 independent directors. As per section 177, every company covered u/s 177 shall have a minimum of 3 directors in the audit committee (termed as members of the audit committee), and the majority of members of the Audit Committee shall be the independent directors. Suppose, A Ltd. has 3 directors in the audit committee. As per section 177, A Ltd. is required to have at least 2 independent directors in the audit committee. Thus, A Ltd. shall have to appoint a minimum of 2 independent directors so that the requirements of section 149(4) as well as section 177 are met.

Example 2: B Ltd. is an unlisted public company having paid up share capital of Rs. 10 crore. It has 10 directors. As per section 149(4), B Ltd. shall have a minimum of 2 independent directors. Suppose, B Ltd. has 5 directors in the audit committee. As per section 177, B Ltd. is required to have at least 3 independent directors in the audit committee. Thus, B Ltd. shall have to appoint a minimum of 3 independent directors so that the requirements of section 149(4) as well as section 177 are met.

(e) Higher number of independent directors as per any law. Where a company belongs to any class of companies for which a higher number of independent directors has been specified in any law, it shall comply with the requirements specified in such law.

3. Criteria of independence for an independent director [Section 149(6)]

An independent director 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;

As per Notification No. G.S.R. 463(E) dated 5th June, 2015, in case of a Government company which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, clause (a) of sub-section (6) of section 149 shall be read as follows:

"who, in the opinion of the Ministry or Department of the Central Government which is administratively in charge of the company, or as the case may be, the State Government, is a person of integrity and possesses relevant expertise and experience;"

(b) (i) who is not a promoter of –

- the company; or
- its holding company; or
- its subsidiary company; or
- its associate company;

(ii) who is not related to promoters or directors in –

- the company; or
- its holding company; or
- its subsidiary company; or
- its associate company;

(c) who has or had no pecuniary relationship, other than remuneration as such director or having transaction not exceeding 10% of his total income or such amount as may be prescribed, with –

- the company; or
- its holding company; or
- its subsidiary company; or
- its associate company; or
- their promoters, or directors

at anytime during –

- the immediately preceding 2 financial years; or
- the current financial year;

1. Where a transaction is entered into by an Independent director with the company concerned at par with any member of the general public and at the same price as is payable / paid by such member of public, it would not be termed as 'pecuniary relationship' in terms of section 149(6)(c) [General Circular No. 14/2014, dated 09.06.2014]. This circular has been issued keeping in view the provisions of section 188 which takes away the transactions in the ordinary course of business at arm's length price from the purview of related party transactions.

   The above circular also clarifies that 'pecuniary relationship' in terms of section 149(6)(c) shall not include –

   (a) receipt of remuneration by way of sitting fees;

   (b) reimbursement of expenses for participation in the Board and other meetings; and

   (c) profit related commission approved by the members, in accordance with the provisions of the Act.

2. The provisions of section 149(6)(c) shall not apply in case of a Government company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

(d) none of whose relatives –

(i) is holding any security of or any interest in –

- the company; or
- its holding company; or
- its subsidiary company; or
- its associate company

at anytime during –

- the immediately preceding 2 financial years; or
- the current financial year;

However, the relative may hold security or interest in the company of face value not exceeding Rs. 50 lakh or 2% 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; or
- ➢ its holding company; or
- ➢ its subsidiary company; or
- ➢ its associate company; or
- ➢ their promoters, or directors

in excess of such amount as may be prescribed (as per Rule 5(2) of the Companies (Appointment and Qualification of Directors) Rules, 2014, the amount prescribed is Rs. 50 lakh) at anytime during –
- ▪ the immediately preceding 2 financial years; or
- ▪ 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; or
- ➢ its holding company; or
- ➢ its subsidiary company; or
- ➢ its associate company; or
- ➢ their promoters; or
- ➢ directors of such holding company

for such amount as may be prescribed (as per Rule 5(2) of the Companies (Appointment and Qualification of Directors) Rules, 2014, the amount prescribed is Rs. 50 lakh) at anytime during –
- ▪ the immediately preceding 2 financial years; or
- ▪ the current financial year;

(iv) has any other pecuniary transaction or relationship with –
- ➢ the company; or
- ➢ its holding company; or
- ➢ its subsidiary company; or
- ➢ its associate company; or

amounting to 2% 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) above;

(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 3 financial years immediately preceding the financial year in which he is proposed to be appointed;

However, in case of a relative who is an employee, this restriction shall not apply for his employment during preceding 3 financial years.

(ii) is or has been an employee or proprietor or a partner, in any of the 3 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 10% or more of the gross turnover of such firm;

(iii) holds together with his relatives 2% or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives 25% or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company;

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

As per Rule 5 of the Companies (Appointment and Qualification of Directors) Rules, 2014, an independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company' business.

Meaning of 'nominee director'. For the purposes of this section, 'nominee director' means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests.

4. Submission of declaration of independence by independent directors [Section 149(7)]

Every independent director shall give a declaration that he meets the criteria of independence as provided in Section 149(6). Such declaration shall be given –

(a) at the first meeting of the Board in which he participates as a director;

(b) at the first meeting of the Board in every financial year; and

(c) whenever there is any change in the circumstances which may affect his status as an independent director.

5. Duty to abide by Schedule IV [Section 149(8)]

The company and independent directors shall abide by the provisions specified in Schedule IV.

Schedule IV contains guidelines of professional conduct, role and functions, duties, manner of appointment, etc. of independent directors.

6. No stock options for independent director [Section 149(9)]

(a) An independent director shall not be entitled to any stock options.

(b) An independent director may receive remuneration by way of sitting fees.

(c) The company may reimburse to the independent director the expenses for participation in the Board and other meetings.

(d) An independent director may be paid profit related commission as may be approved by the members.

7. Term of office of independent director [Section 149(10)]

(a) An independent director shall hold office for a maximum term of 5 consecutive years.

(b) He shall be eligible for reappointment if –

(i) a special resolution is passed for his appointment; and

(ii) disclosure of such appointment is made in the Board's report.

An independent director re-appointed for second term under sub-section (10) of section 149 shall be removed by the company only by passing a special resolution and after giving him a reasonable opportunity of being heard [First Proviso to Section 169(1)].

8. Restrictions on terms of independent director [Section 149(11)]

(a) No independent director shall hold office for more than 2 consecutive terms.

(b) An independent director shall be eligible for appointment after the expiry of 3 years of cessation of his office as an independent director. During the said period of 3 years, an independent director shall not be appointed in or be associated with the company in any other capacity, either directly or indirectly.

The period of 3 years for which an individual cannot be appointed as an independent director is generally termed as 'cooling period'.

(c) Any tenure of an independent director prior to the date of commencement of this Act shall not be counted as a 'term'.

A clarification was sought from MCA as to whether it would be possible to appoint an individual as an independent director for a period less than 5 years.

MCA has clarified that section 149(10) of the Act provides for a term of "upto 5 consecutive years" for an independent director. As such while appointment of an independent director for a term of less than 5 years would be permissible, appointment for any term (whether for 5 years or less) is to be treated as a one term under section 149(10) of the Act. Further, under section 149(11) of the Act, no person can hold office of independent director for more than '2 consecutive terms'. Such a person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such 2 consecutive terms is less than 10 years. In such a case the person completing 'consecutive terms of less than 10 years' shall be eligible for appointment only after the expiry of the requisite cooling-off period of 3 years.

9. Exemption from liability [Section 149(12)]

Notwithstanding anything contained in this Act, –

(i) an independent director;

(ii) a non-executive director not being promoter or key managerial personnel,

shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

10. Independent director not to retire by rotation [Section 149(13)]

The provisions of section 152(6) and 152(7) with respect to rotational and non-rotational directors and retirement of directors by rotation, shall not apply to the appointment of independent directors.

11. Requirements of explanatory statement for appointing an independent director [Section 152(6)]

In the case of appointment of an independent director in the general meeting, an explanatory statement for such appointment, annexed to the notice of the general meeting, shall include a statement that in the opinion of the Board, he fulfils the conditions specified in this Act for such an appointment.

1. Every company existing on or before the date of commencement of this Act shall, within 1 year from such commencement or from the date of notification of the rules in this regard as may be applicable, appoint the independent directors in accordance with the provisions of Section 149 [Section 149(5)]. Thus, every company which is required to appoint the independent directors as per the provisions of section 149, shall appoint the independent directors on or before 31.03.2015.

   Independent directors appointed prior to 01.04.2014 may continue till 31.03.2015. Beyond 31.03.2015, they may continue if they are appointed as the independent directors subject to fulfilling the eligibility and other conditions prescribed under section 149 and Schedule IV (General Circular No. 14/2014 dated 09.06.2014).
2. The provisions of sub-sections (4), (5), (6), (7), (8), (9), (10), (11), clause (i) of sub-section (12) and sub-section (13) of section 149 shall not apply to a company licenced under section 8 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015].

Practical Problems from CA Examinations

Number of independent directors required to be appointed in case of listed and unlisted companies

P 1.20A.

Case I. ABC Limited is an unlisted public company having a paid up equity share capital of Rs. 20 crores and a turnover of Rs. 150 crores as on 31st March, 2018. The total number of directors on the Board is 13.

Referring to the provisions of the Companies Act, 2013 answer the following:

(i) The minimum number of independent directors that the company should appoint.

(ii) How many independent directors are to be appointed in case ABC Limited is a listed public company?

[CA (Final) Nov. 2018]

OR

XYZ Limited is an unlisted public company having a paid-up capital of twenty crore rupees as on 31st March, 2015 and a turnover of one hundred fifty crore rupees during the year ended 31st March, 2015. The total number of directors is thirteen.

Referring to the provisions of the Companies Act, 2013 answer the following:

(i) State the minimum number of independent directors that the company should appoint.

(ii) How many independent directors are to be appointed in case XYZ Limited is a listed public company?

[CA (Final) May, 2016]

Case II. XYZ Limited is an unlisted public company having a paid up capital of Rs. 20 crore as on 31st March, 2017 and a turnover of Rs. 150 crore during the year ended 31st March, 2017. The total number of directors is 13.

Answer the following questions:

(i) Minimum number of directors to be appointed as independent directors in XYZ Limited.

(ii) What will be the consequences if XYZ Ltd. ceases to fulfil any of the required conditions with respect to appointment of independent directors for 3 continuous years?

(iii) If XYZ Ltd. (unlisted public company) were a dormant company, what shall be the law relating to the appointment of independent directors? **[ICAI, Mock Test Paper, March, 2018]**

Ans. The given problem relates to section 149(4) of the Companies Act, 2013 read with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

The legal position

1. As per Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the following class(es) of companies shall have at least 2 directors as independent directors:
   (a) Public companies having paid up share capital of Rs. 10 crore or more.
   (b) Public companies having turnover of Rs. 100 crore or more.
   (c) Public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 crore.
2. If a company ceases to fulfil the prescribed criteria (*i.e.* all the 3 conditions given in Point (1) above) for 3 consecutive years, it shall not be required to comply with these provisions (*i.e.* it shall not be required to appoint any independent director) until such time as it meets any of such conditions.
3. As per Rule 4, the paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

4. Rule 4 also provides that the following classes of unlisted public companies shall not be required to have any independent director:
   (a) A joint venture
   (b) A wholly owned subsidiary
   (c) A dormant company as defined under section 455 of the Act.
5. In case of listed public companies, Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 does not apply, and such companies are required to appoint the independent directors in accordance with section 149(4).
6. As per section 149(4), in case of a listed public company, at least 1/3rd of its total number of directors shall be independent directors, and any fraction contained in that 1/3rd shall be rounded off as 1.

Answers to Case I.

(i) ABC Limited is an unlisted public company. The paid up capital of ABC Limited is Rs. 20 crore, and turnover is Rs. 150 crore. ABC Limited fulfils two criteria out of the 3 criteria given under Rule 4. Accordingly, ABC Limited is required to appoint a minimum of 2 independent directors.

(ii) In case ABC Limited is a listed public company, it is required to appoint at least 1/3rd of its total number of directors as independent directors.

Accordingly, out of 13 directors, at least 5 directors (1/3rd of 13 = 4.33; any fraction contained in such 1/3rd shall be rounded off as one) shall be independent directors.

Answers to Case II.

(i) XYZ Limited is an unlisted public company. The paid up capital of XYZ Limited is Rs. 20 crore, and turnover is Rs. 150 crore. XYZ Limited fulfils two criteria out of the 3 criteria given under Rule 4. Accordingly, XYZ Limited is required to appoint a minimum of 2 independent directors.

(ii) If XYZ Limited ceases to fulfil all the 3 criteria contained in Rule 4 for a continuous period of 3 years, then, it shall not be required to appoint any independent director until such time as it meets any of these 3 criteria.

(iii) If XYZ Limited were a dormant company, then, provisions contained in Rule 4 shall not apply to it, and so it shall not be required to appoint any independent director.

Situation where 2 out of 7 directors have vacated their offices – Compliances required

P 1.20B. The composition of the Board of Directors of a listed public company as on 31-03-2017 comprised of (i) Mr. A, Director (ii) Mr. B, Director (iii) Mr. C, Director (iv) Mr. D, Director (v) Mrs. E, Independent Director (iv) Mr. F, Independent Director and (vii) Mr. G, Independent Director.

Mr. D & Mrs. E vacated their office of director on 15-04-2017.

You are required to examine with reference to the provisions of the Companies Act, 2013 and what course of action would you suggest which can be taken up by the company in this regard? [CA (Final) May, 2017]

Ans. The given problem relates to section 149(4) of the Companies Act, 2013 and second proviso to sub-section (1) of section 149 of the Companies Act, 2013 read with Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

1. As per section 149(4), every listed public company shall have at least 1/3rd of the total number of directors as independent directors. For this purpose, any fraction contained in such 1/3rd shall be rounded off as one.
2. As per second proviso to sub-section (1) of section 149 read with Rule 3, every listed company shall have at least 1 woman director.
3. Rule 3 further provides that any vacancy in the office of a woman director shall be filled-up by the Board at the earliest but not later than –
   (i) immediately next Board meeting; or
   (ii) 3 months from the date of such vacancy,
   whichever is later.
4. In the given case, because of vacation of office of director by Mr. D and Mrs. E, –
   (a) total number of directors have reduced to 5;
   (b) number of independent directors have reduced to 2 (viz. Mr. F and Mr. G);
   (c) there is no woman director in the company.
5. Even after vacation of office of Mr. D and Mrs. E, the requirement of independent directors being not less than 1/3rd of total number of directors is satisfied. Thus, there is no requirement to appoint any independent director. However, the company is required to appoint at least 1 woman director. Such appointment shall be made by making an appointment by the Board in the next Board meeting or within 3 months of the date of vacancy, whichever is later.

6. After the vacancy in the office of woman director is filled, –
   (a) total number of directors shall be 6;
   (b) number of independent directors shall be 2 (assuming that the woman director appointed to fill the vacancy of Mrs. E is not an independent director);
   (c) there will be 1 woman director.

   The above constitution shall be valid as per the provisions of section 149(4) and second proviso to section 149(1).
7. To conclude, the company is required to fill the vacancy of Mrs. E by appointing a woman director, who may or may not be an independent director. Such vacancy shall be filled-up by the Board in the immediately next Board meeting or within 3 months from the date of such vacancy, whichever is later.

Tutorial Note:

In the question asked in exams, the second paragraph of the question read as under:

"Mr. D & Mrs. E vacated their office of director on 15-03-2017."

However, first paragraph of this question states that Mr. D and Mr. E and 5 other individuals were directors as on 31-03-2017.

It appears to the Author, that there has been a mistake in the drafting of this question. So, the Author has modified the wordings of this question by substituting the words "Mr. D & Mrs. E vacated their office of director on 15-03-2017." by the words "Mr. D & Mrs. E vacated their office of director on 15-04-2017."

In the Suggested Answers issued by the Board of Studies, ICAI, the answer to this question has been given by taking the same assumption as taken by the Author. The relevant paragraph from the Suggested Answers issued by Board of Studies, ICAI, is as under:

[Presumption: Date of Vacation of office of Mr. D and Mrs. E will be taken as 15.4.2017 rather than 15.3.2017. There seems to be clerical error.]

Appointment as independent director of a person who is promoter of joint venture company or a nominee director of the company, removal of independent director, etc.

P 1.20C. VGP Ltd. is a listed public company with a paid up capital of Rs. 100 crores as on 31st March, 2018. Mrs. Jasmine, who was one of the promoters of PDS Ltd. (a Joint Venture Company of VGP Ltd.), was appointed as woman director on the Board of VGP Ltd. VGP Ltd. has the following proposals :

(1) To remove Mr. Z, an independent director who was re-appointed for a second term.

(2) To appoint Mr. N, a nominee director in the Board as an independent director.

(3) To appoint Mrs. Jasmine as an independent-cum-woman director.

With reference to the relevant provisions of the Companies Act, 2013, examine:

(i) The validity the above proposals and the appointment of woman director already made.

(ii) Whether Mr. N, can be appointed as an independent director of PDS Ltd.?

(iii) Is an independent director entitled for stock option? [CA (Final) Nov. 2018]

Ans. The given problem relates to second proviso to sub-section (1) of section 149, section 149(4), section 149(9) and section 169 of the Companies Act, 2013 and Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

The legal position

1. As per second proviso to sub-section (1) of section 149 read with Rule 3, it is mandatory for the following classes of companies to appoint one or more woman director:
   (i) Every listed company; and
   (ii) Every public company having paid up share capital of Rs. 100 crore or more; and
   (iii) Every public company having turnover of Rs. 300 crore or more.

   For this purpose, the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

   In the given case, VGP Ltd. is a listed company, and so it is mandatory for VGP Ltd. to appoint one or more woman director.
2. As per section 169, a company may, by ordinary resolution and by complying with the requirements of section 169, remove a director before the expiry of the period of his office. However, as per first proviso to section 169(1), an independent director re-appointed for second term under sub-section (10) of section 149 shall be removed by the company only by passing a special resolution and after giving him a reasonable opportunity of being heard.
3. As per section 149(9), –
   (a) an independent director shall not be entitled to any stock options;
   (b) an independent director may receive remuneration by way of sitting fees;
   (c) the company may reimburse to the independent director the expenses for participation in the Board and other meetings;
   (d) an independent director may be paid profit related commission as may be approved by the members.

The questions asked in the given problem are answered as under:

(i) The validity the above proposals and the appointment of woman director already made

(a) Removal of Mr. Z, an independent director who was re-appointed for a second term

As per first proviso to section 169(1), Mr. Z can be removed by VGP Ltd. only by passing a special resolution and after giving him a reasonable opportunity of being heard.

(b) Appointment of Mr. N, a nominee director, as an independent director of VGP Ltd.

As per section 149(6)(a), a person can be appointed as an independent director only if he is not a managing director or a whole-time director or a nominee director.

Since Mr. N is a nominee director in VGP Ltd., he cannot be appointed as an independent director in VGP Ltd.

(c) Appointment of Mrs. Jasmine as an independent-cum-woman director

As per section 149(6)(b), an independent director means a director who is not a promoter of the company or its holding, subsidiary or associate company.

Mrs. Jasmine is a promoter of PDS Ltd., which is an associate company of VGP Ltd. (since as per section 2(6), an associate company includes a joint venture company).

Therefore, Mrs. Jasmine cannot be appointed as an independent director of VGP Ltd.

(d) Validity of appointment of Mrs. Jasmine as woman director in VGP Ltd.

Section 149 does not contain any ground of disqualification for appointment as a woman director. Thus, a person who is a promoter of a joint venture company is not disqualified for appointment as a woman director.

Accordingly, Mrs. Jasmine's appointment as a woman director of VGP Ltd. is valid.

(ii) Whether Mr. N, can be appointed as an independent director of PDS Ltd.?

(a) As per section 149(6)(a), a person can be appointed as an independent director only if he is not a managing director or a whole-time director or a nominee director.

(b) As per section 149(6)(b), an independent director means a director –

(i) who is 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.

(c) As per section 149(6)(e)(i), an independent director means a director who, neither himself nor any of his relatives holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the 3 financial years immediately preceding the financial year in which he is proposed to be appointed.

In the given case, Mr. N is a nominee director in VGP Ltd., but he is not a nominee director in PDS Ltd. So, he is not disqualified for appointment as independent director in PDS Ltd. as per section 149(6)(a). Also, he is not disqualified for appointment as independent director in PDS Ltd. as per section 149(6)(b) or 149(6)(e)(i).

Therefore, Mr. N can be appointed as a nominee director in PDS Ltd.

(iii) Is an independent director entitled for stock option?

As per section 149(9), an independent director is not entitled to any stock options.

Whether appointment of independent directors is mandatory? – Few cases

P 1.20D. Considering the regulatory provisions of the Companies Act, 2013 and the rules thereof regarding the appointment of independent directors on a company's Board, state whether Z Limited, a listed public company is required to appoint independent directors. Also state whether appointment of independent director is required in the following cases:

(i) The public company has a paid up share capital of Rs. 10 crores.

(ii) What shall be your answer in case the company's paid up share capital is only Rs. 2 crores.

(iii) Whether a person who holds the position of a Key Managerial Personnel in the same company can be appointed as an independent director?

(iv) In relation to mandatory women directors as required under the Companies Act, 2013 should such directors also be independent directors? [CA (Final) Nov. 2018]

Ans. The given problem relates to second proviso to sub-section (1) of section 149, section 149(4) and section 149(6) of the Companies Act, 2013 and Rule 3 and Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

The legal position

1. As per section 149(4), every listed public company shall have at least 1/3rd of the total number of directors as independent directors. For this purpose, any fraction contained in such 1/3rd shall be rounded off as one.

2. As per Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the following class(es) of companies shall have at least 2 directors as independent directors:
   (a) Public Companies having paid up share capital of Rs. 10 crore or more.
   (b) Public Companies having turnover of Rs. 100 crore or more.
   (c) Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 crore.

   However, the following classes of unlisted public companies shall not be required to have any independent director:
   (a) A joint venture
   (b) A wholly owned subsidiary
   (c) A dormant company as defined under section 455 of the Act.

   Relevant date. The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

The given problems are answered as under:

(a) Whether Z Limited, a listed public company, is required to appoint independent directors?

Z Limited is a listed public company. In case of listed public companies, Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 does not apply, and such companies are required to appoint the independent directors in accordance with section 149(4). Thus, Z Limited is required to appoint at least 1/3rd of its total number of directors as independent directors, and any fraction contained in that 1/3rd shall be rounded off as 1.

(b) Whether appointment of independent directors is required in the following cases?

(i) The public company has a paid up share capital of Rs. 10 crores.

A public company having a paid up share capital of Rs. 10 crore fulfils 1 criterion out of the 3 criteria given under Rule 4. Accordingly, it is required to appoint a minimum of 2 independent directors.

(ii) What shall be your answer in case the company's paid up share capital is only Rs. 2 crores?

In case the paid up share capital of an unlisted public company is Rs. 2 crores, it is not required to appoint any independent director.

(iii) Whether a person who holds the position of a Key Managerial Personnel in the same company can be appointed as an independent director?

As per section 149(6)(e)(i), an independent director means a director who, neither himself nor any of his relatives holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the 3 financial years immediately preceding the financial year in which he is proposed to be appointed.

Thus, a person who is presently holding the position of a Key Managerial Personnel in the same company cannot be appointed as an independent director.

(iv) In relation to mandatory women directors as required under the Companies Act, 2013 should such directors also be independent directors?

As per second proviso to sub-section (1) of section 149 of the Companies Act, 2013 and Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014, it is mandatory for the following classes of companies to appoint one or more woman director:

(a) Every listed company; and
(b) Every public company having paid up share capital of Rs. 100 crore or more; and
(c) Every public company having turnover of Rs. 300 crore or more.

For this purpose, the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

Neither second proviso to sub-section (1) of section 149 nor Rule 3 requires that a person can be appointed as a woman director only if he is an independent director. Thus, a woman director need not be an independent director.

Practical Problems from CS Examinations

Number of independent directors required to be appointed in case of listed and unlisted companies

P 1.20E. Examine the validity of the Board of directors' decision in respect of the following appointments of directors as per the provisions of the Companies Act, 2013:

(i) Board of directors of a company which is not listed at any of the stock exchanges, having a turnover of Rs. 500 crore decides not to appoint women director on the company's Board.

(ii) Board of directors of a company, which is not listed at any of the stock exchanges, decides not to appoint a resident director.

(iii) Board of directors of a company, having paid-up share capital of Rs. 50 crore decides not to appoint an independent director. The company is listed at Bombay Stock Exchange. **[CS (Final) June 2016]**

Ans.

(i) The given problem relates to second proviso to sub-section (1) of section 149, section 149(3) and section 149(4) of the Companies Act, 2013 and Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

As per second proviso to sub-section (1) of section 149 read with Rule 3, it is mandatory for the following classes of companies to appoint one or more woman director:

(i) Every listed company; and

(ii) Every public company having paid up share capital of Rs. 100 crore or more; and

(iii) Every public company having turnover of Rs. 300 crore or more.

For this purpose, the paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements shall be taken into account.

In the given case, the turnover of the company is Rs. 500 crore which is more than the required limit for mandatory appointment of woman director. Accordingly, it is mandatory for the company to appoint one or more woman director. Thus, the decision of the Board not to appoint any woman director would result in contravention of second proviso to sub-section (1) of section 149 read with Rule 3.

(ii) As per section 149(3), every company shall have at least 1 director who stays in India for a total period of not less than 182 days during the financial year. This requirement applies to all companies, whether listed or unlisted.

In the given case, the Board has decided not to appoint any resident director. This would amount to contravention of section 149(3).

(iii) As per section 149(4), every listed public company shall appoint at least 1/3rd of its total number of directors as independent directors. Thus, for listed public companies, it is mandatory to have at least 1/3rd of total number of directors as independent directors, irrespective of its paid up share capital.

In the given case, the company is a listed public company, and so at least 1/3rd of its total number of directors shall be independent directors. The amount of paid up share capital is not relevant. Accordingly, the decision of the Board not to appoint any independent director would result in contravention of section 149(4).

Practical Problems from ICAI, RTP

A person holds along with his relatives 3% of total voting power of a company – Can he be appointed as an independent director in the company?

P 1.20F. Mr. Person together with one of his relatives holds 3% of the total voting power of XYZ Ltd. The Board of directors of the company appointed him as an independent director. Examine the validity of such appointment with reference to the provisions of the Companies Act, 2013. **[ICAI, Revision Test Paper, May 2016]**

Ans. The given problem relates to section 149(6) of the Companies Act, 2013.

The legal position

1. Section 149(6) contains various conditions with respect to eligibility for appointment as an independent director. If a person does not fulfil any condition with respect to eligibility criteria contained in section 149(6), he cannot be appointed as an independent director.
2. Besides other conditions, one of the conditions with respect to eligibility criteria contained in section 149(6) is that a person cannot be an independent director in a company if he along with his relatives holds 2% or more of the total voting power of the company.

The given case and analysis of the case

3. Mr. Person, together with one of his relatives, holds 3% of the total voting power of XYZ Ltd. Mr. Person has been appointed as an independent director in XYZ Ltd.
4. The issue raised in the given question is: "Whether the appointment of Mr. Person as an independent director in XYZ Ltd. is valid?"
5. Section 149(6) does not permit the appointment of a person as an independent director, if he, along with his relatives, holds 2% or more of the total voting power of the company.

Conclusion

6. Mr. Person does not satisfy the eligibility criteria contained in section 149(6), and so he cannot be appointed as an independent director in XYZ Ltd.
7. The appointment of Mr. Person as an independent director in XYZ Ltd. is not valid.

Whether an independent director appointed for 3 years and then reappointed for 5 years, can again be reappointed for 2 years?

P 1.20G. Mr. Azad, an independent director of X company, was appointed in the AGM for a period of three years. After the expiry of 3 years he was re-appointed for a period of 5 years. Considering that though Mr. Azad has completed two tenures/terms but hasn't completed ten years in total, therefore he may be appointed in the upcoming AGM for another 2 years to complete his total term of 10 years. In the light of the Companies Act, 2013, state the validity of reappointment of Mr. Azad for further term in the company. [ICAI, Revision Test Paper, Nov. 2017]

Ans. The given problem relates to section 149(10) and 149(11) of the Companies Act, 2013.

The legal position

1. As per section 149(10), –
   (a) an independent director shall hold office for a maximum term of 5 consecutive years;
   (b) he shall be eligible for reappointment if –
      (i) a special resolution is passed for his appointment; and
      (ii) disclosure of such appointment is made in the Board's report;
2. As per section 149(11), –
   (a) no independent director shall hold office for more than 2 consecutive terms.
   (b) an independent director shall be eligible for appointment after the expiry of 3 years of cessation of his office as an independent director, and during the said period of 3 years, he shall not be appointed in or be associated with the company in any other capacity, either directly or indirectly.

The given case and analysis of the case

3. Mr. Azad was appointed as an independent director for a period of 3 years. Such appointment is valid as the period of his office is 3 years, *i.e.* does not exceed 5 years as specified under section 149(10).
4. On completion of first tenure of 3 years, Mr. Azad was reappointed as an independent director for a period of 5 years.
5. On completion of his second tenure of 5 years, the total period for which he has continuously served as independent director is 8 years.
6. It is proposed to reappoint Mr. Azad as an independent director on completion of his second tenure.
7. Section 149(11) expressly provides that an independent director shall not hold office for more than 2 consecutive terms. No exception has been provided under the Act by way of which an independent director can hold office for 3rd consecutive term.
8. Neither section 149(10) nor section 149(11) states that an independent director shall be appointed for a total period of 10 years. *In other words*, where a person has held his office as an independent director for 2 consecutive terms, he cannot be further reappointed although his period of office during these 2 consecutive terms was less than 10 years.

Conclusion

9. On expiry of his second term, Mr. Azad cannot be further reappointed for a period of 3 years.
10. In case Mr. Azad is further reappointed for a period of 2 years, such appointment constitutes a contravention of section 149(11), and so such reappointment shall not be valid.

Advanced Practical Problems

Can an independent director be appointed as a director in the subsidiary or holding or associate company?

P 1.20H. Can Mr. Khan appointed as an independent director on the Board of a company, be appointed in its subsidiary or its holding or its associate company. [ICAI, Mock Test Paper, October 2018]

Ans. The given problem relates to section 149(6) of the Companies Act, 2013.

The legal position

1. Section 149(6) contains various conditions with respect to eligibility for appointment as an independent director. If a person does not fulfil any condition with respect to eligibility criteria contained in section 149(6), he cannot be appointed as an independent director.
2. Besides other conditions, some of the conditions with respect to eligibility criteria contained in section 149(6) are as under:
   (a) A person can be an independent director in a company only if he not a managing director or whole-time director or nominee director in such company.
   (b) A person can be an independent director in a company only if he is not a promoter of the company or its holding company or its subsidiary company or its associate company.
   (c) A person can be an independent director in a company only if he does not hold and has not held the position of a key managerial personnel in the company or its holding, subsidiary or associate company in any of the 3 financial years immediately preceding the financial year in which he is proposed to be appointed.

(d) A person can be an independent director in a company only if he is not and has not been an employee of the company or its holding, subsidiary or associate company in any of the 3 financial years immediately preceding the financial year in which he is proposed to be appointed.

The given case and analysis of the case

3. Mr. Khan holds the office of an independent director in a company.
4. The issue raised in the given question is: "Can Mr. Khan be appointed as an independent director or a director in subsidiary or holding or associate company?".
5. Section 149(6) does not restrict appointment of an independent director as an independent director or a director in the subsidiary or holding or associate company. Also, section 149(6) does not restrict appointment of a person as an independent director if he is already an independent director or a director in the subsidiary or holding or associate company.

Conclusion

6. Mr. Khan can be appointed as an independent director or a director in the subsidiary or holding or associate company. Also, it shall not result in vacation of his office of independent director in the company.

1.21 Code for independent directors (Schedule IV to the Companies Act, 2013)

Schedule IV contains the code for independent directors. This Code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors. This Code is explained as follows:

I. Guidelines of professional conduct:

An independent director shall:

(1) uphold ethical standards of integrity and probity;
(2) act objectively and constructively while exercising his duties;
(3) exercise his responsibilities in a bona fide manner in 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 vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, 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 action 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) help in 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) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
(5) safeguard the interests of all stakeholders, particularly the minority shareholders;
(6) balance the conflicting interest of the stakeholders;
(7) determine appropriate levels of 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 shareholder's interest.

III. Duties:

The independent directors shall—

(1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;

(2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;

(3) strive to 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) strive to attend the general meetings of the company;

(6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;

(7) keep themselves well informed about the company and the external environment in which it operates;

(8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;

(9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;

(10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;

(11) report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;

(12) act within their authority, assist in protecting the legitimate interests of the company, shareholders and its employees;

(13) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

IV. Manner of appointment:

(1) Appointment process of independent directors shall be independent of the company management; 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 of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be 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 directors and employees to follow;

(f) the list of actions that a director should not do while functioning as such in the company; and

(g) the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.

(5) The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours.

(6) The terms and conditions of appointment of independent directors shall also be posted on the company's website.

V. Re-appointment:

The re-appointment of independent director shall be on the basis of report of performance evaluation.

VI. Resignation or removal:

(1) The resignation or removal of an independent director shall be in the same manner as is provided in sections 168 and 169 of the Act.

(2) An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within 3 months from the date of such resignation or removal, as the case may be.

(3) Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

VII. Separate meetings:

(1) The independent directors of the company shall hold at least one meeting in a financial year, without the attendance of non-independent directors and members of management;

(2) All the independent directors of the company shall strive to be present at such meeting;

(3) The meeting shall:

(a) review the performance of non-independent directors and the Board as a whole;

(b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;

(c) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

VIII. Evaluation mechanism:

(1) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.

(2) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

Note:

The provisions of sub-paragraph (2) and (7) of paragraph II, paragraph IV, paragraph V, clauses (a) and (b) of sub-paragraph (3) of paragraph VII and paragraph VIII shall not apply in the case of a Government company as defined under clause (45) of section 2 of the Companies Act, 2013, if the requirements in respect of matters specified in these paragraphs are specified by the concerned Ministries or Departments of the Central Government or as the case may be, the State Governments and such requirements are complied with by the Government companies.

In order to support and enable companies to focus on taking necessary measures to address the COVID-19 threat, including the economic disruptions caused by COVID-19, MCA has provided a relaxation with respect to holding of at least one meeting of independent directors without the attendance of non-independent directors. As per this relaxation, for the financial year 2019-20, if the independent directors of a company have not been able to hold such a meeting, the same shall not be viewed as a contravention. However, the independent directors may share their views amongst themselves through telephone or e-mail or any other mode of communication, if they deem fit (MCA General Circular No. 11/2020 dated 24th March, 2020).

1.22 Manner of selection of independent directors and maintenance of databank of independent directors (Section 150 and Rule 6)

The provisions relating to manner of selection of independent directors and maintenance of databank of independent directors are contained in section 150 of the Companies Act, 2013 read with Rule 6 of the Companies (Appointment and Qualification of Directors) Rules, 2014 and the Companies (Creation and Maintenance of databank of Independent Directors) Rules, 2019. These provisions are explained as follows:

(A) Provisions contained in section 150 of the Companies Act, 2013.

1. Maintenance of data bank

(a) An independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors.

(b) The data bank shall be created and maintained in accordance with such rules as may be prescribed.

(c) The data bank may be maintained by any body, Institute or association, as may be notified by the Central Government, having expertise in creation and maintenance of such data bank.

(d) The data bank shall be put on the website for the use by the companies making the appointment of independent directors.

2. Responsibility of the company to exercise due diligence

The responsibility of exercising due diligence before selecting a person from the data bank, as an independent director shall lie with the company making such appointment.

3. Approval of appointment of independent director by the members [Section 150(2)]

(a) The appointment of independent director shall be approved by the company in general meeting.

(b) The explanatory statement annexed to the notice of the general meeting called to consider the said appointment shall indicate the justification for choosing the appointee for appointment as independent director.

4. Manner and procedure of selection of independent directors out of such data bank

The Central Government may prescribe the manner and procedure of selection of independent directors who fulfil the qualifications and requirements specified under section 149.

(B) Provisions contained in the Companies (Appointment and Qualification of Directors) Rules, 2014: Compliances required by a person eligible and willing to be appointed as an independent director (Rule 6).

1. Mandatory application for inclusion of name in the data bank

An individual shall make an online application to the Institute for inclusion of his name in the data bank in the following 2 cases:

(a) He holds the appointment as an independent director in any company, as on the date of the commencement of the Companies (Appointment and Qualification of Directors) Fifth Amendment Rules, 2019 (i.e. as on 1st December, 2019).

The online application shall be made within a period of 13 months from the commencement of the Companies (Appointment and Qualification of Directors) Fifth Amendment Rules, 2019 (*i.e.* within 13 months from 1st December, 2019).

(b) He intends to get appointed as an independent director in a company after the commencement of the Companies (Appointment and Qualification of Directors) Fifth Amendment Rules, 2019.

The online application shall be made before such appointment.

Meaning of 'Institute'

For the purposes of this rule, the expression 'Institute' means the 'Indian Institute of Corporate Affairs at Manesar' notified under sub-section (1) of section 150 of the Companies Act, 2013 as the Institute for the creation and maintenance of data bank of Independent Directors.

2. Voluntary application for inclusion of name in the data bank

Any individual, including an individual not having DIN, may voluntarily apply to the Institute for inclusion of his name in the data bank.

3. Period for which the name can be included in the data bank

The individual making such application, shall specify in the application made by him, the period for which he intends to get his name included in the data bank. Such period can be –

(a) 1 year; or

(b) 5 years; or

(c) life-time.

4. Duty to renew the inclusion of name in the data bank

(a) An individual whose name has been included in the data bank shall, from time to time, file an application to the Institute to renew the inclusion of his name in the data bank, till he continues to hold the office of an independent director in any company.

(b) The application for renewal may be made for a period of –

(i) 1 year; or

(ii) 5 years; or

(iii) life-time.

(c) The application for renewal shall be made within a period of 30 days from the date of expiry of the period upto which the name of the individual was included in the data bank, failing which, the name of such individual shall stand removed from the data bank of the Institute.

(d) An individual who has paid life-time fees for inclusion of his name in the data bank, shall not be required to file an application for renewal.

5. Submission of declaration by independent director

(a) Every independent director shall submit a declaration to the Board that he has complied with the provisions relating to making of application to the Institute –

(i) for inclusion of his name in the data bank; and

(ii) to renew the inclusion of his name in the data bank.

(b) Such declaration shall be submitted by him along with the declaration required to be submitted under section 149(7).

As per section 149(7), every independent director shall give a declaration that he meets the criteria of independence as provided in Section 149(6). Such declaration shall be given –

(a) at the first meeting of the Board in which he participates as a director;

(b) at the first meeting of the Board in every financial year; and

(c) whenever there is any change in the circumstances which may affect his status as an independent director.

6. Requirement to pass an online proficiency self-assessment test

(a) Every individual whose name is included in the data bank, shall pass an online proficiency self-assessment test conducted by the Institute within a period of 1 year from the date of inclusion of his name in the data bank, failing which, his name shall stand removed from the databank of the Institute.

(b) An individual who has obtained a score of not less than 60% in aggregate in the online proficiency self-assessment test shall be deemed to have passed such test.

(c) There shall be no limit on the number of attempts an individual may take for passing the online proficiency self-assessment test.

However, an individual shall not be required to pass the online proficiency self-assessment test, if he has served as a director or key managerial personnel, for a total period of not less than 10 years, as on the date of inclusion of his name in the databank, in one or more of the following:

(a) A listed public company

(b) An unlisted public company having a paid-up share capital of Rs. 10 crore or more; or

(c) A body corporate listed on a recognised stock exchange.

For the purpose of calculation of the period of 10 years, any period during which an individual was acting as a director or as a key managerial personnel in 2 or more companies or bodies corporate at the same time, shall be counted only once.

(C) Provisions contained in the Companies (Creation and Maintenance of databank of Independent Directors) Rules, 2019.

1. Creation and maintenance of data bank

(i) The Institute shall create and maintain a data bank of persons willing and eligible to be appointed as independent directors, and such data bank shall be an online data bank which shall be placed on the website of the Institute.

For the purpose of these Rules, "Institute" means the 'Indian Institute of Corporate Affairs' notified under sub-section (1) of section 150 of the Companies Act, 2013.

(ii) The data bank shall contain the following details in respect of each person whose name is included in the data bank:

(a) DIN (Director Identification Number), if applicable

(b) Income Tax PAN

(c) Name and surname in full

(d) Father's name

(e) Date of birth

(f) Gender

(g) Nationality

(h) Occupation

(i) Full address with PIN code (present and permanent)

(j) Phone number

(k) e-mail id

(l) Educational and professional qualifications

(m) Experience or expertise, if any

(n) Any pending criminal proceedings as specified in clause (d) of sub-section (1) of section 164

(o) List of limited liability partnerships in which he is or was a designated partner along with –

(I) the name of the limited liability partnership;

(II) the nature of industry; and

(III) the duration (with dates)

(p) List of companies in which he is or was director along with –

(I) the name of the company;

(II) the nature of industry;

(III) the nature of directorship – Executive or Non-executive or Managing Director or Independent Director or Nominee Director; and

(IV) the duration (with dates)

(iii) The information available in the data bank shall be provided only to companies required to appoint independent director after paying a reasonable fees to the Institute.

(iv) Any individual whose name is included in the data bank, may restrict his personal information to the Institute, to be disclosed in the data bank.

(v) Any individual whose name appears in the data bank, shall make changes in his particulars within 30 days of such change through web based framework made available by the Institute for this purpose.

(vi) A disclaimer shall be conspicuously displayed on the website hosting the data bank that a company must carry out its own due diligence before appointment of any person as an independent director.

(vii) The Institute shall, with the prior approval of the Central Government, fix a reasonable fee to be charged from–

(a) individuals, for inclusion of their names in the data bank; and

(b) companies, for providing the information on independent directors available in the data bank.

For the purpose of this rule, the expression 'persons willing and eligible to be appointed as independent director' shall include individuals already serving as independent directors on the Board of companies.

2. Duties of the Institute

(a) With respect to every individual whose name has been included in the data bank, the Institute shall comply with the following:

(i) Conduct an online proficiency self-assessment test covering companies law, securities laws, basic accountancy, and such other areas which are relevant to the functioning of an individual acting as an independent director.

(ii) Prepare a basic study material, online lessons, including audio-visuals for easy reference of individuals taking the online proficiency self-assessment test.

(iii) Provide an option for individuals to take advanced tests in the areas covered in the online proficiency self-assessment test (*viz.* companies law, securities laws, basic accountancy, and such other areas which are relevant to the functioning of an individual acting as an independent director) and prepare the necessary advanced study material in this respect.

No separate fees shall be charged by the Institute in respect of duties specified in (i), (ii) and (iii) above.

(b) The Institute shall, on a daily basis, share with the Central Government, a cumulative list of all individuals –

(i) whose names have been included in the data bank along with the date of inclusion and their Income Tax PAN or Passport number in case of foreign director (not required to have Income-tax PAN);

(ii) whose applications for inclusion in the data bank have been rejected along with grounds and the dates of such rejection; and

(iii) whose names have been removed from the data bank along with grounds and the dates of such removal.

3. Panel

(i) There shall be a panel of not more than 10 members nominated by the Central Government, for the purpose of approving the outline of the courses and study material prepared by the Institute.

(ii) The Panel shall consist of the following:

(a) Secretary, Ministry of Corporate Affairs or his nominee

(b) Director General and Chief Executive Officer of the Institute or his nominee

(c) 1 member nominated by the Department of Economic Affairs

(d) 1 member nominated by the Department of Public Enterprises

(e) 1 member nominated by the Securities and Exchange Board of India

(f) At least 1 representative from the stock exchange, nominated by the Central Government

(g) At least 1 representative from the industry, nominated by the Central Government

(h) At least 1 representative from the academia, nominated by the Central Government.

The provisions of section 150 shall not apply to a company licenced under section 8 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015].

1.23 Appointment of directors by small shareholders (Section 151 and Rule 7)

1. Applicability

The provisions relating to appointment of a 'Small Shareholders' Director' apply only if the company is a listed company. These provisions are applicable to every listed company irrespective of its paid up share capital or number of small shareholders or any other criterion.

2. Meaning of small shareholder

A 'Small shareholder' means a shareholder holding shares of nominal value of not more than Rs. 20,000 or such other sum as may be prescribed. As on date, no other sum has been prescribed.

It is pertinent to note that what is relevant is 'nominal value' and not 'paid up value' or 'market value'. However, a small shareholder may be a holder of equity shares or preference shares or both.

Example. Mr. X, holds 3,000 equity shares of Rs. 10 each (Rs. 6 paid up) in ABC Ltd. Mr. X is not a small shareholder since the nominal value of shares held by him (*i.e.* Rs. 30,000) exceeds Rs. 20,000.

3. Appointment of Small Shareholders' director as a result of notice given by small shareholders

The small shareholders may propose to the company the appointment of a Small Shareholders' Director. Such proposal shall be made by giving a notice in writing. The notice must comply with the following requirements:

(a) Time of giving notice. The notice shall be left at the office of the company at least 14 days before the meeting.

(b) Shareholders eligible to give notice. The notice shall be given by at least –

(i) 1,000 small shareholders; or

(ii) 1/10th of the total number of small shareholders,

whichever is lower.

(c) Signing of notice. The notice shall be signed by all the small shareholders proposing the appointment of Small Shareholders' Director.

(d) Contents of notice. The notice shall specify that the small shareholders intend to propose a person as a candidate for the post of small shareholders' director. The notice shall specify the name, address, number of shares held and folio number of–

- all the small shareholders who propose the appointment of Small Shareholders' Director; *and*
- the person whose name is proposed as a 'Small Shareholders' Director'.

If the person being proposed as a Small Shareholders' Director does not hold any shares in the company, the details of shares held and folio number need not be specified in the notice. Thus, a person, who does not hold any shares in a company, may be appointed as a Small Shareholders' Director of such company.

(e) Statement by the proposed Small Shareholders' Director. 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 –

(i) his Director Identification Number (allotted to him under section 154);

(ii) that he is not disqualified to become a director under the Act (as per Section 164); and

(iii) his consent to act as a director of the company.

Rule 8 of the Companies (Appointment and Qualification of Directors) Rules, 2014 reads as under:

"Every person who has been appointed to hold the office of a director shall, on or before the appointment, furnish to the company a consent in writing to act as such in Form DIR-2.

Provided that the company shall, within 30 days of the appointment of a director, file such consent with the Registrar in Form DIR-12 along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014."

A combined reading of Rule 7 and Rule 8 suggests that the person proposed as a Small Shareholders' Director shall have to file his consent with the company before his appointment as Small Shareholders' Director.

4. Appointment of Small Shareholders' director by the company *suo motu*

A 'Small Shareholders' Director' may be elected voluntarily by any listed company. Thus, a listed company may, on its own, act to appoint a Small Shareholders' Director. In such a case, no notice from small shareholder(s) is required.

5. Small Shareholders' Director to be an independent director

Small Shareholders' Director shall be considered as an independent director, if–

(a) he is eligible for appointment as an independent director as per sub-section (6) of section 149; and

(b) he gives a declaration of his independence as per sub-section (7) of section 149.

6. Tenure of office and no retirement by rotation

The provisions of section 152 shall apply to the appointment of Small Shareholders' Director, except that–

(a) he shall not be liable to retire by rotation;

(b) his tenure of office shall not exceed a period of 3 consecutive years; and

(c) on the expiry of the tenure, he shall not be eligible for re-appointment.

Removal of Small Shareholders' Director

A Small Shareholders' Director may be removed by passing an ordinary resolution in the general meeting in accordance with the provisions of section 169. At the time of voting on such resolution, every equity shareholder shall have a right to vote, irrespective of the fact as to whether he is a small shareholder or not.

7. Grounds of disqualification

Disqualifications of a 'Small Shareholders' Director' are the same as that of any other director (specified under section 164).

There is no eligibility criterion in terms of shareholding in the company for being appointed as a small shareholders' director. Thus, a person may be appointed as a small shareholders' director, even if he is–

(a) not a shareholder of the company; or

(b) a shareholder, but not a small shareholder (*i.e.* where he holds shares of nominal value exceeding Rs. 20,000).

8. Grounds of vacation of office

The office of small shareholders' director shall become vacant if–

(a) he incurs any of the disqualifications specified in section 164;

(b) any of the grounds contained in section 167 becomes applicable on him;

(c) he ceases to meet the criteria of independence as provided in sub-section (6) of section 149.

9. Number of Small Shareholders' Directorships

(a) A person shall not hold the position of Small Shareholders' Director in more than 2 companies at the same time.

(b) It shall be ensured that the second company in which he is appointed as a Small Shareholders' Director shall not be in a business which is competing or is in conflict with the business of the first company.

10. No association with the company for next 3 years

A small shareholders' director shall not be appointed in or be associated with such company in any other capacity, either directly or indirectly. Such restriction shall apply for a period of 3 years from the date on which he ceases to hold office as a small shareholders' director.

1. Small Shareholders' Director shall be included in 'total number of directors'

A Small Shareholders' Director appointed as per section 151 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014 shall be included in the 'total number of directors' for the purpose of section 152(6), since section 151 does not over-ride section 152(6).

2. **Manner of appointment of Small Shareholders' Director**

   As per section 110 read with Rule 22 of the Companies (Management and Administration) Rules, 2014, the appointment of a small shareholders' director shall be made by postal ballot.

Theoretical Questions from CA Examinations

Q 1.23A. Some of the small shareholders of M/s Progressive Industries Ltd. approach you for advice regarding appointment of one of them as a director of the company. Explain the meaning of a small shareholder and the legal position regarding appointment of a director by such small shareholders. [CA (Final) Nov. 2001]

Q 1.23B. Some small shareholders of TRG Ltd., a company listed with Mumbai Stock Exchange, want to appoint Mr. Raj, who is holding 1,000 equity shares of Rs. 10 each of the company as a director as their representative on the Board of directors of the said company. You are required to state the relevant provisions of the Companies Act, 2013 in respect of such proposal to appoint Mr. Raj as a Small Shareholders' director.

Also state whether Mr. Raj can be appointed as a Small Shareholders' Director if he is already a Small Shareholders' Director in two other companies. [CA (Final) Nov. 2004, Nov. 2005]

Practical Problems from CA Examinations

Can an unlisted company appoint a director elected by the small shareholders?

P 1.23A. The Board of directors of M/s. ABC Limited, an unlisted company having a paid-up capital of Rs. 6 crores consisting of equity share capital of Rs. 5 crores and preference share capital of Rs. 1 crore seeks your advice on the following:

(i) Is it necessary for the company to appoint a director to represent the 'Small Shareholders'?

(ii) In case the company decides to appoint such a director, the procedure to be followed by the company for such appointment and the period for which such appointment can be made. [CA (Final) May 2004, Nov. 2008 (Modified)]

Ans.

(i) The provisions relating to appointment of directors by small shareholders are contained in section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014. These provisions are applicable to listed companies only. Thus, it is not necessary for ABC Limited to appoint a director to represent the small shareholders.

(ii) ABC Limited cannot appoint a small shareholders' director because of the following reasons:

   (a) Section 151 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014 authorises a listed company to appoint a small shareholders' director. However, section 151 and Rule 7 shall not apply to ABC Limited since it is an unlisted company.

   (b) A small shareholders' director is elected only by the small shareholders, and thus, his appointment is not made in the general meeting. As per section 152(6), in the case of a public company, the appointment of rotational directors shall be made in general meeting, and the other directors shall, in default of, and subject to any regulations in the articles of the company, also be appointed by the company in general meeting. 'Appointment in general meeting' means that at the time of appointment, every member shall be entitled to vote whether or not he is a small shareholder. Since the articles of ABC Limited do not expressly authorise the appointment of a director by small shareholders only, the appointment of small shareholders' director in ABC Limited is not possible.

Difference in answer as compared to the answer given by ICAI

The Author's answer to Part (ii) of this question differs from the answer given in the Practice Manual issued by the Board of Studies, ICAI for May, 2015 Exams. As per the answer given in the Practice Manual, M/s. ABC Limited (an unlisted company) may voluntarily appoint a Small Shareholders' Director.

The Author does not agree with the Answer given in the Practice Manual.

This question, along with its answer, has been omitted from the Practice Manual applicable for November, 2016 Exams.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Appointment of a director representing the small shareholders in a listed company

P 1.23B. M/s. Neemuch Pharma Limited is a company listed with Malhargarh Stock Exchange. Some small shareholders of the said company want to appoint Mr. Avadhesh as a Director as their representative on the Board of Directors of the said company. Mr Avadhesh is holding 1000 equity shares of Rs. 10 each in the said company. State the provisions of the Companies Act, 2013 in relation to the proposal to appoint Mr. Avadhesh as a Small Shareholders' Director. [CA (Final) Nov. 2011]

Ans. The provisions relating to appointment of directors by small shareholders are contained in section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014. These provisions are explained as follows:

1. These provisions are applicable to listed companies only.
2. A listed company may have one director elected by small shareholders.
3. The manner of election of small shareholders' director and the terms and conditions of his appointment shall be such as may be prescribed.
4. The small shareholders may propose to the company the appointment of a Small Shareholders' Director. Such proposal shall be made by giving a notice in writing. The notice must comply with the following requirements:
   (a) The notice shall be left at the office of the company at least 14 days before the meeting.
   (b) The notice shall be given by at least –
      (i) 1,000 small shareholders; or
      (ii) 1/10th of the total number of small shareholders,
      whichever is lower.
   (c) The notice shall be signed by all the small shareholders proposing the appointment of Small Shareholders' Director.
5. The notice shall specify that the small shareholders intend to propose a person as a candidate for the post of small shareholders' director. The notice shall specify the name, address, number of shares held and folio number of–
   (a) all the small shareholders proposing the appointment of Small Shareholders' Director; and
   (b) the person whose name is proposed as a 'Small Shareholders' Director'.
   However, if the person being proposed as a Small Shareholders' Director does not hold any shares in the company, the details of shares held and folio number need not be specified in the notice.

In the present case, the notice has been given for the appointment of small shareholders' director by 'some' small shareholders. The question does not specify the total number of small shareholders in the company. Also, the number of small shareholders who have given notice to the company has not been specified. Assuming that the notice has been given by at least 1,000 small shareholders or 1/10th of total number of small shareholders, the notice is valid.

There is no eligibility criterion in terms of shareholding in the company for being appointed as a small shareholders' director. Thus, Mr. Avadhesh is not debarred from being appointed as a small shareholders' director provided he is not disqualified as per section 164, he has been allotted Director Identification Number and he is not disqualified as per any other provision of the Act.

Various issues relating to appointment of small shareholders' director

P 1.23C. DD Ltd. is a listed company and it has been served with notice for appointment of small shareholder's director. Referring to the provisions of the Companies Act, 2013, advise on the following:

(i) Define the expression 'small shareholder' and specify the number of small shareholders who may serve notice on the company for director representing them.

(ii) Is it possible to appoint a person, who does not hold any share in the company, as small shareholders' director?

(iii) What is the tenure of small shareholders' director and whether he can be re-appointed as such, after expiry of his tenure? Also state whether he can be appointed as an officer of the company on expiry of his tenure as small shareholders' director. **[CA (Final) May 2016]**

Ans. The provisions relating to appointment of directors by small shareholders are contained in section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

Answer to (i).

1. **Definition of 'small shareholder'**

   A 'Small shareholder' means a shareholder holding shares of nominal value of not more than Rs. 20,000 or such other sum as may be prescribed. As on date, no other sum has been prescribed.

2. **Number of small shareholders entitled to serve notice on the company for appointing a director representing them**
   (a) The notice shall be given by at least –
      (i) 1,000 small shareholders; or
      (ii) 1/10th of the total number of small shareholders,
      whichever is lower.
   (b) The notice shall be signed by all the small shareholders proposing the appointment of Small Shareholders' Director.

Answer to (ii).

As per Rule 7, the notice given to the company by the small shareholders shall specify the details of shares (*i.e.* the number of shares held and folio number) held by the person proposed as a small shareholders' director. However, if the person proposed as a small shareholders' director does not hold any shares in the company, such details need not be specified in the notice.

Thus, Rule 7 makes it clear that a person who does not hold any shares in the company, may also be appointed as a Small Shareholders' Director.

Also, the disqualifications of a 'Small Shareholders' Director' are the same as that of any other director (specified under section 164). Since section 164 does not disqualify for appointment a person who does not hold any shares in the company, a person not holding any shares in the company is not disqualified for appointment as a small shareholders' director. Further, there is no eligibility criterion in terms of shareholding in the company for being appointed as a small shareholders' director. Therefore, it is possible to appoint a person as a small shareholders' director even if he does not hold even a single share in the company.

Answer to (iii).

1. **Tenure of small shareholders' director, and whether he can be reappointed?**
   (a) His tenure of office shall not exceed a period of 3 consecutive years.
   (b) He shall not be liable to retire by rotation.
   (c) On the expiry of the tenure, he shall not be eligible for re-appointment.
2. **Whether he can be appointed as an officer of the company on expiry of his tenure as small shareholders' director?**
   As per Rule 7, a small shareholders' director shall not, for a period of 3 years from the date on which he ceases to hold office as a small shareholders' director in a company, be appointed in or be associated with such company in any other capacity, either directly or indirectly.
   Thus, a person who ceases to be a small shareholders' director cannot be appointed as an officer of the company for a period of 3 years from the expiry of his tenure as small shareholders' director.

Tenure of small shareholders' director, whether he can be reappointed, and whether he can be appointed as an officer of the company on expiry of his tenure?

P 1.23D. B Ltd. is a listed company and it has been served with a notice for appointment of a small shareholders director. Referring to the provisions of the Companies Act, 2013, examine the following:

(i) The tenure of small shareholders' director and whether he can be re-appointed as such, after expiry of his tenure?

(ii) Whether he can be appointed as an officer of the company on expiry of his tenure as small shareholders' director.

[CA (Final) May 2019]

Ans. The provisions relating to appointment of directors by small shareholders are contained in section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

Answer to (i): Tenure of small shareholders' director, and whether he can be reappointed?

(a) The tenure of office of Small Shareholders' Director shall not exceed a period of 3 consecutive years.

(b) He shall not be liable to retire by rotation.

(c) On the expiry of the tenure, he shall not be eligible for re-appointment.

Answer to (ii): Whether he can be appointed as an officer of the company on expiry of his tenure as small shareholders' director?

As per Rule 7, a small shareholders' director shall not, for a period of 3 years from the date on which he ceases to hold office as a small shareholders' director in a company, be appointed in or be associated with such company in any other capacity, either directly or indirectly.

Thus, a person who ceases to be a small shareholders' director cannot be appointed as an officer of the company for a period of 3 years from the expiry of his tenure as small shareholders' director.

Number of companies in which a person can be a small shareholders' director

P 1.23E. Referring to the provisions of the Companies Act, 2013, examine the following:

Mr. Intelligent, was appointed as a small shareholder's director of XYZ Limited, which is in the business of Oil refining. Subsequently, A Limited and B Limited have also appointed him as small shareholder's director. Is the appointment valid?

[CA (Final) Nov. 2016]

Ans. The provisions relating to appointment of directors by small shareholders are contained in section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

As per Rule 7, a person shall not hold the position of Small Shareholders' Director in more than 2 companies at the same time. Further, it shall be ensured that the second company in which he is appointed as a Small Shareholders' Director shall not be in a business which is competing or is in conflict with the business of the first company.

In the given case, Mr. Intelligent is already a Small Shareholders' Director in XYZ Limited.

If Mr. Intelligent accepts the appointment as Small Shareholders' Director in A Limited as well as in B Limited, it would result in contravention of section 151 read with Rule 7. Thus, appointment of Mr. Intelligent as a Small Shareholders' Director in A Limited and B Limited is not valid.

Mr. Intelligent can accept the appointment as a Small Shareholders' Director either in A Limited or in B Limited. Also, Mr. Intelligent shall have to ensure that the second company (*i.e.* A Limited or B Limited) in which he accepts the directorship as a Small Shareholders' Director shall not be in a business which is competing or is in conflict with the business of XYZ Limited.

Appointment of small shareholders' director – Whether mandatory, procedure for appointment, term of office, etc.

P 1.23F. The Board of directors of M/s. Diya Steels and Aluminium Limited, a listed company having a paid up equity share capital of Rs. 15 crores and preference share capital of Rs. 1 crore and 1100 small shareholders holding equity shares, seeks your advice on the following:

(i) Is it mandatory for the company to appoint a director to represent small shareholders?

(ii) If the company decides to appoint such a director, the procedure to be followed by the company for such appointment and the tenure for which such appointment can be made.

(iii) Whether such a director be considered as an independent director?

(iv) When does a person appointed as a small shareholders director vacate his office?

Advise suitably in the light of the provisions of the Companies Act, 2013 and the rules framed thereunder. [CA (Final) Nov. 2018]

Ans. The given problem relates to section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014, as discussed below.

(i) Whether it is necessary for M/s Diya Steels and Aluminium Limited to appoint a Small Shareholders' Director?

1. Section 151 reads as under:

   A listed company may have 1 director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed.

2. Rule 7(1) reads as under:

   A listed company, may upon notice of not less than 1,000 small shareholders or 1/10th of the total number of such shareholders, whichever is lower, have a small shareholders' director elected by the small shareholders:

   Provided that nothing in this sub-rule shall prevent a listed company to opt to have a director representing small shareholders *suo motu* and in such a case the provisions of sub-rule (2) shall not apply for appointment of such director.

3. Rule 7(2) specifies the conditions and requirements to be complied with by the small shareholders for giving notice to the company for appointment of a small shareholders' director.

4. M/s Diya Steels and Aluminium Limited is a listed company, and so the provisions contained in section 151 and Rule 7 are applicable to it.

5. M/s Diya Steels and Aluminium Limited has not received any notice from the eligible small shareholders requiring it to appoint the small shareholders' director.

6. It is optional for M/s Diya Steels and Aluminium Limited to appoint the small shareholders' director. This is evident by use of the word 'may' in section 151 as well as in Rule 7(1) and use of the words "nothing in this sub-rule shall prevent a listed company to opt to have a director representing small shareholders suo motu" in proviso to Rule 7(1).

7. Thus, it is not mandatory for M/s Diya Steels and Aluminium Limited to appoint the small shareholders' director.

(ii) If M/s Diya Steels and Aluminium Limited decides to appoint a small shareholders' director, the procedure for such appointment and the tenure of small shareholders' director

1. Since M/s Diya Steels and Aluminium Limited has not received any notice from the eligible small shareholders requiring it to appoint the small shareholders' director, the procedure for giving notice by eligible small shareholders' as contained in Rule 7(2) shall not be applicable.

2. Neither section 151 nor rule 7 nor any other provision contained in the Act or the Rules specifies any specific procedure for appointment of a small shareholders' director, where a listed company opts to appoint a small shareholders' director *suo motu*.

3. As per section 110 read with Rule 22 of the Companies (Management and Administration) Rules, 2014, the appointment of a small shareholders' director shall be made by postal ballot.

4. In voting by postal ballot, only small shareholders shall have a right to vote. If the votes cast in favour of the resolution exceeds the votes cast against the resolution, the person proposed as small shareholders' director shall be appointed.

5. As per Rule 7(5), the tenure of small shareholders' director shall not exceed a period of 3 consecutive years and on the expiry of the tenure, he shall not be eligible for re-appointment.

(iii) Can a small shareholders' director be considered as an independent director?

As per Rule 7(4), a Small Shareholders' Director shall be considered as an independent director, if –

(a) he is eligible for appointment as an independent director as per sub-section (6) of section 149; and

(b) he gives a declaration of his independence as per sub-section (7) of section 149.

(iv) When does a person appointed as a small shareholders' director vacate his office?

As per Rule 7(7), the office of small shareholders' director shall become vacant if –

(a) he incurs any of the disqualifications specified in section 164;

(b) any of the grounds contained in section 167 becomes applicable on him;

(c) he ceases to meet the criteria of independence as provided in sub-section (6) of section 149.

A Small Shareholders' Director may be removed by passing an ordinary resolution in the general meeting in accordance with the provisions of section 169. At the time of voting on such resolution, every equity shareholder shall have a right to vote, irrespective of the fact as to whether he is a small shareholder or not. Removal under section 169 shall also result in vacation of office of the small shareholders' director.

A company in which a person is a small shareholders' director makes a default specified in section 164(2) – Whether office of small shareholders' director held by such person in such company and one other company becomes vacant?

P 1.23G. Mr. 'K' is a small shareholders' director in M/s KGP Tyres Limited from 1st April 2018 and in M/s VSR Cotton Mills Limited from 1st April 2019, in compliance with the relevant provisions of the Companies Act, 2013. M/s KGP Tyres Limited has not paid interest on the public deposits due from 1st July 2018. In the light of the information given above, examine the following under the provisions of the Companies Act 2013:

(i) Whether the office of Mr. 'K' (a small shareholders' director), shall become vacant in M/s KGP Tyres Limited and M/s VSR Cotton Mills Limited?

(ii) If yes, state the period from which the office of the directorship shall become vacant. [CA (Final) Nov. 2019]

Ans. The given problem relates to section 151 and section 164 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014, as discussed below.

The legal position

1. As per Rule 7(6), a person shall not be appointed as small shareholders' director of a company, if the person is not eligible for appointment in terms of section 164.
2. As per Rule 7(7), the office of small shareholders' director shall become vacant if –
   (a) he incurs any of the disqualifications specified in section 164;
   (b) any of the grounds contained in section 167 becomes applicable on him;
   (c) he ceases to meet the criteria of independence as provided in sub-section (6) of section 149.
3. As per section 164(2), a person who is or has been a director of a company shall be disqualified from being reappointed as a director of that company or appointed in any other company for a period of 5 years, if the company of which he is or has been a director –
   (a) has not filed financial statements or annual returns for any continuous period of 3 financial years; or
   (b) has failed to ⇨ – repay the deposits accepted by it or pay interest thereon; or – redeem any debentures on the due date or pay interest due thereon; or – pay the declared dividend, ⇨ and such failure continues for 1 year or more.
4. As per section 167, if a director who becomes disqualified under section 164(2) is also a director in any other company, then, his office of director in all such other companies shall become vacant, but his office of director in the defaulting company shall not become vacant.

The given case and analysis of the case

5. M/s KGP Tyres Limited has defaulted in payment of interest on public deposits which became due on 1st July, 2018. Assuming that such default in payment of interest has continued till 30th June, 2019, all the directors of M/s KGP Tyres Limited shall be disqualified for appointment as a director for a period of 5 years, as per the provisions of section 164(2).
6. If any director of M/s KGP Tyres Limited holds office of director in any other company also, then, his office of director in such other company shall become vacant, but his office of director in M/s KGP Tyres Limited shall not become vacant.
7. Mr. 'K' is a small shareholder director in M/s KGP Tyres Limited and M/s VSR Cotton Mills Limited. As per Rule 7(6) and Rule 7(7), the grounds of disqualification and vacation of office as contained in sections 164 and 167 respectively, shall apply to him in the same manner as they apply to any other director.

Conclusions

8. As a result of default in payment of interest on public deposits by M/s KGP Tyres Limited, –
   (a) Mr. K stands disqualified for being appointed as a director for a period of 5 years, *i.e.* from 1st July, 2019 to 30th June, 2024 [As per section 164(2)].
   (b) The office of small shareholders' director held by Mr. K in M/s KGP Tyres Limited shall not become vacant [As per section 167(1)].
   (c) The office of small shareholders' director held by Mr. K in M/s VSR Cotton Mills Limited shall become vacant on 1st July, 2019 [As per section 167(1)].

Other Practical Problems

400 small shareholders out of total 5,000 small shareholders serve a notice requiring appointment of Small Shareholders' Director – Can the company refuse to make the appointment?

P 1.23H. ABC Ltd., a listed company having 5,000 small shareholders, upon receiving notice from 400 of such small shareholders has refused to appoint a small shareholders' director under section 151 of the Companies Act, 2013. Examine the validity of refusal of the company. **[ICAI, Revision Test Paper, May 2016]**

Ans. The provisions relating to appointment of directors by small shareholders are contained in section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

The legal position

1. The provisions contained in section 151 read with Rule 7 are applicable to listed companies only.
2. The small shareholders are entitled to give a notice to the company requiring the company to make appointment of a Small Shareholders' Director. The notice shall be given by at least –
   (i) 1,000 small shareholders; or
   (ii) 1/10th of the total number of small shareholders
   whichever is lower.
3. The notice shall be signed by all the small shareholders proposing the appointment of Small Shareholders' Director.

The given case and analysis of the case

4. ABC Ltd. is a listed company. It has 5,000 small shareholders. 400 small shareholders have given a notice to the company requiring the company to appoint a Small Shareholders' Director.
5. The small shareholders eligible to give notice for appointment of Small Shareholders' Director shall be –
   (a) 1,000 small shareholders; or
   (b) 1/10th of 5,000, *i.e.* 500 small shareholders,
   whichever is lower.
   Since lower of 1,000 and 500 is 500, the notice for appointment of Small Shareholders' Director has to be given by at least 500 small shareholders.
6. The notice given by 400 small shareholders does not satisfy the eligibility requirements for giving such notice since it has not been given by at least 500 small shareholders.

Conclusion

7. Since the requirements of section 151 read with Rule 7 have not been satisfied, it is not mandatory for ABC Ltd. to appoint a Small Shareholders' Director and so ABC Ltd. can validly refuse to act on such notice.

Notice for appointment of a Small Shareholders' Director given by some small shareholders – Various issues

P 1.23I. M/s. Bharat Pharma Limited is a company listed with Bombay Stock Exchange. The company has 500 small shareholders. Some of the small shareholders want to appoint Mr. A as a director as their representative on the Board of directors of the said company. Mr. A holds 1000 equity shares of Rs. 10 each in the said company. State, in the light of the Companies Act, 2013, whether the proposal to appoint Mr. A as a Small Shareholders' Director can be adopted by the company. What would be your answer if Mr. A is already holding a position of Small Shareholders' Director in two companies. **[ICAI, RTP, Nov. 2015]**

Ans. The provisions relating to appointment of directors by small shareholders are contained in section 151 of the Companies Act, 2013 read with Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

The legal position

1. The provisions contained in section 151 read with Rule 7 are applicable to listed companies only.
2. The small shareholders are entitled to give a notice to the company requiring the company to make appointment of a Small Shareholders' Director. The notice shall be given by at least –
   (i) 1,000 small shareholders; or
   (ii) 1/10th of the total number of small shareholders,
   whichever is lower.

3. The notice shall be signed by all the small shareholders proposing the appointment of Small Shareholders' Director.
4. A person shall not hold the position of Small Shareholders' Director in more than 2 companies at the same time.

The given case and analysis of the case

5. M/s Bharat Pharma Limited is a listed company. Some small shareholders have given a notice to the company requiring the company to appoint a Small Shareholders' Director.
6. The small shareholders eligible to give notice for appointment of Small Shareholders' Director shall be –
   (a) 1,000 small shareholders; or
   (b) 1/10th of 500, i.e. 50 small shareholders,
   whichever is lower.
   Since lower of 1,000 and 50 is 50, the notice for appointment of Small Shareholders' Director has to be given by at least 50 small shareholders.
7. Whether the eligibility requirements for giving notice for appointment of Small Shareholders' Director are fulfilled or not, is not clear, since the Question states that the notice has been given by 'some' small shareholders.

Conclusions

8. If the notice is given by 50 or more small shareholders of M/s Bharat Pharma Limited, then, the company shall adopt the procedure given in Rule 7 for appointment of the Small Shareholders' Director.
9. Neither section 151 nor Rule 7 states any eligibility criterion for appointment of a person as a Small Shareholders' Director. Thus, any person may be appointed as a Small Shareholders' Director, whether or not he himself is a small shareholder. Thus, Mr. A, holding 1,000 shares of Rs. 10 each, may be appointed as a Small Shareholders' Director.
10. If Mr. A already holds position of Small Shareholders' Director in 2 companies, then, he cannot be appointed as a Small Shareholders' Director in M/s Bharat Pharma Limited.

1.24 Appointment of an additional director [Section 161(1)]

Although it is the prerogative of the members to appoint the directors, yet the exigencies of corporate management may demand appointment of directors by the Board of directors itself. Accordingly, section 161(1) authorises the Board to appoint additional directors from time to time. However, such power should be exercised in the best interests of the company.

The provisions applicable to an additional director are explained as follows:

1. Conditions for appointment of an additional director

The Board may, at anytime, in its discretion, appoint the additional directors. However, the power of the Board to appoint an additional director is restricted, as follows:

(a) Section 161(1) does not give any power to the Board to appoint additional directors. The Board may appoint the additional directors only if the articles of the company authorise the Board to appoint the additional directors.

1. **Model provisions of Table F**

   Regulation 66 of Table F authorises the Board to appoint the additional directors. Therefore, if Regulation 66 of Table F is applicable to a company, the Board may appoint the additional directors even if the registered articles of the company do not contain any express provision empowering the Board to appoint the additional directors.

2. **Conclusions with respect to power of the Board to appoint the additional directors**

   Where Regulation 66 of Table F is not applicable to a company and the registered articles of the company do not empower the Board to appoint the additional directors, –

   (a) the Board cannot appoint the additional directors even if the members, by passing an ordinary resolution or a special resolution in the general meeting, authorise the Board to appoint the additional directors;

   (b) the Board shall be empowered to appoint the additional directors only if the members, by passing a special resolution, alter the articles of the company in such a way that the articles authorise the Board to appoint the additional directors;

   (c) the members may appoint a director in accordance with the provisions of section 152(2), but such director shall not be an 'additional director' as per section 161(1), and the provisions contained in section 161(1) shall not apply to him.

(b) A person who fails to get appointed as a director in a general meeting, cannot be appointed as an additional director.

2. Relaxations in the appointment of an additional director

(a) ***Appointment by resolution by circulation.*** There is no condition that an additional director shall be appointed only by passing a resolution at a Board meeting. Thus, an additional director may be appointed by passing a resolution at a Board meeting or by passing a resolution by circulation.

(b) Appointment at the discretion of the Board. The Board may, at any time, in its discretion, appoint additional directors.

The appointment of an additional director may be made by the Board, by –

(a) passing a resolution by circulation (as per section 175); or

(b) passing a resolution in a Board meeting (termed as 'Board resolution' or 'resolution by majority', but it would be incorrect to term it as 'ordinary resolution of the Board' or 'ordinary resolution' since the term 'ordinary resolution' is defined under section 114 to mean a resolution passed by the members, and not by the Board).

3. Term of office of an additional director

The additional director has a limited term of office. He holds office upto –

(a) the date of next annual general meeting; or

(b) the last date on which the annual general meeting should have been held (in case AGM is not held upto the last due date);

whichever is earlier.

Consequences if annual general meeting is not held

If default is made in holding annual general meeting, the additional director shall vacate his office on the last day on which the annual general meeting ought to have been held.

4. Position of an additional director

An additional director has the same rights, powers, duties and liabilities as any other director. The provisions relating to disqualifications, grounds of vacation of office, disclosure of interest by a director, etc. are applicable to an additional director as they apply to any other director. Further, there is no restriction that an additional director can be appointed as a non-executive director only. He may be appointed as a whole time director or managing director in accordance with the provisions of the Act.

1. **Applicability of section 161(1)**

   Section 161(1) applies to all companies, whether public or private.

2. **Limit on number of additional directors**

   As per Regulation 66 of Table F, the number of the directors and additional directors together shall not exceed the maximum strength fixed for the Board by the articles.

3. **Additional director is not a 'retiring director'**

   An additional director holds office upto the next annual general meeting, *i.e.* he does not retire at the next annual general meeting. Therefore, he is not a 'retiring director' within the meaning of section 152 and 160 [Explanation to section 152(7)]. Thus, appointment of an additional director as a regular director (*i.e.* appointment as a director by the members at the annual general meeting) requires compliance with the provisions of section 160.

4. **Section 161(1) does not override Section 152(6)(a)**

   Section 161(1) does not override Section 152(6)(a). Therefore, –

   (a) at the time of appointment of additional director, it must be ensured that the provisions of Section 152(6)(a) are not contravened.

   (b) additional directors shall be included while calculating the 'total number of directors' [Explanation to Section 152(6)].

Practical Problems from CA Examinations

AGM not-held – Can additional directors continue in office?

P 1.24A. M, who was appointed as additional director at the Board meeting held on 31st May, 2014 continues to be in his office on the ground that the annual general meeting for the financial year 2013-14 was not held as required under the Act. Whether continuation of M in the office is valid? Will your answer be different if M was also appointed as managing director for a period of 5 years with effect from 1st June 2014 at the same Board meeting? [CA (Final) May 1996 (Modified)]

Ans. As per section 161(1) of the Companies Act, 2013, an additional director holds office upto the date of next annual general meeting or the last day on which the annual general meeting should have been held, whichever is earlier. Thus, an additional director vacates his office on the last day on which the annual general meeting ought to have been held as per the provisions of section 96 of the Companies Act, 2013, and cannot continue in office thereafter on the ground that the meeting was not called or could not be held within the time prescribed under section 96.

A managing director must be a director of the company. Therefore, if a managing director ceases to be a director, he automatically ceases to be a managing director. Accordingly, where an additional director, who is also appointed as a managing director, vacates the office of the additional director at the annual general meeting, the office of the managing director also ceases simultaneously with the cessation of office of additional director.

However, if the additional director is re-elected as a regular director at the annual general meeting (by complying with the provisions of section 160 of the Companies Act, 2013) and thereby he continues as a director, he shall continue as a managing director also for the period for which he has been appointed as a managing director.

Thus, in the given case –

- M would vacate the office of a director on the last day on which the annual general meeting ought to have been held as per section 96.
- Only a director can be appointed as a managing director. Since, M vacates the office of additional director, the office of managing director is also vacated, as he is not re-elected as a regular director at the annual general meeting. He shall vacate the office of managing director irrespective of the fact that his appointment as a managing director was made for a period of 5 years.

Appointment of an additional director as a regular director – Legal requirements

P 1.24B. One of the items to be considered at the annual general meeting of a public company is the reappointment of a director who has been appointed as an additional director at a Board meeting. State the statutory requirements under the Companies Act, 2013. [CA (Final) Nov. 1996 (Modified)]

OR

Mr. Suresh, an additional director appointed by the board of directors of a public company, is proposed to be appointed as a regular director in the Annual General Meeting. Explain the requirements under the Companies Act, 2013 to give effect to the proposed appointment. [CA (Final) Nov. 2008]

Ans. 'Retiring director' for the purpose of sections 152 and 160 of the Companies Act, 2013, means a director retiring by rotation [Explanation to section 152(7)]. Where a director retires by rotation, he can be reappointed without complying with the requirements of section 160 of the Companies Act, 2013 [Section 152(6)(e)].

However, an additional director holds office upto the date of next annual general meeting (Section 161(1) of the Companies Act, 2013), *i.e.* he does not retire by rotation. Therefore, if an additional director seeks appointment as a regular director, he must comply with the requirements of section 160.

Following requirements shall be complied with:

1. **Requirements of notice**
   (a) Notice proposing the appointment of additional director must be given to the company either by the additional director himself or by some other member of the company.
   (b) Notice shall be given at least 14 days before the annual general meeting.
   (c) Notice shall be deposited at the registered office of the company.
   (d) A sum of Rs. 1 lakh shall be deposited along with the notice.
   (e) The amount deposited with the company shall be refunded, if the person proposed as a director –
      (i) gets elected as a director; or
      (ii) gets more than 25% of the total valid votes cast (whether on a show of hands or on poll).
2. **Duty of the company to inform its members**
   The company shall inform its members about the candidature of the person proposed as a director in such manner as may be prescribed.

Additional director - Appointment by whom, consequences if AGM is not held etc.

P 1.24C. Prince Ltd. desires to appoint an additional director on its board of directors. The Articles of the company confer upon the board to exercise the power to appoint such a director. As such M is appointed as an additional director. In the light of the provisions of the Companies Act, 2013 examine:

(i) Whether M can continue as director if the annual general meeting of the company is not held within the stipulated period and is adjourned to a later date?

(ii) Can the power of appointing additional director be exercised by the Annual General Meeting?

(iii) As the Company Secretary of the company what checks would you make after M is appointed as an additional director? [CA (Final) May 2010]

Ans. The provisions relating to additional director are contained in section 161(1) of the Companies Act, 2013. Applying these provisions, the given problem is answered as under:

(i) An additional director holds office upto the date of next annual general meeting or the last day on which the annual general meeting should have been held, whichever is earlier.

In the given case, the AGM could not be held as scheduled, and is adjourned to a later date. Therefore, M shall have to vacate his office on the last day on which the annual general meeting ought to have been held as per section 96 of the Companies Act, 2013.

(ii) The power to appoint additional directors is expressly conferred on the Board of directors by Section 161(1) of the Companies Act, 2013. Accordingly, it is not possible for the members to exercise this power. Thus, additional directors cannot be appointed in the annual general meeting or any other general meeting **[*Blair Open Hearth Furnace Co. Ltd.* v *Reigart* (1914) 1 Ch. 390]**.

However, in some exceptional cases like when there is a deadlock in the Board or where all the directors become interested, the power to appoint additional directors may be exercised by the members **[*Barron* v *Potter* (1914) 1 Ch 895]**.

(iii) The Company Secretary of the company should apply the following checks:

(a) That Mr. M is not disqualified as per the provisions of section 164 and other applicable provisions of the Companies Act, 2013.

(b) That Mr. M holds a valid Director Identification Number before he is appointed as an additional director.

(c) That before appointment, Mr. M furnished to the company his Director Identification Number and a declaration that he is not disqualified to become a director under this Act.

(d) That Mr. M has furnished to the company his consent in writing to act as a director in Form DIR-2.

(e) That the consent filed by Mr. M with the company is filed by the company with the Registrar in Form DIR-12 within 30 days of appointment of Mr. M .

(f) That the particulars of Mr. M along with the details of his shareholding are entered into the register of directors and key managerial personnel maintained as per the provisions of section 170.

Issues relating to additional director – Where AGM is not held, appointment by members and appointment of a person who failed to get appointed at AGM

P 1.24D. Queens Limited is a company listed at Bombay Stock Exchange. Company's Articles empower the Board of directors to appoint additional director. The Board of directors, therefore, appoints Mr. K, as the additional director. It may, however, be pointed out that earlier, the proposal to appoint Mr. K, as a director on the company's Board was rejected by the members at the company's annual general meeting.

Examining the provisions of the Companies Act, 2013 answer the following:

(i) Whether Mr. K's appointment as additional director by the Board of directors is valid?

(ii) Whether the company's annual general meeting can appoint Mr. K as the additional director when the proposal to appoint comes before the meeting for the first time?

(iii) In case the AGM of the company is not held within the stipulated time, decide whether Mr. K who was appointed by the Board as additional director, for the first time, can continue to act as a director? [CA (Final) May 2015]

Ans. The provisions relating to additional director are contained in section 161(1) of the Companies Act, 2013. Applying these provisions, the given problem is answered as under:

(i) As per section 161(1), a person who fails to get appointed as a director in a general meeting, cannot be appointed as an additional director. Since, earlier, the proposal to appoint Mr. K as a director of the company was rejected by the members at the company's Annual General Meeting, Mr. K cannot be appointed as an additional director.

(ii) The power to appoint additional directors is expressly conferred on the Board of directors by Section 161(1) of the Companies Act, 2013. Accordingly, it is not possible for the members to exercise this power. Thus, additional directors cannot be appointed in the annual general meeting or any other general meeting **[*Blair Open Hearth Furnace Co. Ltd.* v *Reigart* (1914) 1 Ch. 390]**.

However, in some exceptional cases like when there is a deadlock in the Board or where all the directors become interested, the power to appoint additional directors may be exercised by the members **[*Barron* v *Potter* (1914) 1 Ch 895]**.

(iii) An additional director holds office upto the date of next annual general meeting or the last day on which the annual general meeting should have been held, whichever is earlier.

Therefore, if the AGM is not held upto the last day AGM ought to have been held as per section 96 of the Companies Act, 2013, Mr. K shall have to vacate his office on the last day on which the AGM ought to have been held.

AGM could not be held due to heavy rains and floods – Can the additional director continue in case extension of time is granted by the Registrar?

P 1.24E. Mr. Abhi was appointed as an additional director of Pioneer Limited on 14th March, 2016. The annual general meeting of the company was scheduled to be held on 29th September, 2016 but due to heavy rains and floods all records of the company were destroyed. In order to rebuild the records, the company approached the Registrar of Companies for extension of time for holding the annual general meeting till 30th December, 2016. In the light of the Companies Act, 2013 advise Mr. Abhi, who was appointed as additional director during the year. [CA (Final) May 2017]

Ans. The given problem relates to section 161(1) read with section 96 of the Companies Act, 2013.

The legal position

1. As per section 161(1), an additional director holds office upto the date of next annual general meeting or the last day on which the annual general meeting should have been held, whichever is earlier.
2. If the AGM is not held upto the last day AGM ought to have been held as per section 96, the additional director shall have to vacate his office on the last day on which the AGM ought to have been held.
3. As per section 96, the company shall hold AGM within 6 months of the close of the financial year.
4. As per section 96, the Registrar may, for any special reason, grant extension of time (not exceeding 3 months)

The given case and analysis of the case

5. AGM of Pioneer Ltd. could not be held on 29th September, 2016 due to heavy rains and floods. Generally, such reasons are considered as 'special reason' within the meaning of section 96, and accordingly extension of time is granted by the Registrar.
6. Pioneer Ltd. has applied to the Registrar for extension of time for holding the AGM till 30th December, 2016. The question is silent as to whether the Registrar has granted extension of time or not.
7. Assuming that the Registrar granted the extension of time for holding the AGM till 30th December, 2016, the issue that arises is 'whether Mr. Abhi can continue as additional director till 30th December, 2016?'
8. The last date for holding the AGM without any extension of time is 30th September, 2016, and the last date for holding AGM including extension of time is 30th December, 2016.
9. As per section 161(1), the additional director cannot continue beyond the last date on which the AGM ought to have been held. However, in the situation raised in the given question in which the extension of time is granted by the Registrar, section 161(1) is silent as to whether the additional director can continue in office upto the last date of the AGM including the extension granted by the Registrar.
10. As per reasonable interpretation, where extension is granted by the Registrar, the additional director should have a right to continue in office upto the date of the AGM including the extension granted by the Registrar.

Conclusion

11. Mr. Abhi is entitled to continue in office as additional director upto 30th December, 2016. If for any reason AGM is not held upto 30th December, 2016, Mr. Abhi shall have to vacate his office on 30th December, 2016.

Practical Problems from CS Examinations

Additional director appointed as a managing director – Whether ceases to be a managing director at next AGM?

P 1.24F. Samrat, vice-president of PQR Ltd., was appointed as an additional director in January, 2014. On the office of managing director falling vacant he was appointed as managing director on existing remuneration. Whether Samrat will cease to be managing director in the next annual general meeting? [CS (Final) Dec. 2000 (Modified)]

Ans. The given problem relates to section 161(1), Explanation to section 152(7), section 2(54) and section 160 of the Companies Act, 2013.

As per section 161(1), an additional director holds office upto the date of next annual general meeting.

As per Explanation to Section 152(7), 'retiring director' means a director retiring by rotation. Since an additional director does not retire by rotation, he is not a 'retiring director' as per Explanation to Section 152(7). Therefore, an additional director may be appointed as a regular director in the annual general meeting only if the conditions prescribed under section 160 are complied with.

The term 'managing director' is defined under clause (54) of section 2 of the Companies Act, 2013. The opening words of clause (54) of section 2 are as under:

"Managing director means a director who....". The use of the words 'a director' in clause (54) of section 2 makes it clear that a managing director has to be a director first. If a managing director ceases to be a director, he will automatically cease to be a managing director.

In the given case, Samrat will hold office upto the date of next annual general meeting. Since, he will cease to be a director, he will also vacate the office of managing director. Further, even if the annual general meeting is not held, he will cease to be an additional director on the last day, on which the annual general meeting ought to have been held (Section 161(1) of the Companies Act, 2013).

However, if a notice is given of the candidature of Samrat under section 160 and at the annual general meeting he is appointed as a director, he shall continue as a managing director.

Advanced Practical Problems

Legal requirements for appointment of 6 additional directors by a company having 10 directors

P 1.24G. The maximum number of directors as per the articles of association of Deficient Ltd. is 12. At present, Deficient Ltd. has 10 directors. The Board of directors of Deficient Ltd. proposes to appoint 6 additional directors. Can the Board do so?

Ans. As per section 149(1), a company shall have a maximum of 15 directors. However, a company may appoint more than 15 directors by passing a special resolution.

As per Regulation 66 of Table F, the number of the directors and additional directors together shall not at any time exceed the maximum strength fixed for the Board by the articles.

As per section 161(1), the Board may, at anytime, in its discretion, appoint the additional directors, if the articles of the company so authorise the Board. As per Regulation 66 of Table F, the Board is authorised to appoint the additional directors.

Assuming that Regulation 66 of Table F is applicable to Deficient Ltd., the Board of directors of Deficient Ltd. may appoint 6 additional directors. However, if Regulation 66 of Table F is not applicable to Deficient Ltd. and the articles of association of Deficient Ltd. do not authorise the appointment of additional directors, then, Deficient Ltd. shall have to alter its articles (by passing a special resolution) authorising its Board of directors to appoint the additional directors.

The appointment of 6 additional directors may be made either by passing a resolution at a Board meeting or by passing a resolution by circulation.

However, before the appointment of 6 additional directors is made by the Board of directors, Deficient Ltd. shall ensure the following:

1. That a special resolution has been passed by the members approving the appointment of more than 15 directors [Section 149(1)].
2. That a special resolution has been passed by the members for alteration of articles of association of the company, and the amended articles provide for the maximum number of directors as 16 or more than 16. The company shall have to comply with other legal requirements for alteration of articles as contained in section 14.

Appointment of 3 additional directors by a company having 6 rotational and 3 non-rotational directors – Whether permissible?

P 1.24H. The maximum number of directors as per the articles of association of A Ltd. is 12. The company has appointed 9 directors out of which 6 are rotational directors and 3 are non-rotational directors. The Board of directors of A Ltd. intends to appoint 3 additional directors. Answer the following questions:

(a) Can the Board appoint 3 additional directors as per section 260 of the Companies Act, 1956?

(b) Can the Board appoint 3 additional directors as per section 161(1) of the Companies Act, 2013?

Ans.

(a) Section 260 of the Companies Act, 1956 reads as under:

"Nothing in section 255, 258 or 259 shall affect any power conferred on the Board of directors by the articles to appoint additional directors:

Provided that such additional directors shall hold office only upto the date of the next annual general meeting of the company:

Provided further that the number of the directors and additional directors together shall not exceed the maximum strength fixed for the Board by the articles."

The provisions relating to rotational and non-rotational directors are contained in section 255 of the Companies Act, 1956. It is clear from the language of section 260 of the Companies Act, 1956 that while appointing an additional director as per section 260 of the Companies Act, 1956, the provisions of section 255 of the Companies Act, 1956 are not required to be complied with. Thus, as per the provisions of section 260 of the Companies Act, 1956, the Board of directors of A Ltd. can appoint 3 additional directors, if the Board is so authorised by the articles.

Section 260 of the Companies Act, 1956 corresponds to section 161(1) of the Companies Act, 2013. Section 161(1) of the Companies Act, 2013 has come into force with effect from 12.09.2013 and is relevant for Exams. Section 260 of the Companies Act, 1956 is not applicable for Exams, but has been included here so that the students may compare it with section 161(1) of the Companies Act, 2013.

(b) Section 161(1) of the Companies Act, 2013 reads as under:

"The articles of a company may confer on its Board of Directors the power to appoint any person, other than a person who fails to get appointed as a director in a general meeting, as an additional director at any time who shall hold office upto 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."

The provisions relating to rotational and non-rotational directors are contained in section 152(6) of the Companies Act, 2013.

It is clear from the language of section 161(1) of the Companies Act, 2013 that section 161(1) does not override Section 152(6). Therefore, at the time of appointment of additional director, it must be ensured that the provisions of Section 152(6)(a) are not contravened. Also, the term 'total number of directors' as defined under Explanation to section 152(6) does not state that additional directors shall not be included in the total number of directors. Accordingly, the additional directors shall be included while calculating the 'total number of directors' for the purpose of section 152(6).

At present, the total number of directors of A Ltd. is 9 out of which 6 are rotational directors and 3 are non-rotational directors. If 3 additional directors are appointed by the Board, the total number of directors will increase to 12, and the number of non-rotational directors will increase to 6, but the rotational directors will be only 6. Since the rotational directors will be less than 2/3rd of total number of directors, it would result in a contravention of section 152(6). Accordingly, the Board of directors of A Ltd. cannot appoint the 3 additional directors, even if the Board is so authorised by the articles.

Difference in answer as compared to the answer given by ICAI

The Author's answer to part (b) of this question differs from the answer given in the Practice Manual applicable for November, 2016 Exams issued by the Board of Studies, ICAI. The answer given by ICAI in the Practice Manual is as under:

"Under section 161 (1) of the Companies Act, 2013, the articles of association of a company may confer on its Board of Directors the power to appoint any person, other than a person who fails to get appointed as a director at the general meeting, as an additional director at any time and such director will hold office upto the date of the next annual general meeting or the last date on which such annual general meeting should have been held, whichever is earlier.

From the above provision, it is clear the Board of directors of the company can appoint the additional directors only if they are authorized by the articles of the company to do so. In case such power is not given by the articles of the company, the articles will first have to be altered to confer such power on the Board after which the Board can appoint the 3 additional directors.

Further, 3 additional directors can be appointed as even after appointing 3 additional directors, the total number of directors will not exceed the limit as prescribed in the Articles of Association."

The Author does not agree with the answer given in the Practice Manual for November, 2016 Exams.

The students are advised to analyze the difference between section 260 of the Companies Act, 1956 and section 161(1) of the Companies Act, 2013 so that they may understand the reason for the difference in the answers of the Author and the Practice Manual.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

A person who fails to get appointed as a director in general meeting, is appointed as an additional director – Validity of such appointment

P 1.241. Mr. D, who fails to get appointed as a director in the general meeting of AJD Limited, was subsequently appointed as an additional director by the Board of directors of the company. Examine the validity of appointment of Mr. D, with reference to the provisions of the Companies Act, 2013. [ICAI, Revision Test Paper, May 2016]

Ans. The provisions relating to additional director are contained in section 161(1) of the Companies Act, 2013.

As per section 161(1), a person who fails to get appointed as a director in a general meeting, cannot be appointed as an additional director. Since, earlier, the proposal to appoint Mr. D as a director of the company was rejected by the members at the company's Annual General Meeting, Mr. D cannot be appointed as an additional director.

1.25 Filling of casual vacancies by the Board [Section 161(4)]

A casual vacancy in the office of a director may adversely affect the working of the company. Thus, section 161(4) ensures that a casual vacancy is timely filled in, if so required, and thus, facilitates smooth running of the company.

The provisions relating to filling of casual vacancies are explained as follows:

1. **Manner of filling casual vacancy**
   (a) No express power in the articles is required for filling a casual vacancy.
   (b) However, where the articles provide the manner of filing a casual vacancy, any casual vacancy shall be filled in accordance with the articles.
   (c) Where the articles of a company are silent, then a casual vacancy may be filled by the Board, but only by passing a resolution at a Board meeting, and the appointment made by the Board shall be subsequently approved by the members in the immediately next general meeting.
2. **Can all casual vacancies be filled by the Board?**
   The Board is authorised to fill a casual vacancy in the office of a director only if he was appointed by the company in general meeting. Where a casual vacancy filled by the Board is again vacated, the resulting vacancy cannot be filled by the Board under section 161(4). The Board in such a case can only appoint an additional director, if so authorised by the articles.
3. **Term of office of a director filling a casual vacancy**
   The director filling a casual vacancy holds office only upto the date upto which the director in whose place he is appointed would have held office if it had not been vacated.

1. **Meaning of a 'casual vacancy'**
   A 'casual vacancy' means any vacancy occurring by reason of death, resignation, disqualification, removal or for any other reason other than retirement or expiry of tenure of office of a director. *In other words,* if the office of a director comes to an end otherwise than in the normal course, such vacancy is called as a casual vacancy.

Director not assuming office. Where a director appointed in general meeting does not assume office, no casual vacancy arises. The words used in section 161(4) 'before the term of office will expire in the normal course' imply that firstly a valid appointment of a director should be made and if thereafter a vacancy occurs in his office, it can be filled as a casual vacancy. Where a director does not assume office, there can be no question of vacating that office.

2. **Applicability of section 161(4)**

   Section 161(4) applies to all companies, whether public or private.

3. **Model provisions of Table F**

   There is no provision in Table F regarding filling of casual vacancies.

4. **No obligation of the company to fill a casual vacancy**

   It is not obligatory for the company to fill a casual vacancy, and the Board may resolve to keep the vacancy unfilled.

5. **A director filling a casual vacancy is not a 'retiring director'**

   A director filling a casual vacancy holds office till the expiry of the term of the director in whose place he was appointed, *i.e.* he does not retire at an annual general meeting. Therefore, he is not a 'retiring director' within the meaning of sections 152 and 160 [Explanation to section 152(7)]. Thus, his appointment as a regular director (*i.e.* appointment as a director by the members at a general meeting) requires compliance with section 160.

Practical Problems from CA Examinations

Appointment of director appointed in casual vacancy as a regular director

P 1.25A. The Board of directors of XYZ Limited appointed Mr. A as a director in the casual vacancy caused by resignation of Mr. X. Mr. A is proposed to be reappointed as a director at the annual general meeting, when he vacates his office.

Examine with reference to the relevant provisions of the Companies Act, 2013, whether Mr. A can be considered as a 'retiring director' and state the legal requirements to be fulfilled to give effect to the proposed appointment of Mr. A as a director at the annual general meeting. [CA (Final) Nov. 2003]

Ans. A director who retires by rotation as per the provisions of section 152(6) is termed as a 'retiring director'. *In other words*, 'retiring director' means a director retiring by rotation [Explanation to section 152(7)]. Where a director retires by rotation, he may be reappointed without complying with the requirements of section 160 [Section 152(6) read with section 160].

However, a director filling a casual vacancy *holds office* till the expiry of the term of the director in whose place he was appointed, *i.e.* he *does not retire* at an annual general meeting. He is appointed by the Board (*i.e.* he is not appointed in the general meeting), and so he is not a rotational director, and consequently, he is not a 'retiring director' within the meaning of sections 152(6) and 160 [As per Explanation to section 152(7)]. Thus, his appointment as a regular director (*i.e.* appointment as a director by members at a general meeting) requires compliance with the following legal requirements of section 160:

1. **Requirements of notice**
   - (a) Notice proposing the appointment of Mr. A must be given to the company either by Mr. A himself or by some other member of the company.
   - (b) Notice shall be given at least 14 days before the annual general meeting.
   - (c) Notice shall be deposited at the registered office of the company.
   - (d) A sum of Rs. 1 lakh shall be deposited along with the notice.
   - (e) The amount deposited with the company shall be refunded, if the person proposed as a director –
     - (i) gets elected as a director; or
     - (ii) gets more than 25% of the total valid votes cast (whether on a show of hands or on poll).
2. **Duty of the company to inform its members**

   The company shall inform its members about the candidature of the person proposed as a director in such manner as may be prescribed.

Can a casual vacancy in the office of a director filling a casual vacancy be filled?

P 1.25B. The Board of Directors of XYZ Ltd. filled up a casual vacancy caused by the death of Mr. P by appointing Mr. C as a director on 3rd April, 2014. Unfortunately Mr. C expired on 15th May, 2014 after working about 40 days as a director. The Board now wishes to fill up the casual vacancy by appointing Mrs. C in the forthcoming meeting of the Board. Advise the Board in this regard. [CA (Final) June 2009]

Ans. As per Section 161(4) of the Companies Act, 2013, the Board is authorised to fill a casual vacancy in the office of a director only if he was appointed by the company in general meeting. Further, the appointment made by the Board shall be subsequently approved by the members in the immediately next general meeting.

In the given case, a casual vacancy has arisen as a result of death of Mr. P. Assuming that Mr. P was appointed as a director in a general meeting, such casual vacancy could be filled up by the Board under section 161(4), and has actually been filled up by appointing Mr. C. The appointment of Mr. C also required the approval of the members in the immediately next general meeting, but before any general meeting could be held, Mr. C died. With respect to appointment of Mr. C, there is no contravention of section 161(4).

The death of Mr. C has also resulted in a casual vacancy. However, this casual vacancy cannot be filled up by the Board under section 161(4) since the casual vacancy has arisen in the office of Mr. C who was not appointed in a general meeting. Accordingly, the proposal of the Board to appoint Mrs. C to fill the casual vacancy in the office of Mr. C is not valid.

The Board is advised to appoint Mrs. C as an additional director under section 161(1), if so authorised by the articles. As an additional director, Mrs. C shall hold office till the next annual general meeting.

Casual vacancy filled up by the Board, but after 10 days again the casual vacancy arises – Can such casual vacancy be filled up by the Board?

P 1.25C. The Board of directors of Tours Ltd., in terms of the articles of the company, filled up the causal vacancy caused by the resignation of Mr. Philip (who was appointed in a duly held general meeting) by appointing Mr. Max as a director on 1st May, 2019. Unfortunately Mr. Max expired on 10th May, 2019 after working for a period of about 10 days as a director. The Board now intends to fill up the causal vacancy by appointing Mrs. Nini (wife of late Mr. Max) in the forthcoming meeting of the Board. Referring to and analysing the provisions of Companies Act, 2013, Advise the Board whether it can do so. [CA (Final) May, 2019]

Ans. As per Section 161(4) of the Companies Act, 2013, the Board is authorised to fill a casual vacancy in the office of a director only if he was appointed by the company in general meeting. Further, the appointment made by the Board shall be subsequently approved by the members in the immediately next general meeting.

In the given case, a casual vacancy has arisen as a result of resignation of Mr. Philip. Since Mr. Philip was appointed as a director in a general meeting, such casual vacancy could be filled up by the Board under section 161(4), and has actually been filled up on 1st May, 2019 by appointing Mr. Max. The appointment of Mr. Max also required the approval of the members in the immediately next general meeting, but before any general meeting could be held, Mr. Max died on 10th May, 2019. With respect to appointment of Mr. Max, there is no contravention of section 161(4).

The death of Mr. Max has also resulted in a casual vacancy. However, this casual vacancy cannot be filled up by the Board under section 161(4) since the casual vacancy has arisen in the office of Mr. Max who was not appointed in a general meeting. Accordingly, the proposal of the Board to appoint Mrs. Nini to fill the casual vacancy in the office of Mr. Max is not valid.

The Board is advised to appoint Mrs. Nini as an additional director under section 161(1), if so authorised by the articles. As an additional director, Mrs. Nini shall hold office till the next annual general meeting or the last date on which the annual general meeting should have been held (in case AGM is not held upto the last due date), whichever is earlier.

Appointment of additional director in a casual vacancy by passing a circular resolution – Validity of appointment and continuation beyond AGM

P 1.25D. Mr. Sachin was appointed as an additional director of Conservative Finance Ltd. w.e.f. 1st October, 2014 in a casual vacancy by way of a circular resolution passed by the Board of directors. The next annual general meeting of the company was due on 31st March, 2015, but the same was not held due to delay in the finalisation of the accounts. Some of the shareholders of the company have questioned the validity of the appointment of Mr. Sachin and his continuation as additional director beyond 31st March, 2015. Advise the company on the complaints made by the shareholders. [CA (Final) May 2010 (Modified)]

Ans. The given problem relates to sections 161(1) and 161(4) of the Companies Act, 2013.

The Legal Position

Additional Directors [Section 161(1)]

- The Board may appoint the additional directors in pursuance of the provisions of section 161(1).
- The Board may, in its discretion, appoint the additional directors whenever it deems fit.
- The appointment of additional directors may be made by the Board either by passing a resolution at a Board meeting or by passing a resolution by circulation.
- An additional director holds office upto the date of next annual general meeting. However, if AGM is not held upto the last date for holding AGM as per the provisions of section 96, the additional director shall vacate his office on the last day on which the AGM should have been held.

Director filling a casual vacancy [Section 161(4)]

- The Board is authorised to fill a casual vacancy arising in the office of a director appointed in general meeting.
- The director filling a casual vacancy shall hold office only upto the date upto which the director in whose place he is appointed would have held office if it had not been vacated.
- A casual vacancy cannot be filled by passing a resolution by circulation under section 175.

The given case

- The Board has appointed Mr. Sachin as an additional director in a casual vacancy.
- The appointment of Mr. Sachin has been made by passing a circular resolution.
- The last date for holding the annual general meeting was 31st March, 2015. The annual general meeting has not been held till 31st March, 2015.
- The issue raised in the given problem is –
  (a) Whether appointment of Mr. Sachin is valid or not?; and
  (b) Whether Mr. Sachin can continue after 31st March, 2015?

Analysis of the case

1. Neither section 161(1) nor section 161(4) authorises the Board to appoint an additional director to fill the casual vacancy.
   (a) If appointment of Mr. Sachin is made as an additional director, then, the provisions of section 161(1) apply, and so such appointment cannot amount to filling a casual vacancy.
   (b) If Mr. Sachin is appointed to fill a casual vacancy, then, the provisions of section 161(4) apply to him, and so Mr. Sachin shall not be an additional director.
   (c) Thus, a combined reading of sections 161(1) and 161(4) makes it clear that the appointment of Mr. Sachin as an additional director to fill the casual vacancy is not possible at all.
2. Mr. Sachin has been appointed to fill the casual vacancy by passing a circular resolution. The appointment of a director filling a casual vacancy requires passing of a resolution in a Board meeting only, and subsequent approval by the members in the immediately next general meeting. However, Mr. Sachin has been appointed to fill the casual vacancy by passing a circular resolution. So, it is evident that the appointment of Mr. Sachin is in contravention of section 161(4), and is therefore, invalid.

Conclusion

- The complaint made by the shareholders is valid.
- The appointment of Mr. Sachin is not valid since it is in contravention of sections 161(1) and 161(4).
- Mr. Sachin cannot continue as a director after the date of annual general meeting, since his very appointment is *void ab initio*.

Casual vacancy filled by the Board but the appointment is not approved in the general meeting – Consequences

P 1.25E. M/s. Bright Motors (P) Limited at the Annual General Meeting (AGM) held on 30.09.2016 appointed Mr. Anmol as a Non-Executive Director on the Board of the company for a period of three years. On 2nd October, 2017 Mr. Anmol suffered a severe heart failure and expired. The Board of directors of the company on 16th October, 2017 appointed Mr. Prateek to fill the casual vacancy so created. The appointment of Mr. Prateek was made for a term of three years by the Board. Subsequently at the AGM held on 29-09-2018 Mr. Prateek's appointment was not proposed or approved as the Board was of the view that it is not required. But the CFO of the company is of the opinion that the Board of directors have contravened the provisions of the Companies Act, 2013 in respect of non-approval of the appointment of Mr. Prateek and his office tenure. Decide. [CA (Final) May 2019]

Ans. The given problem relates to section 161(4) of the Companies Act, 2013, as discussed below:

The Legal Position

1. The Board is authorised to fill a casual vacancy arising in the office of a director appointed in general meeting. However, a casual vacancy can be filled by the Board only by passing a resolution at a Board meeting, *i.e.* a casual vacancy cannot be filled by passing a resolution by circulation under section 175.
2. Where a casual vacancy is filled by the Board, the appointment made by the Board shall be subsequently approved by the members in the immediately next general meeting.
3. The director filling a casual vacancy shall hold office only upto the date upto which the director in whose place he is appointed would have held office if it had not been vacated.

The given case

4. Mr. Anmol was appointed as a director in the annual general meeting of M/s. Bright Motors (P) Limited held on 30th September, 2016. The tenure of his appointment was 3 years.
5. On 2nd October, 2017, Mr. Anmol expired. The casual vacancy that arose in the office of Mr. Anmol was filled up by the Board on 16th October, 2017 by appointing Mr. Prateek. The resolution passed by the Board provides that the tenure of appointment of Mr. Prateek shall be for 3 years.
6. After the casual vacancy was filled by the Board by appointing Mr. Prateek, the appointment of Mr. Prateek was not proposed for approval by the members in the immediately next general meeting, *i.e.* the annual general meeting held on 29-09-2018.

Analysis of the case

7. The appointment of a director filling a casual vacancy requires passing of a resolution in a Board meeting, and subsequent approval by the members in the immediately next general meeting. However, the appointment of Mr. Prateek was not approved in the immediately next general meeting, *i.e.* the annual general meeting held on 29-09-2018. Thus, it is evident that M/s Bright Motors (P) Limited has contravened the provisions of section 161(4).
8. The resolution of the Board filling the casual vacancy provided that the appointment of Mr. Prateek was for a period of 3 years with effect from 16th October, 2017, *i.e.* from 16th October, 2017 to 15th October, 2020.

   However, if the casual vacancy had not arisen in the office of Mr. Anmol, Mr. Anmol would have held his office of director upto 29th September, 2019.

   As per the provisions of section 161(4), the tenure of office of the director filling a casual vacancy shall be upto the date upto which the director in whose place he is appointed would have held office if it had not been vacated. Accordingly, the tenure of office of Mr. Prateek should have been upto 29th September, 2019, and not upto 15th October, 2020 (*i.e.* 3 years from 16th October, 2017, as per the resolution of the Board). Thus, the resolution of the Board passed on 16th October, 2017 is defective.

Conclusion

9. The opinions of the CFO that the Board has contravened the provisions of section 161(4) by not getting the appointment of Mr. Prateek approved in the general meeting, and by providing that Mr. Prateek shall hold his office for a period of 3 years, are correct.

1.26 Appointment of an alternate director [Section 161(2)]

Section 161(2) empowers the Board to appoint a director (known as an 'alternate director') to act in place of a director (known as an 'original director') during his absence for a period of *3 months or more* from India. Such an appointment may solve the problem relating to lack of quorum in Board meetings, and may facilitate smooth functioning of the company and effective deliberations in the Board meetings.

The provisions applicable to an alternate director are explained as follows:

1. Conditions for appointment of an alternate director

(a) The Board may appoint an alternate director to act in place of a director (termed as original director) during the absence of the original director from India for a period of 3 months or more.

The Board may appoint an alternate director as soon as the original director goes outside India for a period of 3 months or more, even though the original director's absence has not been for a period of 3 months.

(b) A person cannot be appointed as an alternate director, if –

(i) he already holds any alternate directorship for any other director in the company; or

(ii) he holds any directorship in the same company.

(c) A person can be appointed as an alternate director for an independent director only if he is qualified to be appointed as an independent director as per section 149(6).

2. Power to appoint

The Board may appoint an alternate director only if it is authorised by –

(a) the articles; or

(b) an ordinary resolution passed at a general meeting.

The right to appoint an alternate director vests in the Board. The original director has no right to appoint an alternate director. Further, the members have no right to appoint an alternate director. The members can only empower the Board to appoint the alternate director as and when the Board deems fit.

3. Method of appointment of an alternate director

There is no condition that an alternate director shall be appointed only by passing a resolution at a Board meeting. Thus, it is possible to appoint an alternate director by passing a resolution by circulation.

4. Term of office of an alternate director

(a) Term comes to an end on the return of the original director. The alternate director shall vacate his office when the original director returns back to India. The office of alternate director shall come to an end, irrespective of the fact as to whether the original director returns to India for the purpose of attending a Board meeting or for any other purpose. *In other words*, an alternate director automatically ceases to be a director as soon as the original director returns back to India.

Where the original director, when he is outside India, attends a Board meeting by video conferencing or other audio visual means, it does not result in vacation of office of the alternate director.

(b) ***Not exceeding the term permissible to original director.*** An alternate director shall not hold office for a period longer than that 'permissible' to the original director. Thus, an alternate director shall cease to hold his office when the term of the original director expires. The word 'permissible' used in section 161(2) implies that if the original director ceases to be a director (*e.g.* by reason of completion of his term or death or resignation or vacation of office under section 167), the alternate director shall immediately cease to hold his office.

Automatic reappointment applies to the original director

If the term of office of an original director expires before he returns back to India, the provision for automatic reappointment of a director as envisaged under section 152(7)(b) shall be applicable to the original director, and not to the alternate director.

5. **Position of an alternate director**

(a) ***A director in his own right.*** An alternate director is appointed by the Board of directors and not by the director in whose place he is appointed (*i.e.* the original director). Therefore, he is not a representative, proxy or an agent of original director. He is a director in his own right. He has same rights, duties and liabilities like any other director.

(b) ***His interest is independent of interest of the original director.*** The provisions of section 184 apply where a director is interested in a contract or arrangement. However, these provisions shall apply to an alternate director only if he, himself, is interested in such contract or arrangement. The mere fact that original director is interested in a contract or arrangement does not make section 184 applicable to an alternate director.

1. **Applicability**

   Section 161(2) applies to all companies, whether public or private.

2. **Model provisions of Table F**

   There is no provision in Table F regarding appointment of alternate director.

3. **Alternate directorship is not excluded under section 165**

   As per section 165, an alternate directorship in a company shall also be included while counting the number of directorships held by a director.

4. **Filing of consent by an alternate director**

   Neither section 152(5) nor section 161(2) grants any exemption to an alternate director with respect to filing of his consent. Thus, an alternate director is required to file his consent with the company in accordance with the provisions of section 152(5), *i.e.* the person proposed as an alternate director shall, on or before his appointment as an alternate director, furnish to the company his consent in writing (in Form DIR-2) to act as a director.

   Further, the consent filed by the alternate director with the company, shall be filed by the company with the Registrar within 30 days of such appointment in Form DIR-12.

5. **Vacation of office as a result of not attending the Board meetings**

   As per section 167, the office of a director becomes vacant if he absents himself from all the Board meetings held during a period of 12 months.

   This ground of vacation is equally applicable to the original director, even if an alternate director has been appointed to act in his place. Thus, the original director should ensure that he does not absent himself from all the Board meetings held during a period of 12 months. He may attend the Board meetings by being physically present or by participating in Board meetings by video conferencing or other audio visual means.

Practical Problems from CA Examinations

Is the original director empowered to appoint an alternate director?

P 1.26A. Mr. Q, a director of PQR Limited proceeding on a long foreign tour, appointed Mr. Y as an alternate director to act for him during his absence. The articles of the company provide for the appointment of an alternate director. Mr. Q claims that he has a right to appoint an alternate director. Examine the given case in the light of the provisions of the Companies Act, 2013.

[CA (Final) May 2002 (Modified)]

OR

Examine the following with reference to the provisions of the Companies Act, 2013:

Mr. Narayan, a Director of KPR Limited who is proceeding on a long foreign tour, appointed Mr. Shankar as an alternate director to act for him during his absence. The Articles of the company provide for appointment of alternate directors. Mr. Narayan claims that he has a right to appoint an alternate director. **[CA (Final) May, 2017]**

Ans. The given problem relates to section 161(2) read with section 166(6) of the Companies Act, 2013.

As per section 166(6), no director shall assign his office to any other person, and if a director, in contravention of section 166(6) assigns his office, such assignment shall be void.

As per section 161(2), the Board is empowered to appoint an alternate director in place of a director during his absence for a period of not less than 3 months from India. The Board can appoint an alternate director only if it is authorised by the articles or by a resolution passed at a general meeting.

In the present case, the Board of directors of PQR Ltd. may appoint Mr. Y or any other person as an alternate director for Mr. Q since PQR Ltd. is authorised by the articles to appoint the alternate director, provided the duration of foreign tour of Mr. Q is not less than 3 months.

However, if the appointment of Mr. Y as an alternate director is made by Mr. Q, it would amount to assignment of office which is prohibited under section 166(6) and therefore, the appointment of Mr. Y as an alternate director would be void. Further, an alternate director is appointed by the Board of directors and not by the director in whose place he is appointed (i.e. the original director). Therefore, in the present case Mr. Q has no power to nominate a person to act as an alternate director in his place and the appointment of Mr. Y is not in order.

Appointment of an alternate director for 2 months for a director who has proceeded abroad on leave for 6 months – Whether valid?

P 1.26B. Referring to the provisions of the Companies Act, 2013, examine the validity of the following:

The Board of directors of AJD Limited appointed Mr. N as an alternate director for a period of two months against a director who has proceeded abroad on leave for a period of six months. Articles of Association of the company are silent.

[CA (Final) Nov. 2014]

Ans. The given problem relates to section 161(2) of the Companies Act, 2013.

As per section 161(2), the Board may appoint an alternate director for a director (termed as original director) during the absence of the original director from India for a period of 3 months or more. The Board may appoint an alternate director only if it is authorised by the articles or by an ordinary resolution passed at a general meeting. The alternate director shall vacate his office when the original director returns back to India.

In view of the provisions of section 161(2), the appointment of Mr. N as an alternate director is not valid since the Board, in the given case, is not authorised to appoint the alternate director by the articles or by a resolution passed in general meeting. Also, the Board is not authorised to appoint an alternate director for any fixed period (2 months in the given case) since the term of office of alternate director has been fixed by the Act, i.e. section 161(2), which is upto the date when the original director returns back to India.

Appointment of an alternate director for an independent director

P 1.26C. Referring to the provisions of the Companies Act, 2013, examine the validity of the following:

Mr. P who is not qualified to be appointed as an independent director is appointed by the Board of Directors of XYZ Company Limited, for an independent director, as an alternate director. [CA (Final) Nov. 2014]

Ans. As per section 161(2), the Board may appoint an alternate director for a director (termed as original director) during the absence of the original director from India for a period of 3 months or more. Section 161(2) also provides that a person can be appointed as an alternate director for an independent director only if he is qualified to be appointed as an independent director as per Section 149(6).

In the given case, the appointment of Mr. P as an alternate director for an independent director is not valid, since Mr. P is not qualified to be appointed as an independent director.

Various issues with respect to alternate director

P 1.26D. You are the CFO and in-charge of legal compliances of a large multinational company in India. The Board of directors of the company are broad based and comprise of competent directors who are Indian as well as foreign nationals. Mr. 'X', who is a Director (Business Development) on the Board is very often on business tour abroad. He approached you and wants to know from you the regulatory provisions of the Companies Act, 2013 relating to appointment of alternate directors. Analyse the following situations and advise suitably, Mr. X referring to the provisions of the Companies Act, 2013.

(a) To how many directors can a person be appointed as an alternate director and how many votes does he have in one Board Meeting?

(b) If the original director joins the Board Meeting through video conferencing without returning to India, then, can the alternate director appointed in his place attend the same board meeting? If yes, whose presence and vote will be counted?

(c) In case of a private company, where an alternate director is appointed in place of a non-executive director whose term is indefinite, then, what will be the tenure of such alternate director, provided the original director does not return to India for a longer period say 3-4 years?

(d) Can an Executive Director/Whole Time Director/Managing Director appoint alternate directors? [CA (Final) Nov. 2019]

Ans. The provisions relating to alternate director are contained in section 161(2) of the Companies Act, 2013.

1. As per section 161(2), the Board may appoint an alternate director for a director (termed as original director) during the absence of the original director from India for a period of 3 months or more.

2. Section 161(2) further provides that a person cannot be appointed as an alternate director, if –
   (i) he already holds any alternate directorship for any other director in the company; or
   (ii) he holds any directorship in the same company.
3. An alternate director shall vacate his office when the original director returns back to India. Further, an alternate director shall not hold office for a period longer than that 'permissible' to the original director.

The questions asked in the given problem are answered as under:

(a) A person can be appointed as an alternate director for not more than 1 director of any particular company. Since a person can be an alternate director for only 1 director, he shall have one vote only in a Board meeting of such company.

As per section 165, no person shall hold office as a director (including alternate directorships) in –

(i) more than 20 companies, whether public or private;

(ii) more than 10 public companies (including any private company which is either a holding company or a subsidiary company of a public company).

Thus, a person can be appointed as an alternate director for maximum 20 directors of 20 different companies, of which maximum 10 companies can be public companies (including any private company which is either a holding company or a subsidiary company of a public company).

(b) There is no provision in the Companies Act, 2013 or rules made thereunder, which deal with the situation where the original director, without returning to India, participates in a Board meeting through video conferencing and the alternate director intends to participate in such Board meeting.

In such a situation, the alternate director's presence should be ignored, and accordingly, the vote of the original director should be considered.

(c) Where an alternate director is appointed for a director of a private company who has been appointed for life, the alternate director shall continue till –

(i) the original director returns back to India; or

(ii) the term of the original director expires or the office of director held by the original director is vacated,

whichever is earlier.

As per section 167, the office of a director becomes vacant, if he absents himself from all the Board meetings held during a period of 12 months (whether leave of absence is granted to him or not). Accordingly, if the original director does not return back to India for a longer period say 3-4 years, the office of director held by him shall become vacant as soon as the period of 12 months expires during which he has not attended any Board meeting. On vacation of office of director of original director, the office of director held by alternate director shall also become vacant.

Difference in answer as compared to the answer given by ICAI

The Author's answer, as given above, differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. The answer given in the Suggested Answers is as under:

"According to second proviso to section 161(2), an alternate director shall not hold office for a period longer than that permissible to the director in whose place he has been appointed and shall vacate the office if and when the director in whose place he has been appointed returns to India.

Third proviso says that 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.

Hence, in the instant case, the alternate director shall hold office till the time original director returns to India, even if the period is as long as 3-4 years."

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

(d) The appointment of alternate director can be made only by the Board. Accordingly, the appointment of alternate director cannot be made by any director, whether he is an executive director or whole time director or managing director.

Practical Problems from CS Examinations

Term of office of alternate director

P 1.26E. X, an employee of ABC Ltd., was appointed as an alternate director. In the meantime, the original director returned and wanted to attend the Board meeting. Advise. **[CS (Final) June 96; Dec. 1999]**

Ans. The provisions relating to alternate director are contained in section 161(2) of the Companies Act, 2013, as discussed below:

An alternate director shall not hold office for a period longer than that permissible to the original director. The alternate director shall vacate his office when the original director returns back to India, irrespective of the fact as to whether the original director attends the Board meetings or not. Thus, after an original director comes back to India, only he can attend the Board meetings. The alternate director would automatically cease to be director.

In the given case, the contention of the original director is correct and he is entitled to attend the Board meeting.

Practical Problems from ICAI Material

Comprehensive illustration on retirement of directors

P 1.26F. A company has 11 directors on the board consisting of the following:

(a) Mr. Active, Mr. Archieve as nominees from two Public Financial Institutions.

(b) Mr. First, Mr. Second, Mr. Third appointed at the 2nd AGM.

(c) Mr. Fourth, Mr. Fifth appointed at the 3rd AGM.

(d) Mr. Addition was appointed as additional director subsequent to 3rd AGM.

(e) Mr. Casual was appointed as director in place of Mr. Soul who died and was earlier appointed during the 3rd AGM.

(f) Mr. Excellent was appointed as Managing Director for 5 years w.e.f. 2nd AGM.

(g) Mr. One More was appointed as additional director soon after Mr. Addition was appointed as Additional Director.

List out in order, who shall be vacating the office at the 4th AGM of the company.

Ans. Computation of 'total number of directors' for the purpose of section 152(6):

Assuming that the two Public Financial Institutions which have appointed two directors, viz. Mr. Active and Mr. Archieve, have been constituted under separate Acts of Parliament and such Acts of Parliament over-ride the provisions of the Companies Act, 2013, the two directors, viz. Mr. Active and Mr. Archieve shall not be included in the total number of directors for the purpose of section 152(6).

As per Explanation to section 152(6), an independent director shall not be included in the 'total number of directors'. However, Explanation to section 152(6) or section 161(1) does not provide that an additional director shall not be included in the 'total number of directors'. Thus, an additional director appointed as per the provisions of section 161(1) shall also be included in the 'total number of directors'. Since an additional director is appointed by the Board, and is not appointed in the general meeting, an additional shall always be a non-rotational director.

A managing director is not always a non-rotational director. He may be a rotational or non-rotational director depending upon the terms of his appointment. Irrespective of whether a managing director is rotational or non-rotational, he shall be included in 'total number of directors'.

Mr. Casual was appointed in the place of Mr. Soul. Assuming that Mr. Soul was a non-rotational director, Mr. Casual shall hold his office upto the date Mr. Soul would have held office had the casual vacancy not arisen.

In the given case, 'total number of directors' in terms of section 152(6) is 9. Out of these 9 directors, a minimum of 6 directors shall be rotational directors, and thus, a maximum of 3 directors shall be non-rotational directors. Mr. Additional and Mr. One More, being the additional directors, are non-rotational directors. Mr. Casual, being a director filling a casual vacancy, is also a non-rotational director. Therefore, Mr. First, Mr. Second, Mr. Third, Mr. Fourth, Mr. Fifth and Mr. Excellent shall be the rotational directors.

Out of the 6 rotational directors (viz. Mr. First, Mr. Second, Mr. Third, Mr. Fourth, Mr. Fifth and Mr. Excellent), 2 directors (being 1/3rd of 6) shall retire in the 4th AGM. The 4 directors who have been longest in office are Mr. First, Mr. Second, Mr. Third and Mr. Excellent. Since all these 4 directors became the directors on the same day, the 2 directors who shall have to retire in the 4th AGM shall be determined by agreement among these 4 directors. In case, no such agreement is reached, the 2 directors who shall have to retire in the 4th AGM shall be decided by lots.

Mr. Additional and Mr. One More, being the additional directors, shall hold office upto the date of 4th AGM, i.e. they shall vacate their offices as on the date of 4th AGM.

Difference in answer as compared to the answer given by ICAI

Author's answer to this Question differs from the Answer given in the Practice Manual issued by the Board of Studies, ICAI for November, 2016 Exams.

This question, along with its answer, has been omitted from the latest publications released by ICAI.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Appointment of a person as an alternate director where he is already a director in the same company

P 1.26G. Mr. Single, a director or XYZ Ltd. goes to Singapore for a period of 6 months. The Board appoints Mr. Replacement in his place as an alternate director. Mr. Replacement was also holding directorship in XYZ Ltd. Identify the nature of appointment of Mr. Replacement in XYZ Ltd. as an alternate director. **[ICAI, Mock Test Paper, August 2018]**

Ans. Section 161(2) empowers the Board of directors to appoint an alternate director for a director (*i.e.* original director) during the absence of the original director for a period of not less than 3 months from India. Further, as per section 161(2), a person cannot be appointed as an alternate director, if –

(a) he already holds any alternate directorship for any other director in the company; or

(b) he holds any directorship in the same company.

In the given case, Mr. Replacement himself holds a directorship in the same company, *viz.* XYZ Ltd. Therefore, Mr. Replacement cannot be appointed as an alternate director for any other director of XYZ Ltd.

Accordingly, the appointment of Mr. Replacement as an alternate director for Mr. Single is not valid.

Advanced Practical Problems

Appointment of a person as an alternate director where he is already a director or alternate director in the same company or other company – Various cases

P 1.26H. Mr. Busy, a director of Superb Ltd., goes to USA for a period of 4 months. The Board of directors of Superb Ltd., authorised by the articles of the company to appoint the alternate director, appoints Mr. Idle as an alternate director to act for Mr. Busy. Is the appointment of Mr. Idle as an alternate director for Mr. Busy valid in the following cases?

(i) If Mr. Idle is already an alternate director for Mr. Shyam, another director of Superb Ltd.

(ii) If Mr. Idle is already a director of Superb Ltd.

(iii) If Mr. Idle is already a director of Fantastic Ltd.

(iv) If Mr. Idle is already an alternate director for Mr. Farhan, another director of Fantastic Ltd.

Ans. Section 161(2) empowers the Board of directors to appoint an alternate director for a director (*i.e.* original director) during the absence of the original director for a period of not less than 3 months from India. Further, as per section 161(2), a person cannot be appointed as an alternate director, if –

(a) he already holds any alternate directorship for any other director in the company; or

(b) he holds any directorship in the same company.

The given problems are answered as under:

(i) Mr. Idle cannot be appointed as an alternate director for Mr. Busy since he already holds an alternate directorship for another director of Superb Ltd., *viz.* Mr. Shyam.

(ii) Mr. Idle cannot be appointed as an alternate director for Mr. Busy since he holds directorship in the same company, *viz.* Superb Ltd.

(iii) Mr. Idle may be appointed as an alternate director for Mr. Busy since he is neither a director in Superb Ltd. nor an alternate director for any other director in Superb Ltd.

(iv) Mr. Idle may be appointed as an alternate director for Mr. Busy since he is neither a director in Superb Ltd. nor an alternate director for any other director in Superb Ltd.

1.27 Appointment of directors by third parties, *i.e.* Nominee directors [Section 161(3)]

Nominee director means a director appointed by a third party (*e.g.* a director appointed by a financial institution or a bank which has provided financial assistance to the company). The main objective of appointment of a nominee director is to ensure that borrower company complies with all the legal requirements under various corporate laws. The nominee directors are watchdogs of the financial institutions to safeguard their funds in the assisted companies.

Nominee directors ensure that all the conditions of the loan agreement between the institution and assisted company are being complied with. Nominee directors also serve the interest of sound public policy. They are expected to be vigilant and have an independent approach and check undesirable practices prevailing in the assisted companies.

Section 161(3) reads as under:

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.

Practical Problems from CA Examinations

Appointment of nominee director – Whether valid?

P 1.27A. Referring to the provisions of the Companies Act, 2013, examine the validity of the following:

On the request of bank providing financial assistance the Board of directors of PQR Limited decides to appoint on its Board Mr. Peter, as nominee director. Articles of Association of the company do not confer upon the Board of Directors any such power. Further, there is no agreement between the company and the bank for any such nomination. [CA (Final) Nov. 2014]

OR

The Board of directors of Sakthi Limited decides to appoint on its Board, Mr. Ravi as a nominee director upon the request of a bank which has extended a long term financial assistance to the company. The Articles of Association of the company do not confer upon the Board any such power. Also, there is no formal agreement between the company and the bank for any such nomination. **[CA (Final) May, 2017]**

Ans. As per section 161(3) of the Companies Act, 2013, 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. The provisions of section 161(3) are subject to any provision contained in the articles of the company.

In the given case, no agreement has been entered into between PQR Limited and the bank providing the financial assistance with respect to appointment of nominee director. Also, no provision contained in any law for the time being in force authorises the appointment of nominee director. Further, the articles of the company do not confer any power on the Board to appoint the nominee directors. Thus, the appointment of Mr. Peter as nominee director is not valid.

1.28 Removal of a director by shareholders (Section 169)

Under section 169 of the Companies Act, 2013, a company may, by ordinary resolution remove a director before the expiry of the period of his office. Thus, section 169 enables the members to exercise effective control over the directors by removing all such directors whose continuation in the company is not in the interests of the company. The provisions of section 169 shall apply regardless of the manner of appointment of the director concerned (*i.e.* whether he is a rotational director or non-rotational director, or is an additional director or a director filling a casual vacancy or alternate director or nominee director or woman director or Indian resident director or independent director or Small Shareholders' Director, or any other director). The provisions of section 169 shall apply notwithstanding anything to the contrary contained in the articles of the company or any agreement with the director concerned.

1. Procedure for removal of director

A director may be removed before the expiry of his term by following the prescribed procedure, as given hereunder:

(a) Special notice (in accordance with the provisions of section 115 of the Companies Act, 2013) shall be required for proposing a resolution for removal of a director.

Legal requirements of special notice (section 115). The intention to move the resolution for removal of a director must be–

(i) given to the company not earlier than 3 months before the date of the general meeting but at least 14 days before the general meeting (excluding the day on which such notice is given and the day of the general meeting);

(ii) signed by member(s) holding not less than –

- 1% of total voting power; or
- paid up share capital of Rs. 5 lakh,

whichever is lower.

1. **Grounds of removal of a director – Not necessary**

   A member cannot be restrained from calling a general meeting to remove existing directors and appoint new directors. A member giving a special notice is not bound to give grounds of removal of the director. As per section 102, it is the duty of the Board to disclose the material facts in the explanatory statement. Neither section 169 nor section 102 requires the shareholders to disclose the reasons for the resolutions proposed at the meeting **[*LIC* v *Escorts Ltd.* (1986) 59 Comp Cas 548].**

   Thus, in order to remove a director, it is not required to establish any breach of trust, misconduct, misfeasance or fraud on his part.

2. **Special notice need not comply with section 111**

   The provisions of section 169 are not subject to the provisions of section 111. It means that if a notice complies with the requirements of section 169 read with section 115 (*i.e.* requirements of a special notice), the provisions of section 111 need not be complied with.

(b) On receipt of special notice, the company shall forthwith send a copy of the special notice to the director concerned.

(c) The director concerned shall be given a reasonable opportunity of being heard. The director concerned shall have a right to make a written representation against his removal. The director may request the company to send his written representation to every member of the company.

(d) The company shall give notice of the intention to move the resolution, to all its members at least 7 days before the date of the general meeting (excluding the day on which such notice is given and the day of the general meeting). The company shall also –

(i) send a copy of written representation to every member; *and*

(ii) specify the fact of written representation made by the director in the notice sent to the members.

If the written representation made by the director concerned is not sent by the company to the members (because it was received too late or because of the company's default), the director may require that his written representation be read out at the meeting.

(e) At the general meeting, the proposal to remove the director concerned shall be discussed in the general meeting.

The director concerned shall have a right to be heard at the meeting. His oral representation need not be confined to a discussion of the matters discussed in the written representation made by him.

(f) If the resolution for the removal of the director concerned is passed (by way of an ordinary resolution), the director shall be removed from the office.

(g) At the meeting at which a director is removed, any other person may be appointed in the place of director so removed, only if –

(i) the director removed from office was appointed in general meeting or by the Board; and

(ii) special notice for appointing such person has been given in accordance with the provisions of section 115.

The director so appointed, shall hold office his office only upto the date upto which his predecessor would have held office, had he not been removed.

(h) If the vacancy is not filled at the meeting at which the director is removed, the vacancy may be filled as a casual vacancy in accordance with the provisions of section 161(4).

However, the director who was removed from office shall not be appointed by the Board of Directors.

2. Defamatory representation by the director – Consequences

Where the Tribunal is satisfied that the right to make representation is being abused to secure needless publicity for a defamatory matter, the Tribunal may order that –

(a) the written representation need not be sent to the members by the company;

(b) the written representation need not be read out at the meeting; *and*

(c) costs incurred for making such application to the Tribunal be paid in whole or in part by the director concerned, even though he was not a party to the application.

The application may be made to the Tribunal by the company or any person who claims to be aggrieved.

3. Directors that cannot be removed under section 169

(a) Directors appointed by the Tribunal under section 242.

(b) Directors appointed by way of proportional representation under section 163.

This privilege extends only to those directors who are appointed by the method of proportional representation. *For example,* where a company has appointed 4 directors out of total 6 directors, by way of proportional representation, only these 4 directors cannot be removed; the remaining 2 directors may be removed in accordance with section 169.

(c) Nominee directors appointed by any financial institution constituted under a special Act of Parliament, if the provisions contained in the special Act restrain removal of such nominee directors by the members.

1. Applicability of section 169

Section 169 applies to all companies, whether public or private.

2. Removal of independent director

An independent director re-appointed for second term under sub-section (10) of section 149 shall be removed by the company only by passing a special resolution and after giving him a reasonable opportunity of being heard.

3. Removal of managing director

A director holding the office of a managing director may also be removed from directorship under section 169.

4. Removal from managing directorship is out of purview of section 169

The appointment of a managing director was revoked by the Board. It was held that section 169 was not attracted since the business proposed to be transacted related only to the removal from his managerial position and so his continuing in the office as an ordinary director was not disturbed **[*Major General Shanta Shamsher* v *Kamani Brothers* AIR 1959 Bom 201]**.

5. Compensation to the director removed under section 169

Section 169(8)(a) reads as under:

"Nothing in this section shall be taken as depriving a person removed under this section of any compensation or damages payable to him in respect of the termination of his appointment as director as per the terms of contract or terms of his appointment as director, or of any other appointment terminating with that as director."

Analysis of section 169(8)(a). A director removed under section 169 is entitled to claim compensation for loss of office in accordance with the terms of his appointment or contract. However, the right to compensation is subject to the restrictions imposed under section 202 of the Companies Act, 2013.

Theoretical Questions from CA Examinations

Q 1.28A. Explain briefly the provisions of the Companies Act, 2013 relating to removal of a director in case of receipt of an appropriate special notice by the company for this purpose. [CA (Final) May 2004]

Q 1.28B. A member holding 20% of the paid-up equity capital has requested for an extraordinary general meeting to remove a director. [CS (Final) Dec. 1996]

Q 1.28C. Mr. Stubborn is a director of M/s Doubtful Industries Ltd. He along with other two directors has been running the company for the past twenty years without declaring any dividends or giving any benefit to the shareholders. Frustrated by this, some shareholders are desirous of giving notice to pass a resolution with the support of other shareholders for his removal as a director in the annual general meeting of the company to be held in the month of December of 2001. State the procedure to be followed for the removal of Mr. Stubborn as a director and the right of Stubborn to defend his position. [CA (Final) Nov. 2001]

Practical Problems from CA Examinations

Requirements for giving special notice and removal of a director

P 1.28A. Mr. SDR, a shareholder in M/s. JKP Ltd. holding 50,000 equity shares of Rs. 10 each fully paid up, wants to give a special notice to the company for removal of Mr. EDM, a director of M/s. JKP Ltd. without stating any reason in the notice. You are required to state as per the provisions of the Companies Act, 2013 and/or any decided case law whether Mr. SDR is entitled to do so. [CA (Final) Nov. 2007, May 2004]

Ans. In the given problem, a special notice has been given by a member of the company holding 50,000 equity shares of Rs. 10 each fully paid up. The member has not stated any reason for removal of a director.

These two issues are discussed in detail as follows:

Issue I: Whether Mr. SDR is eligible to give special notice for removal of a director?

Section 169 gives a statutory right to the members to remove a director before the expiry of his tenure of office. Section 169 requires that a special notice shall be given to the company where a director is proposed to be removed under section 169. As per section 115, the intention to move the resolution for removal of a director must be –

(a) given to the company at least 14 days before the general meeting (excluding the day on which such notice is given and the day of the general meeting);

(b) signed by member(s) holding not less than 1% of total voting power or member(s) holding paid up share capital of Rs. 5 lakh.

In the present case, the paid up share capital held by Mr. SDR is Rs. 5 lakh. Thus, Mr. SDR is eligible under section 115.

Issue II: Whether the special notice must disclose the reasons for removal of a director?

It was held in ***LIC v Escorts Ltd.*** (1986) 59 Comp Cas 548 that it is not necessary for a member to state the grounds of removal of a director at the time of calling the extraordinary general meeting. As per the provisions of section 102 of the Companies Act, 2013, it is the duty of the Board to disclose in the explanatory statement all the material facts, all the necessary information and facts that may enable the members to understand the meaning, scope and implications of the proposed business and take decision thereon. Thus, neither section 169 nor section 102 requires a member to disclose the reasons for the resolutions proposed at the meeting.

Therefore, non-disclosure of reasons for removal of a director does not make a special notice invalid. Therefore, the notice is as per the requirements of Companies Act, 2013, and the company is required to act on such notice as per the provisions of section 169.

Difference in answer as compared to the answer given by ICAI

Author's answer to this Question differs from the Answer given in the Practice Manual issued by the Board of Studies, ICAI for May, 2015 Exams. The answer given in the Practice Manual applicable for May, 2015 Exams is as under:

"The problem as stated in the question is governed by the provisions of section 169 (1) of the Companies Act, 2013. Further, sub-section (2) of the said section states that a special notice is required of any resolution to remove a director. The section does not put any condition in respect of the number of members or their shareholding for the giving of the special notice and furnishing any reason therefore.

However, the provisions of section 169 (1) and (2) must be read with the provisions of section 115 which deal with resolutions requiring special notice and section 102 of the Companies Act, 2013 which requires an explanatory statement to be annexed with every resolution passed in respect of a special business.

It must be understood that apart from the ordinary businesses conducted at an AGM every other business conducted either at an AGM or at any other general meeting of members will fall within the category of "special business" and hence must be accompanied by an explanatory statement under section 102 of the Act. Section 102(1) (b) states that the explanatory statement to every resolution proposed to be passed for a special business must include all necessary information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Therefore, Mr. SDR cannot give a special notice without full details and facts of the case."

The Author does not agree with the answer given in the Practice Manual issued for May, 2015 Exams.

In the Practice Manual issued for November, 2016 Exams, this question has been omitted.

This question, along with its answer, has been omitted from the latest publications released by ICAI.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Articles of a private company prohibit removal of a 'life director' – Whether he can be removed?

P 1.28B. Mr. X is named as a director for life in the articles of association of M/s. XYZ Private Limited which was incorporated on 1st April, 1977. The articles of association of the company also provide that he cannot be removed by the members in general meeting. Some of the members want to remove 'X' by passing an ordinary resolution in general meeting. State with reference to the relevant provisions of the Companies Act, 2013 whether the proposed action is valid. [CA (Final) Nov. 1997]

OR

'X' was appointed as managing director for life, by the articles of association of a private company incorporated on 1st June, 1970. Is it possible for the company in general meeting to remove 'X' from his office of directorship during his lifetime?

[CA (Final) Nov. 1995]

Ans. Section 169 gives a statutory right to the shareholders to remove any director before the expiry of his term by following the prescribed procedure. It applies to public companies as well as private companies.

Any provision in the articles that a director shall not be removed, violates the statutory right given to the shareholders, and is ultra vires the Act as provided by section 6. Section 6 stipulates that the provisions of the Act have an overriding effect on clauses contained in the memorandum, articles or any other agreement, if they are not in conformity with the provisions of the Act.

The articles of a company entitled a director to hold office for life. The Court held that section 169 has been enacted to enable the shareholders to exercise control over the directors and therefore the shareholders have been empowered to remove the directors. Therefore, the said permanent director could be removed from the office **[*Tarlok Chand Khanna* v *Rajkumar Kapoor* (1983) 54 Comp Cas 12]**.

In the present case the articles of the company provide that X shall be a director holding office for life and he shall not be removed by the members in general meeting. In view of the over-riding effect of section 6, this clause is repugnant to section 169 and is therefore void. Accordingly, the proposed action of removal of X by passing an ordinary resolution in general meeting is valid subject to compliance of the procedure laid down in section 169.

Whether removal of MD who is a non-rotational director, is possible by a member without stating the reasons for such removal?

P 1.28C. Adam, a 15% shareholder of a company and other shareholders have lost confidence in the Managing Director (MD) of the company. He is a director not liable to retire by rotation and was re-appointed as Managing Director for 5 years w.e.f. 1.4.2015 in the last Annual General Meeting of the company.

Mr. Adam seeks your advice to remove the MD after following the procedure laid down under the Companies Act, 2013.

(i) Specify the steps to be taken by Mr. Adam and the company in this behalf;

(ii) Is it necessary to state reasons to support the resolution for his removal? [CA (Final) Nov. 2006]

Ans. Removal of a non-rotational managing director is possible, since section 169 empowers the members to remove any director, whether he is a rotational or non-rotational director, or managing director, whole time director or a non-executive director.

The given problems are answered as under:

(i) Steps to be taken by Mr. Adam

Mr. Adam shall have to give a special notice to the company in accordance with the provisions of section 115. In the special notice, Mr. Adam shall propose a resolution for removal of the managing director. The special notice must be –

(i) given to the company not earlier than 3 months before the date of the general meeting but at least 14 days before the general meeting (excluding the day on which such notice is given and the day of the general meeting);

(ii) signed by member(s) holding not less than 1% of total voting power or member(s) holding paid up share capital of Rs. 5 lakh.

Steps to be taken by the company

(a) The company shall send a copy of special notice to the managing director.

(b) The managing director has a right to make a representation against his removal.

(c) Representation given by the managing director, if any, shall be sent by the company to every member at least 7 days before the general meeting.

(d) If the representation is not sent to the members, the representation shall be read at the general meeting.
(e) The general meeting shall be held.
(f) The managing director shall have a right to be heard at the meeting. The right to make an oral representation is in addition to written representation.

(ii) Whether the special notice must disclose the reasons for removal of a director?

It was held in ***LIC v Escorts Ltd.*** (1986) 59 Comp Cas 548 that it is not necessary for a member to state the grounds of removal of a director at the time of calling the extraordinary general meeting. The Court held that, under section 102, it is the duty of the Board to disclose the material facts in the explanatory statement. Neither section 169 nor section 102 requires a member to disclose the reasons for the resolutions proposed at the meeting. In other words, a member cannot be compelled to disclose the reasons for proposing a resolution for removal of a director.

Therefore, non-disclosure of reasons for removal of managing director does not make a special notice invalid. Accordingly, the special notice given by Mr. Adam is as per the requirements of section 169, and the company is required to act on such notice.

Legal requirements for removal of independent directors

P 1.28D. Super Speciality Hospital Limited has a paid up share capital of Rs. 10 crores and annual turnover of Rs. 90 crores. There are 5 directors in its Board. Two doctors Mr. ZA and Mr. AZ are appointed as independent directors. Mr. ZA was appointed for a period of 5 years on 1st August, 2015 while Mr. AZ was originally appointed for 3 years on 1st August, 2014 and was subsequently reappointed for 5 years on 1st August 2017. Now, in August, 2019, the company wants to remove both the independent directors. Referring to the relevant provisions of Companies Act, 2013, decide whether the company can do so.

[CA (Final) Nov. 2019]

Ans. Section 169 empowers the members to remove any director, including an independent director and an independent director reappointed for second term.

Generally, the removal of a director under section 169 requires an ordinary resolution in a general meeting. However, an independent director re-appointed for second term under sub-section (10) of section 149 can be removed only by passing a special resolution and after giving him a reasonable opportunity of being heard.

In the given case, the company wants to remove two independent directors, viz. Mr. ZA and Mr. AZ. For removal of Mr. ZA, an ordinary resolution shall be required, but for removal of Mr. AZ, a special shall be required. Also, the following legal requirements shall have to be complied with for removal of Mr. ZA and Mr. AZ:

(a) A special notice for removal of Mr. ZA and Mr. AZ shall be required to be given to Super Speciality Hospital Limited by one or more members holding not less than 1% of total voting power or holding paid up share capital of Rs. 5 lakh or more. The special notice shall have to be given to the company not earlier than 3 months before the date of the general meeting but at least 14 days before the general meeting (excluding the day on which such notice is given and the day of the general meeting).
(b) The company shall send a copy of special notice to Mr. ZA and Mr. AZ.
(c) Mr. ZA and Mr. AZ shall have a right to make a representation against their removal.
(d) Representation given by Mr. ZA and Mr. AZ, if any, shall be sent by the company to every member at least 7 days before the general meeting.
(e) If the representation is not sent to the members, the representation shall be read at the general meeting.
(f) The general meeting shall be held.
(g) Mr. ZA and Mr. AZ shall have a right to be heard at the meeting. The right to make an oral representation shall be in addition to written representation.

Practical Problems from CS Examinations

Articles prohibit removal of a permanent director – Whether he can be removed?

P 1.28E. The articles of association of a company provided that X will be a permanent director of the company so long as he holds one-third of the issued share capital. A shareholder sends a special notice to the company for removal of the director X in the general meeting by ordinary resolution. Can X be removed from the directorship? [CS (Final) Dec. 1997]

Ans. Section 169 gives a statutory right to every shareholder to remove a director before the expiry of his term by following the prescribed procedure.

Any provision in the articles that a director shall not be removed, violates the statutory right given to the shareholders, and is ultra vires the Act as provided by section 6. Section 6 stipulates that the provisions of the Act have an overriding effect on clauses contained in the memorandum, articles or any other agreement, if they are not in conformity with the provisions of the Act.

The articles of a company entitled a director to hold office for life. The Court held that section 169 has been enacted to enable the shareholders to exercise control over the directors and therefore the shareholders have been empowered to remove the directors. Therefore, the said permanent director could be removed from the office **[*Tarlok Chand Khanna* v *Rajkumar Kapoor* (1983) 54 Comp Cas 12]**.

In the present case, the articles of the company provide that X will be a permanent director of the company so long as he holds 1/3rd of the issued share capital. In view of the overriding effect of section 6, this clause is repugnant to section 169 and is therefore void. Thus, Mr. X can be removed under section 169.

Whether a civil court has jurisdiction to remove a director?

P 1.28F. A, one of the shareholder of a company, filed a civil suit in a Court for removal of directors B, C and E. Is the suit maintainable? **[CS (Final) June 96; June 1998]**

Ans. A Civil Court has no jurisdiction to entertain a suit for removal of a director since the matter relates to the internal management of the company which is governed by the Companies Act, 2013 ***[Khetan Industries Pvt. Ltd v Manju Ravindra Prasad Khetan* (1995) 16 CLA 169 (Bom)]**. Section 169 has given to the shareholders necessary powers (subject to adequate safeguards) to remove a director and thus a Civil Court has no jurisdiction to entertain a suit for removal of a director.

1.29 Register of directors and key managerial personnel and their shareholding (Section 170 and Rules 17 and 18)

(A) Provisions contained in the Act.

1. Contents of the Register

With respect to every director and key managerial personnel, the Register shall contain such particulars (including the details of securities held by each of them in the company or its holding, subsidiary, subsidiary of company's holding company or associate companies) as may be prescribed.

2. Place of keeping the Register

The Register shall be kept at the registered office of the company.

3. Filing of return with the Registrar

The company shall file with the Registrar a return containing such particulars and documents as may be prescribed. The return shall be filed within 30 days of –

(a) appointment of every director and key managerial personnel; and

(b) any change taking place.

(B) Provisions contained in Rule 17 and Rule 18 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

1. Contents of the Register

The register of directors and key managerial personnel shall contain the following particulars:

(a) Director Identification Number (optional for key managerial personnel)

(b) Present name and surname in full

(c) Any former name or surname in full

(d) Father's name, mother's name and spouse's name (if married) and surnames in full

(e) Date of birth

(f) Residential address (present as well as permanent)

(g) Nationality (including the nationality of origin, if different)

(h) Occupation

(i) Date of the board resolution in which the appointment was made

(j) Date of appointment and reappointment in the company

(k) Date of cessation of office and reasons therefor

(l) Office of director or key managerial personnel held or relinquished in any other body corporate

(m) Membership number of the Institute of Company Secretaries of India in case of Company Secretary, if applicable

(n) Permanent Account Number (mandatory for key managerial personnel if not having DIN).

2. Additional contents of the Register with respect to securities held

In addition, the company shall also include in the Register the following details of securities held by each director and key managerial personnel, in the company, its holding company, subsidiaries, subsidiaries of the company's holding company and associate companies:

(a) The number, description and nominal value of securities

(b) The date of acquisition and the price or other consideration paid
(c) Date of disposal and price and other consideration received
(d) Cumulative balance and number of securities held after each transaction
(e) Mode of acquisition of securities
(f) Mode of holding - physical or in dematerialized form
(g) Whether securities have been pledged or any encumbrance has been created on the securities.

3. Filing of return with the Registrar

The return shall be filed in Form DIR-12 along with the prescribed fee.

The provisions of section 170 shall not apply in case of a Government company in which the entire 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, if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

1.30 Members' right to inspect the Register of directors and key managerial personnel and their shareholding (Section 171)

1. Time of inspection, and copies of register of securities

(a) The register of directors and key managerial personnel and their shareholding shall be open for inspection during business hours.

(b) The members shall have a right to take extracts from, and copies of, the register of directors and key managerial personnel. On a request made by any member, the extract or the copy as the case may be, shall be provided to such member, free of cost within 30 days.

(c) The register of directors and key managerial personnel and their shareholding shall also be kept open for inspection at every annual general meeting of the company and shall be made accessible to any person attending the meeting.

2. Consequences of refusal by the company

If any inspection is refused, or if any copy is not sent within 30 days, the Registrar shall on an application made to him, order an immediate inspection and supply of copies.

The provisions of section 171 shall not apply in case of a Government company in which the entire 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 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

Theoretical Questions from CS Examinations

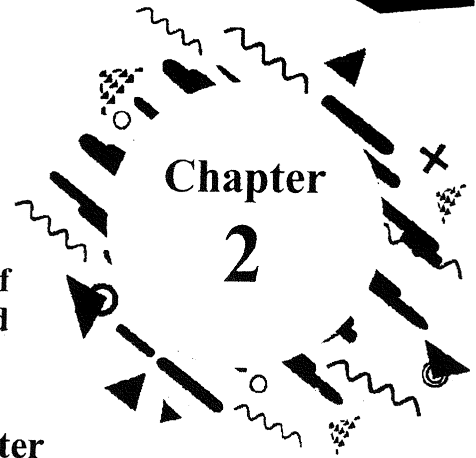
Q 1.30A. B, who is not a member of the company, wants to inspect the register of directors. Can the company refuse inspection? Has B any remedy? [CS (Final) June 1997; June 1999; Dec. 2001]

1.31 Punishment for contravention of Chapter XI (Section 172)

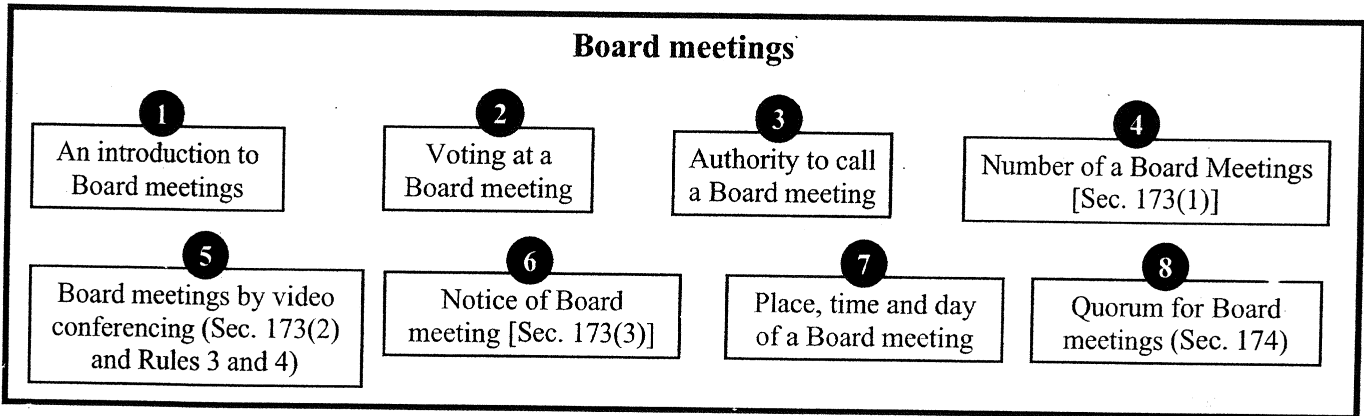
If a company contravenes any of the provisions of Chapter XI of the Companies Act, 2013 (*i.e.* comprising of sections 149 to 172) for which no specific punishment is provided therein, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5 lakh.

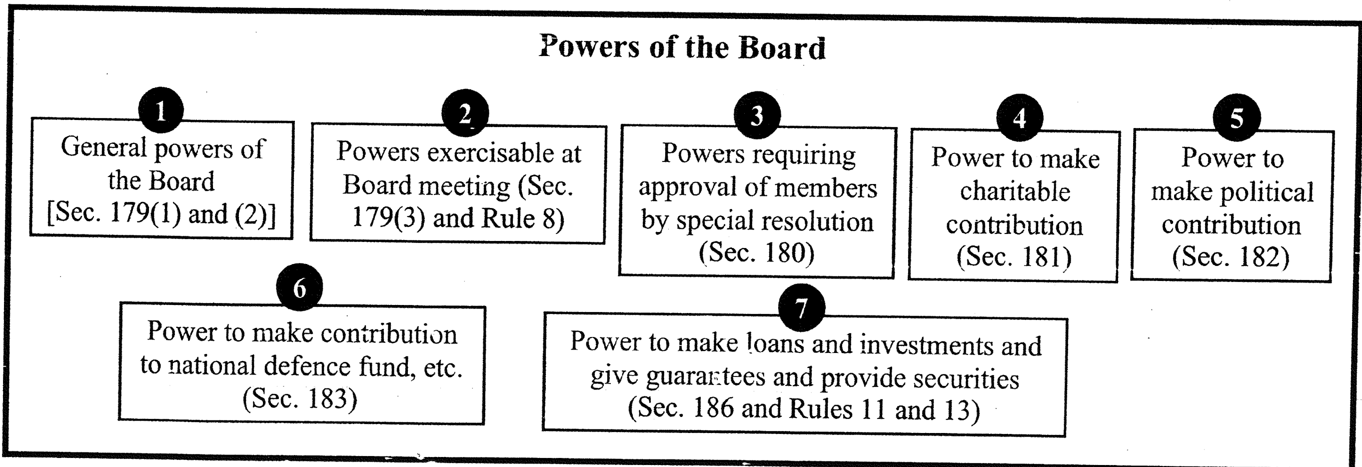
Meetings of Board and its Powers

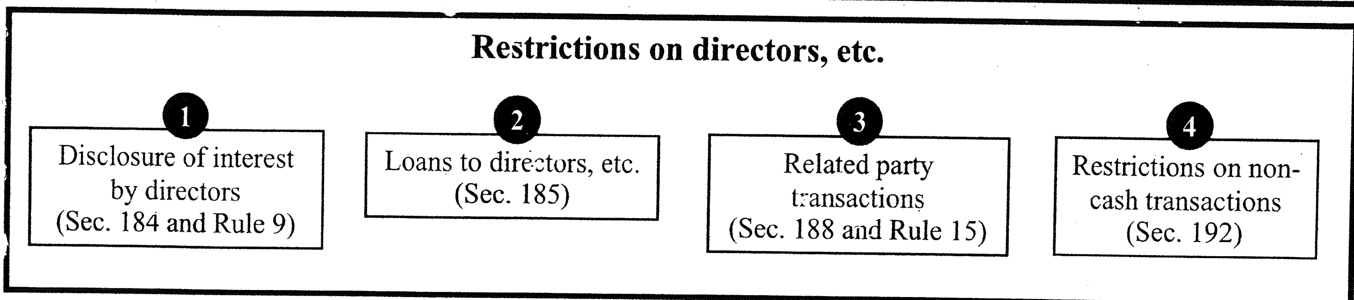
(Chapter XII of the Companies Act, 2013 consisting of Sections 173 to 195 and the Companies (Meetings of Board and its Powers) Rules, 2014)

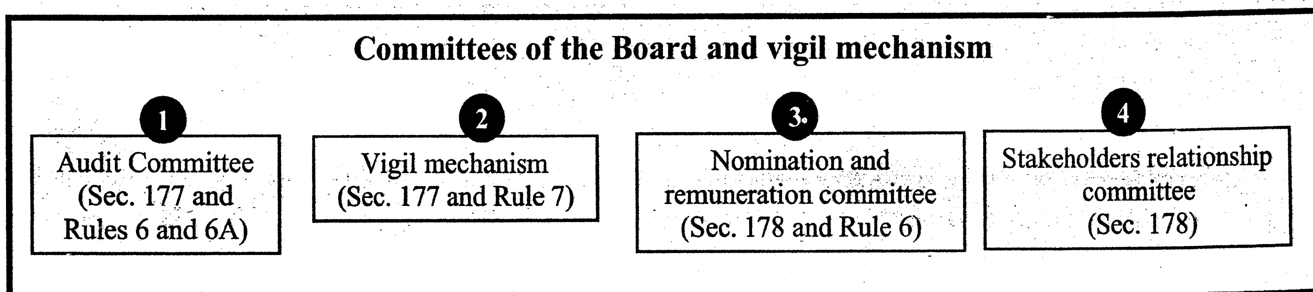


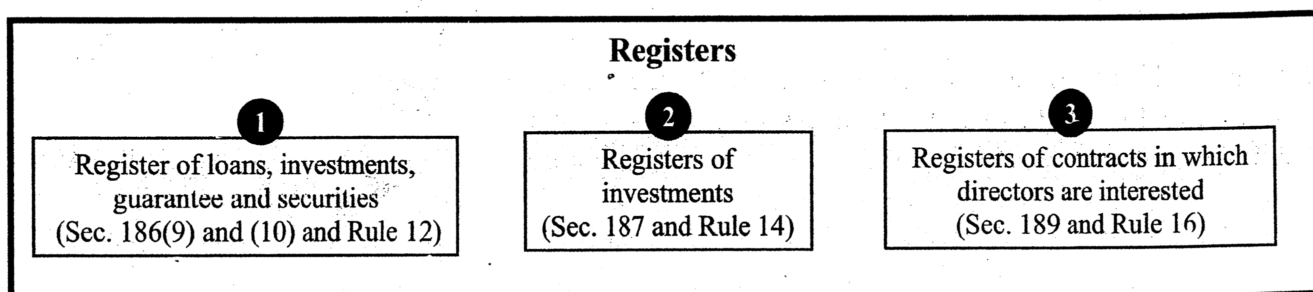
Bird's eye-view of the Chapter

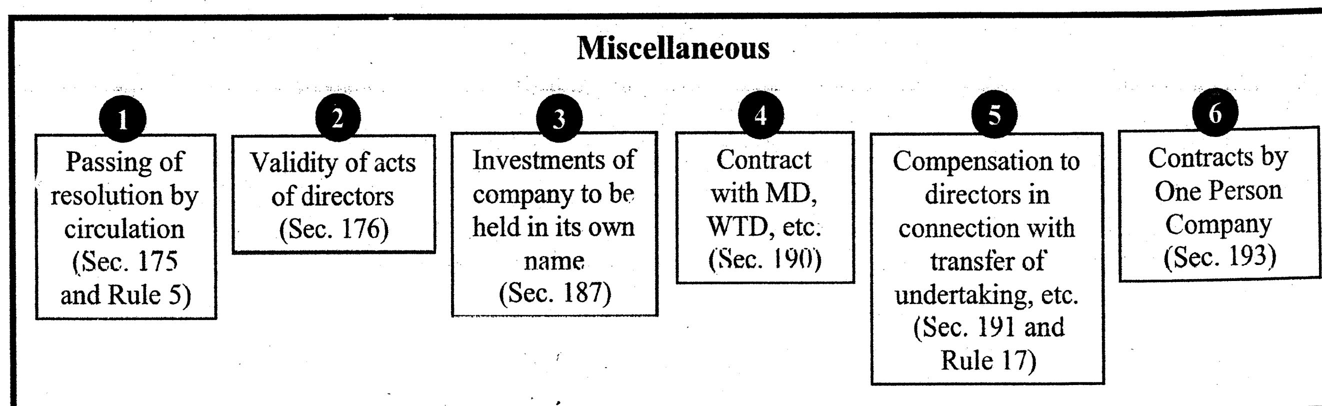












Bird's eye-view of the Companies (Meetings of Board and its Powers) Rules, 2014

Rule No.	Marginal Heading
1	Short title and commencement
2	Definitions
3	Meetings of Board through video conferencing or other audio visual means
4	Matters not to be dealt with in a meeting through video conferencing or other audio visual means
5	Passing of resolution by circulation
6	Committees of the Board
6A	Omnibus approval for related party transactions on annual basis.
7	Establishment of vigil mechanism
8	Powers of Board

9	Disclosures by a director of his interest
10	* * * [Omitted]
11	Loan and investment by a company under section 186 of the Act
12	Register
13	Special Resolution
14	Investments of company to be held in its own name
15	Contract or arrangement with a related party
16	Register of contracts or arrangements in which directors are interested
17	Payment to director for loss of office, etc. in connection with transfer of undertaking, property or shares

Bird's eye-view of the Forms used in this Chapter

Form No.	Description of E-Form (Purpose of E-Form)	Relevant Section	Relevant Rule
MBP-1	Notice of interest by director	184(1)	9
MBP-2	Register of loans, guarantee, security and acquisition made by the company	186(9)	12
MBP-3	Register of investments not held in its own name by the company	187(3)	14
MBP-4	Register of contracts with related party and contracts and Bodies etc. in which directors are interested	189(1)	16

Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, –
   (a) any reference to any section means reference to the sections of the Companies Act, 2013; and
   (b) any reference to any rule means reference to the Rules contained in the Companies (Meetings of Board and its Powers) Rules, 2014.

2.1 An introduction to Board meetings

The word 'meeting' in its ordinary sense implies coming together of two or more persons face to face (either physically or through video conferencing or other audio visual means) for some purpose and discussion. Accordingly, everybody participating in the meeting must be face to face (either physically or through video conferencing or other audio visual means). There must be an intention to meet and the accidental meeting of a director against the will of the other will not constitute a valid meeting **[*Barron* v *Potter* (1914) 1 Ch 895]**.

The provisions relating to Board meetings, as contained in sections 173 and 174 of the Companies Act, 2013, must be complied with, in calling and holding a Board meeting. Additionally, the provisions contained in the articles of the company shall also be complied with. Following points need to be noted in this regard:

1. Minimum number of Board meetings as specified under section 173(1) read with section 173(5) must be held.
2. A Board meeting must be called by a proper authority.
3. The notice of a Board meeting shall be given in accordance with the provisions of section 173(3).

4. At least 7 days' notice of Board meeting shall be given as per the provisions of section 173(3). However, shorter notice of Board meeting is sufficient for transacting any urgent matter (subject to fulfilling the requirements given under First Proviso or Second Proviso to sub-section (3) of section 173).
5. Neither the business to be transacted at a Board meeting, nor the purpose of any Board meeting need be specified in the notice of a Board meeting. *In other words*, the law does not require agenda of a Board meeting. Even where notice is accompanied by agenda, any matter not included in the agenda may be discussed and voted upon with the permission of the Chairperson.

   However, in some exceptional cases, the notice must specify the business to be transacted (*i.e.* specific notice is required).
6. The required quorum must be present in a Board meeting as per the provisions of section 174.
7. The law does not prescribe any place, time and day of a Board meeting.
8. Proper person must be in the chair.
9. The minutes of the Board meetings must be kept as per provisions of section 118.
10. The directors must sign the attendance book, if so required by the articles.
11. A resolution may be passed by circulation in accordance with the provisions of section 175, unless the Act requires that such a resolution shall be passed at a Board meeting only.
12. The Board may delegate its powers to a committee of directors or any director or any officer or employee of the company.

A mere informality in the proceedings does not invalidate a Board meeting. However, a casual meeting of the directors, even at the office of the company, cannot be treated as a Board meeting.

2.2 Voting at a Board meeting

1. When voting at a Board meeting, every director has one vote, irrespective of the fact as to whether he is a member or not, and irrespective of number of shares held by him, if any. The only method of voting used in Board meetings is 'show of hands'. 'Voting by poll' cannot be used in Board meetings.
2. Except where the Act requires a unanimous resolution, questions arising at a Board meeting shall be decided by a majority of votes (Regulation 68 of Table F).

   Only those directors who are present in the meeting and vote on a resolution are considered while determining majority, *i.e.* the directors absent at a Board meeting or the directors abstaining from voting are not considered while ascertaining the result of a resolution.

   Example. At a meeting of the Board, 7 directors are present out of total 12 directors. 3 directors vote in favour of the resolution while 2 directors vote against it, and 2 directors abstain from voting. The resolution has been passed by majority.
3. In case of equality of votes, the resolution is lost unless the chairman uses his casting vote in favour of the resolution. As per Regulation 68 of Table F, the chairman of the Board may use his casting vote (second vote) in case of equality of votes.
4. Unanimous resolution of the Board (*i.e.* a resolution passed with the consent of all the directors present in the Board meeting) is required in respect of the following matters:
   (a) The power to make loans, give guarantee or security or make investments (Section 186)
   (b) The power to appoint a person as a managing director if he is the manager or managing director in one other company [Third proviso to section 203(3)].
5. The articles of a company may require a unanimous resolution of the Board in respect of certain matters or all the matters coming before the Board.
6. A director can vote on a resolution only if he is present in the meeting.
7. A director shall not participate if he is interested in a contract or arrangement (Section 184). Accordingly, a director cannot vote if he is interested in a contract or arrangement. Even if he votes, his vote shall be void.

1. Board resolutions are binding on all

A resolution passed by the Board is binding on the whole Board including those directors who were absent and the directors who voted against such resolution.

2. **A director cannot appoint a proxy**

The Companies Act, 2013 does not contain any provision either specifically permitting or prohibiting the appointment of a proxy by a director. But, it is well settled that a director has no right to appoint a proxy at common law. As such, the right to appoint a proxy is not an inherent right; the right is available only if it is expressly given by the Act. Thus, in the absence of any such provision in the Companies Act, 2013 a director has no right to appoint a proxy. Even the articles cannot empower a director to appoint a proxy.

Practical Problems from CA Examinations

Whether 2 votes in favour will carry a Board resolution if 8 directors are present in Board meeting?

P 2.2A. ABC Ltd. has 12 directors on its Board and has the following clause in its articles of association:

"The questions arising at any meeting of the Board of directors or any committee thereof shall be decided by a majority of votes, except in cases where the Companies Act, 2013 expressly provides otherwise."

In a meeting of the Board of directors of ABC Ltd. 8 directors were present. After completion of discussion on a matter voting was done. 3 directors voted in favour of the motion, 2 directors voted against the motion while 3 directors abstained from voting. You are required to state with reference to the provisions of the Companies Act, 2013 whether the motion was carried or not.

[CA (Final) Nov. 2004]

OR

ABC Ltd. has 12 directors on its Board and has the following clause in its article of association:

"The question arising at any meeting of the Board of directors or any committee thereof shall be decided by a majority of votes, except in cases where the Companies Act, 2013 expressly provides otherwise."

In one of the meeting of the Board of directors of ABC Ltd 8 directors were present. After completion of discussion of matter, voting was done. 3 directors voted in favour of the motion, 2 directors voted against the motion while 3 directors abstained from voting.

State whether the motion was carried or not. It is clarified that the motion being voted up to was not concerning a matter which requires consent of all the directors present in the meeting. **[CA (Final) June 2009]**

Ans. As per Regulation 68 of Table F, except where the Act requires a unanimous resolution, questions arising at a Board meeting shall be decided by a majority of votes.

In the given case, the articles of ABC Ltd. contain a Regulation similar to Regulation 68 of Table F. The articles of ABC Ltd. state that a resolution shall be deemed to be passed in a Board meeting if it is approved by a majority of votes. In this regard, following points are worth noting:

(a) In a Board meeting, every director has one vote only.

(b) Only those directors who are present in the meeting and vote on a resolution are considered while determining majority, *i.e.* following directors are not considered while ascertaining the result of a resolution:

- ❑ A director who is absent at a Board meeting.
- ❑ A director who abstains from voting.

In the given case, the company has 12 directors, out of which only 8 are present in the Board meeting. Out of 8 directors present, 3 directors have voted in favour, 2 directors have voted against the resolution, and 3 directors have abstained from voting. The directors absent in the Board meeting, and the directors present but abstaining from voting shall be ignored.

This information can be presented for better understanding as follows:

- ❑ Directors present in the Board meeting: 8
- ❑ Directors present and voting in the Board meeting: 5
- ❑ Majority of directors present and voting: 3
- ❑ Directors who have actually voted in favour: 3
- ❑ Whether the majority of directors present and voting have voted in favour of the resolution? Yes
- ❑ Whether the resolution has been passed? Yes

In other words, since the number of votes cast in favour of the resolution exceeds the number of votes cast against the resolution, the said resolution has been passed.

Following assumptions have been made in the above case:

(a) No director voting in favour of the resolution is interested in the resolution, as per the provisions of section 184.

(b) The resolution does not require consent of all the directors present in Board meeting.

2.3 Authority to call a Board meeting

The Companies Act, 2013 does not contain any provision as to who can convene a Board meeting. As per Regulation 67 of Table F, an individual director may requisition a Board meeting. On such requisition of a director, the manager or secretary shall be duty bound to summon a Board meeting. Any director (including the director requisitioning the Board meeting) may also summon the Board meeting.

The notice of Board meeting should be sent on behalf of the company.

A secretary has no authority to call a Board meeting on his own. But, any improper notice may be ratified by the Board of directors.

Practical Problems from CS Examinations

Calling a Board meeting at an early date – Whether permissible?

P 2.3A. Y, one of the directors of the company, sends a letter to the company secretary for convening the Board meeting at an early date. Comment. **[CS (Final) June 1999]**

Ans. Regulation 67 of Table F provides that any director may requisition a Board meeting. On such requisition –

(a) the manager or the secretary *shall* summon the Board meeting; *and*

(b) *any director may* summon the Board meeting.

However, neither the Companies Act, 2013 nor Table F contains any provision regarding postponement of a Board meeting or convening a Board meeting at an early date. Thus, a Board meeting may be convened at an early date if the articles of the company contain a provision in this regard. However, in the absence of any provision in the articles, the secretary should consult the chairman or the managing director and discuss the suitability of holding the Board meeting at an early date.

2.4 Number of Board meetings [Section 173(1) and (5)]

Section 173 makes it obligatory for every company to hold the minimum number of Board meetings. The object of section 173 is to ensure that the Board meetings are held at regular intervals, all the powers of the Board are not delegated to one or more directors, the Board is kept informed of the working of the company and the Board of directors regularly meet to monitor the progress of the company. The provisions of section 173 are discussed in detail as follows:

1. **First Board meeting [Section 173(1)]**

   Every company is required to hold its first Board meeting within 30 days of its incorporation.

2. **Subsequent Board meetings [Section 173(1)]**

   (a) ***Four Board meetings in every calendar year.*** At least four Board meetings shall be held every 'year'. The word *'year'* means a calendar year. Thus, at least four Board meetings must be held during the period 1st January to December 31st.

   (b) ***Interval between any two Board meetings.*** Not more than 120 days shall intervene between two consecutive meetings of the Board. *In other words*, the gap between two consecutive Board meetings shall not exceed 120 days.

   (c) ***Example.*** A company held its Board meetings on 1st January, 15th April, 1st May and 20th August. The company has held four Board meeting in the calendar year and gap between two consecutive Board meetings is not more than 120 days. The company has sufficiently complied with the provisions of section 173.

   1. Under the Companies Act, 2013, there is no requirement of holding at least one Board meeting in every quarter of year.
   2. In order to support and enable companies to focus on taking necessary measures to address the COVID-19 threat, including the economic disruptions caused by COVID-19, MCA has provided a relaxation with respect to holding of Board meetings by companies. As per this relaxation, the gap between 2 consecutive Board meetings may extend to 180 days instead of 120 days. However, this relaxation shall be available only till 30th September, 2020 (MCA General Circular No. 11/2020 dated 24th March, 2020).

3. **Exemption by the Central Government [Proviso to sub-section (1) of section 173]**

   (a) ***Exemption to whom?*** The Central Government is empowered to grant exemption to any class or description of companies.

   (b) ***Manner of granting exemption.*** The exemption may be granted only by issuing a notification in the Official Gazette.

(c) ***Terms of exemption.*** The exemption may provide that the provisions relating to holding of first Board meeting and subsequent Board meeting –

(i) shall not apply; or

(ii) shall apply subject to such exceptions, modifications or conditions as may be specified in the notification.

In case of a company licenced under section 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the provisions of section 173(1) shall apply only to the extent that the Board of directors of such companies shall hold at least 1 meeting within every 6 calendar months [Notification No. G.S.R. 466(E) dated 5th June, 2015].

4. **Relaxed provisions for some companies [Section 173(5)]**

In case of One Person Company, small company and dormant company, it would be a sufficient compliance of section 173, if–

(a) at least one Board meeting is held in each half of a calendar year; and

(b) the gap between the two Board meetings is not less than 90 days.

As per Notification No. G.S.R. 464(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 583(E) dated 13th June, 2017, in case of a private company which is a start-up, it would be a sufficient compliance of section 173, if –

(a) at least one Board meeting is held in each half of a calendar year;

(b) the gap between the two Board meetings is not less than 90 days; and

(c) such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

5. **Non-applicability of section 173 [Proviso to sub-section (5) of section 173]**

Section 173 does not apply to a One Person Company in which there is only 1 director on the Board. Thus, no Board meeting is required to be held by One Person Company in which there is only 1 director.

1. **Maximum number of Board meetings**

Neither section 173 nor any other section of the Act prescribes any maximum limit on the number of Board meetings.

2. **Duty of a director to attend Board meetings**

A director should endeavour to attend the maximum number of Board meetings. But he is not duty bound to attend all the Board meetings. However, if loss is caused to the company because of continuous absence of a director from the meetings of the Board, it would amount to negligence and breach of duty. Moreover, as per section 167, a director shall have to vacate his office if he absents himself, with or without obtaining leave of absence from the Board, from all the Board meetings held within a period of 12 months.

Theoretical Questions from CS Examinations

Q 2.4A. State the provisions relating to frequency of Board meetings of a company. [CS (Final) Dec. 1994]

Practical Problems from CA Examinations

A company conducted 4 Board meetings – Whether it amounts to contravention?

P 2.4A. Seafood Limited, a public limited company was incorporated on 1st April, 2015. The company has conducted four Board meetings during the financial year 2015-16 *i.e.* on 6th April, 2015, 28th August, 2015, 30th September, 2015 and 30th March, 2016.

(i) Has the company contravened the provisions of the Companies Act, 2013 in respect of the conduct of the meetings?

(ii) Will your answer differ if the company was incorporated under Section 8 of the Companies Act, 2013? [CA (Final) Nov. 2016]

Ans. As per section 173(1), the first meeting of the Board of directors shall be held within 30 days of incorporation of the company, and at least four Board meetings shall be held in each calendar year and not more than 120 days shall intervene between two consecutive meetings of the Board.

In the present case, the company was incorporated on 1st April, 2015 and the first meeting of the Board was held on 6th April, 2015. The company has held the first Board meeting within 30 days of its incorporation.

The gap between two consecutive Board meetings held on 6th April, 2015 and 28th August, 2015 exceeds 120 days. Also, the gap between two consecutive Board meetings held on 30th September, 2015 and 30th March, 2016 exceeds 120 days. Therefore, Seafood Limited has contravened the provisions of section 173.

As per Notification No. G.S.R. 466(E) dated 5th June, 2015, in case of a company licenced under section 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the provisions of section 173(1) shall apply only to the extent that the Board of Directors of such Companies shall hold at least 1 meeting within every 6 calendar months.

In the given case, if Seafood Limited were a company incorporated under section 8, there would be no contravention of section 173(1), since it has held one Board meeting upto 30th June, 2015, two Board meetings during the 6 calendar month period 1st July, 2015 to 31st December, 2015 and one Board meeting during the 6 calendar month period 1st January, 2016 to 30th June, 2016.

Practical Problems from CS Examinations

Four Board meetings held from January to December – Is it a contravention of section 173?

P 2.4B. During the year 2015, A Ltd. held four meetings of the Board on 2nd January 2015, 10th May 2015, 16th October 2015 and 31st December 2015. Examine whether this was in accordance with the provisions of the Companies Act, 2013?

[CS (Final) June 1995]

Ans. As per section 173(1), at least four Board meetings shall be held in each calendar year and not more than 120 days shall intervene between two consecutive meetings of the Board.

In the present case the gap between the two consecutive Board meetings held on 2nd January 2015 and 10th May 2015 was more than 120 days, and also the gap between the two consecutive Board meetings held on 10th May, 2015 and 16th October, 2015 was more than 120 days. Hence, section 173 has been contravened.

Advanced Practical Problems

Whether there is a contravention of section 173?

P 2.4C. During the year 2015, B Ltd. held the Board meetings on 15th January 2015, 5th May 2015 and 1st September 2015. In the Board meeting held on 1st September 2015, only 3 matters out of total matters 5 could be discussed and voted upon, and so it was adjourned till 8th September, 2015. In the adjourned Board meeting held on 8th September 2015, the remaining 2 matters were discussed and voted upon. Has the company contravened any of the provisions of the Companies Act, 2013?

Ans. As per section 173(1), at least four Board meetings shall be held in each calendar year and not more than 120 days shall intervene between two consecutive meetings of the Board.

In the present case, the Board meeting held on 01.09.2015 was adjourned, and the adjourned Board meeting was held on 08.09.2015. The Board meeting held on 01.09.2015 and the adjourned Board meeting held on 08.09.2015 shall not be deemed to be two separate Board meetings, since an adjourned meeting is a mere continuation of the original meeting. Accordingly, the Board meeting held on 01.09.2015 and the adjourned Board meeting held on 08.09.2015 shall be counted as one Board meeting only.

Thus, the company has held only 3 Board meetings during the calendar year 2015. Therefore, the company has contravened the provisions of section 173 by not holding the minimum number of 4 Board meetings during the calendar year 2015.

Whether there is a contravention of section 173?

P 2.4D. Three Board meetings of C Ltd. were held on 01.01.2014, 01.04.2014 and 01.07.2014. In the fourth Board meeting scheduled for 27.10.2014, no matter could be discussed since the required quorum was not present, and so it was adjourned till 03.11.2014. In the adjourned Board meeting held on 03.11.2014, 5 matters were discussed and voted upon. Has the company contravened any of the provisions of the Companies Act, 2013?

Ans. As per section 173(1), at least four Board meetings shall be held in each calendar year and not more than 120 days shall intervene between two consecutive meetings of the Board.

In the present case, the Board meeting held on 27.10.2014 was adjourned, and the adjourned Board meeting was held on 03.11.2014. The Board meeting held on 27.10.2014 and the adjourned Board meeting held on 03.11.2014 shall not be deemed to be two separate Board meetings, since an adjourned meeting is a mere continuation of the original meeting. Accordingly, the Board meeting held on 27.10.2014 and the adjourned Board meeting held on 03.11.2014 shall be counted as one Board meeting only. Thus, the company has held 4 Board meetings during the calendar year 2014.

The gap between first and second Board meeting was not more than 120 days. Similarly, the gap between the second and third Board meeting was also not more than 120 days. Regarding the gap between the third and fourth Board meeting, the date of third Board meeting and fourth original Board meeting should be considered. This is so because the Board meeting held on 27.10.2014 and the adjourned Board meeting held on 03.11.2014 shall be counted as one Board meeting only, *i.e.* it shall be deemed that only one Board meeting was held on 27.10.2014. As is evident, the gap between the third Board meeting (*i.e.* 01.07.2014) and fourth Board meeting (*i.e.* 27.10.2014) is not more than 120 days. Since C Ltd. has held four Board meetings during the calendar year 2014, and the gap between no two consecutive Board meetings is more than 120 days, C Ltd. has complied with section 173.

2.5 Board meetings through electronic mode or video conferencing [Section 173(2) and Rules 3 and 4]

1. Manner of participation in Board meeting [Section 173(2)]

(a) A director may attend a Board meeting –

(i) in person (*i.e.* being personally present); or

(ii) through video conferencing or other audio visual means, as may be prescribed.

(b) The system of video conferencing or other audio visual means must be capable of –

(i) recognising and recording the presence of directors; and

(ii) recording and storing the proceedings of the Board meeting along with date and time.

(c) Only such video conferencing or other audio visual means can be used as may be prescribed.

The manner, conditions and other legal requirements for participation through video conferencing or other audio visual means have been prescribed under Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014.

2. Prohibition on transacting certain matters by video conferencing or other audio visual means [Proviso to Section 173(2)]

(a) The Central Government is empowered to specify certain matters which shall not be dealt with in a Board meeting by video conferencing or other audio visual means.

(b) The Central Government may exercise such power by issuing a Notification in the Official Gazette.

As per Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014, the following matters shall not be dealt with in any Board meeting held through video conferencing or other audio visual means:

(i) The approval of the annual financial statements

(ii) The approval of the Board's report

(iii) The approval of the prospectus

(iv) The Meetings of the Audit Committee for consideration of financial statement including consolidated financial statement, if any, to be approved by the Board under section 134

(v) The approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

However, if there is quorum in a Board meeting through physical presence of directors, any other director may participate through video conferencing or other audio visual means in such Board meeting on any of the above matters, *i.e.* points (i) to (v) above.

For the period beginning from the commencement of the Companies (Meetings of Board and its Powers) Amendment Rules, 2020 (*i.e.* 19th March, 2020) and ending on 31st December, 2020, the meetings on the above matters (*i.e.* points (i) to (v) above) may be held through video conferencing or other audio visual means in accordance with Rule 3.

3. Procedure for conducting meetings of the Board through video conferencing or other audio visual means [Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014]

A company shall comply with the following procedure, for convening and conducting the Board meetings through video conferencing or other audio visual means:

(1) Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.

(2) The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care –

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

(b) to ensure availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorised participants at the Board meeting;

(c) to record proceedings and prepare the minutes of the meeting;

(d) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year.

(e) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and

(f) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting:

Provided that the persons, who are differently abled, may make request to the Board to allow a person to accompany him.

(3) (a) The notice of the meeting shall be sent to all the directors in accordance with the provisions of sub-section (3) of section 173 of the Act.

(b) 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.

(c) 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.

10. Assuming that the Chairperson and the company secretary have taken due and reasonable care to ensure availability of proper video conferencing or other audio visual equipment or facilities and for recording, storing and safekeeping the proceedings of the Board meeting, there is no contravention of section 173(2) or Rule 3.

Conclusion

11. After conclusion of the meeting held through video conferencing, the Company Secretary should, in consultation with the Chairman of the Board meeting, prepare the 'draft minutes' by referring to the 'draft minutes' prepared during the conduct of the Board meeting held through video conferencing.
12. The 'draft minutes' prepared by the Company Secretary should be circulated to all the directors within 15 days of the meeting, with a request to the directors to confirm the accuracy of such 'draft minutes'.
13. On receipt of comments or confirmation from the directors, the minutes shall be entered in the minutes book within 30 days of conclusion of the Board meeting.

Is it mandatory for the company to provide the facility to its directors to attend the Board meetings through video conferencing and whether a director is entitled to participate in a Board meeting through video conferencing from his own end?

P 2.5B. M/s OBC Limited at its forthcoming Board meeting decided that it will not provide the directors with the facility of participation in the said meeting through electronic mode; can the directors insist on attending the meeting through such mode? Decide as per the provisions of the Companies Act, 2013. Will your answer differ, if a director participates in a Board meeting through electronic mode from his end, even if the company does not provide such facility? [CA (Final) Nov. 2018]

Ans. The given problem relates to section 173(2) of the Companies Act, 2013 read with Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014.

The legal position

1. As per section 173(2), a director may attend a Board meeting –
   (i) in person (*i.e.* being personally present); or
   (ii) through video conferencing or other audio visual means, as may be prescribed.
2. Further, section 173(2) requires that the system of video conferencing or other audio visual means must be capable of –
   (i) recognising and recording the presence of directors; and
   (ii) recording and storing the proceedings of the Board meeting along with date and time.
3. Also, section 173(2) states that only such video conferencing or other audio visual means can be used as may be prescribed, *i.e.* the video conferencing or other audio visual means which satisfy the manner, conditions and other legal requirements contained in Rule 3 can only be used.
4. The relevant provisions of Rule 3 are as under:
   (a) Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.
   (b) 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 authorised participants at the Board meeting;
      (iii) to record proceedings and prepare the minutes of the meeting;
      (iv) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and
      (v) 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:

The given case and analysis of the case

5. M/s OBC Limited has decided not to provide the facility to participate in Board meeting through video conferencing or other audio visual means.
6. The issue raised in the problem is as to whether the directors can insist the company to provide to the directors the facility to attend the Board meetings through video conferencing or other audio visual means.
7. The same issue was raised *before the Appellate Tribunal* in ***Achintya Kumar Barua v Ranjit Barthkur* (2018) 207 Comp Case 47**. The detailed facts and decision of this case are as under:
   (a) The company referred to clause (e) of sub-rule (2) of Rule 3 to submit that a responsibility has been put on the Chairperson to ensure that no person other than the concerned director is attending or having access to the proceedings of the meeting through video-conferencing. So, the company raised an apprehension that if a director attends a Board meeting through video conferencing, it would not be possible for the Chairperson to ensure that the director is alone when participating from wherever the video call is made as the Chairperson would have no means to know as to who else is sitting in the room or place concerned.

The Appellate Tribunal held that inclusion of the facility to attend the Board meetings through video conferencing is a progressive step taken by the legislature. So, it would not be appropriate to shut-out the provisions contained in section 173(2) read with Rule 3 on mere apprehensions.

(b) The company referred to the word 'may' used in section 173(2). Section 173(2) reads as under:

"The participation of directors in a meeting of the Board may be either in person or through video conferencing or other audio visual means, as may be prescribed ..."

The company was of the view that use of the word 'may' in section 173(2) implies that the provisions contained in section 173(2) read with Rule 3 are directory in nature.

The Appellate Tribunal held that the word 'may' used in section 173(2) only gives an option to the director to choose whether he would participate in the Board meeting in person or through video conferencing. The word 'may' does not give an option to the company to deny the right given to the directors for participation through video conferencing, if they so desire. Thus, the Appellate Tribunal concluded that the provisions contained in section 173(2) read with Rule 3 are mandatory, and the companies shall not be permitted to make any deviations therefrom.

(c) The company was also of the view that as per the Secretarial Standards issued by the Institute of Company Secretaries of India, it is optional for the company to provide the facility of video conferencing and that the provisions contained in Rule 3 are applicable only where a company opts to provide the facility of video conferencing.

The Appellate Tribunal held that the provisions contained in the Secretarial Standards are mere guidelines which cannot override the provisions contained in section 173(2) and Rule 3. So, the mandate of section 173(2) read with Rule 3 cannot be avoided by the companies.

Thus, it was held that it was mandatory for the company to provide the facilities to the directors to attend the Board meetings through video conferencing by fulfilling the requirements contained in section 173(2) and Rule 3.

Conclusions

8. **Can the directors insist on attending the Board meetings through video conferencing?**

It is mandatory for M/s OBC Limited to provide the facility to its directors to attend the Board meetings through video conferencing or other audio visual means. If the company refuses to provide such facility, any director can insist the company to provide such facility, and in case the company refuses to do so, any director can seek legal action against the company.

9. **If the company does not provide the facility to attend the Board meetings through video conferencing, can a director participate in a Board meeting through video conferencing from his own end?**

(a) As per section 173(2), a director may attend a Board meeting –

(i) in person (*i.e.* being personally present); or

(ii) through video conferencing or other audio visual means, as may be prescribed.

(b) It is evident that only such video conferencing or other audio visual means can be used which have been prescribed by the Central Government under Rule 3. Rule 3 requires the companies to make necessary arrangements for conducting the Board meetings through video conferencing or other audio visual means. Rule 3 does not permit any director of the company to make his own arrangements for participating in a Board meeting.

Thus, no director can participate in a Board meeting through video conferencing from his own end.

Validity of approval of financial statements in a Board meeting in which 3 directors were physically present and 2 directors participated through video conferencing

P 2.5C. Wonderland Ltd. convened a meeting of the Board of directors on 1st September, 2019 to approve the financial statements of the company as on 31st March, 2019. The Board has strength of 5 directors and the quorum as per articles of association is 3 directors physically present. While 3 directors participated in the meeting physically, the fourth and the fifth directors participated through video conferencing. Examine the validity of the approval of financial statements in the above said Board meeting. [CA (Final) Nov. 2019]

Ans. The given problem relates to section 173(2) of the Companies Act, 2013 and Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014, read with section 174 of the Companies Act, 2013.

The legal position

1. As per section 173(2), a director may attend a Board meeting –

(i) in person (*i.e.* being personally present); or

(ii) through video conferencing or other audio visual means, as may be prescribed.

2. As per section 174, the quorum required for a Board meeting shall be higher of –
   (i) 1/3rd of total strength (any fraction contained in that 1/3rd shall be rounded off as 1); or
   (ii) 2 directors.
3. As per Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014, the matter relating to approval of the financial statements shall not be dealt with in any Board meeting held through video conferencing or other audio visual means. However, if there is quorum in a Board meeting through physical presence of directors, any other director may participate through video conferencing or other audio visual means in such Board meeting on such matter, i.e. approval of the financial statements.

The given case and analysis of the case

4. In the Board meeting held on 1st September, 2019, 3 directors were physically present, and 2 directors participated through video conferencing.
5. Financial statements were approved in the Board meeting held on 1st September, 2019.
6. Since 3 directors were physically present in the Board meeting held on 1st September, 2019, the requirement contained in Rule 4 (i.e. presence of quorum in Board meeting through physical presence of directors) has been satisfied. Accordingly, the matter relating to approval of the financial statements could be dealt with in the Board meeting held on 1st September, 2019 through video conferencing.

Conclusion

7. The matter relating to approval of financial statements has been validly transacted in the Board meeting held on 1st September, 2019.

2.6 Notice of a Board meeting [Section 173(3) and (4)]

Section 173(3) of the Companies Act, 2013 contains the provisions relating to notice of Board meeting. The purpose of sending notice of Board meeting is to inform the directors about the time and date of the meeting. The notice need not be in any particular form. An informal notice can be a sufficient compliance of law provided it complies with the requirements of section 173(3), explained as follows.

1. Notice to be in writing

(a) Section 173 requires that the notice of Board meeting shall be given in writing.

(b) An oral notice either face to face or over the telephone is not an adequate notice, since the notice in such a case is not given in writing.

(c) Notice sent by telegram or telex or facsimile (fax) is valid as it is in writing [***Ferrucco Sias*** v ***Jai Mangeeram Mukhi*** **(1993) 12 CLA 212**].

2. Notice to whom?

(a) Notice to every director. Notice of every Board meeting shall be sent to every director of the company.

(b) Notice to interested directors. Section 173(3) requires that notice must be given to every director. Therefore, notice must be given to a director even if he is precluded from voting on a proposed business [***Re, Homer District Consolidated Gold Mines*** **(1888) 39 Ch D 546**].

(c) Notice to an alternate director. Where an alternate director has been appointed, the notice shall be served on the original director as well as the alternate director.

(d) No waiver of notice. It is necessary to send notice to each and every director even if a particular director informs the company that he will not be able to attend the meeting [***Re, Portuguese Consolidated Copper Mines Ltd.*** **(1889) 42 Ch D 160 (CA)**].

Consequences where notice is not sent

The Companies Act, 2013 does not contain any provision specifying the consequences where notice of a Board meeting is not sent to one or more directors of the company.

As per the judicial decisions, where it is proved that the notice was improper, following consequences shall follow:

(a) Meeting shall be void. The notice must be sent to all the directors, otherwise the proceedings of the meeting and the resolutions passed thereat may be declared as invalid by the Court of law [***Parmeshwari Prasad Gupta*** **v** ***Union of India*** **(1974) 44 Comp Cas 1**]. Where no notice was sent to some of the directors and unreasonably short notice to some other directors, and certain strangers also participated in the meeting, the meeting was held to be invalid [***Sikkim Bank Ltd.*** **v** ***R.S. Choudhary*** **(2000) 102 Comp Cas 387 (Cal)**]. Even an accidental omission to give notice to a single director would render the resolutions passed at that meeting void.

(b) ***Ratification of improper notice is possible.*** The term 'ratification' means giving consent or approval to an act which has been irregularly done. Where notice is not given as required, but all the directors attend the meeting without any objection or where the absentee directors do not complain of want of notice, the proceedings at the meeting will not be invalid, especially if the proceedings are ratified at a subsequent meeting in which the absentee directors are present.

The ratification shall relate back to the date of the act ratified [***Parmeshwari Prasad Gupta*** v ***Union of India*** **(1974) 44 Comp Cas 1]**.

3. Mode of sending notice

The notice shall be sent by –

(a) hand delivery; or

(b) post; or

(c) electronic means.

4. Where to send notice?

Notice shall be sent to every director of the company at his address registered with the company. The words 'addressed registered with the company' would mean the address supplied by the director to the company for service of notice or other communication. Such address may be an Indian address or of abroad.

5. Notice of adjourned Board meeting

An adjourned meeting is only a continuation of the original meeting. Thus, notice for the original meeting holds good for the adjourned meeting. *In other words*, notice of adjourned Board meeting need not be given. However, fresh notice for adjourned meeting is required in the following cases:

(a) Where the articles of a company provide that a fresh notice for the adjourned meeting shall be given **[*Pramod Kr. Mittal* v *Southern Steel Ltd.* (1980) 50 Comp Cas 555]**.

(b) Where a Board meeting is adjourned *sine die*, *i.e.* adjournment for an indefinite period.

6. Length of notice

(a) Notice shall be given at least 7 days before the Board meeting.

(b) A Board meeting may be called at a shorter notice subject to the following provisions:

Case I. If the company has appointed one or more independent directors, the shorter notice shall be valid, if –

(i) the Board meeting is called at a shorter notice so as to transact some urgent business; and

(ii) at least one independent director is present at such Board meeting, or if no independent director is present at such Board meeting, then, the decisions taken at such Board meeting shall be circulated to all the directors, and such decisions shall be final only on ratification thereof by at least one independent director.

Case II. If the company has not appointed any independent director, the shorter notice shall be valid if the Board meeting is called at a shorter notice so as to transact some urgent business. In such a case, there is no question of presence of, or ratification by, any independent director.

7. Contents of notice

(a) The Companies Act, 2013 has not specified any contents of notice of Board meeting. However, the notice must specify the day, date, time and place of the Board meeting.

(b) Agenda of Board meeting (*i.e.* matters to be transacted at the Board meeting) may or may not be included in the notice of Board meeting. Any matter may be transacted at the Board meeting even if it was not included in the notice sent to the directors.

Specific notice is required in certain cases

The following matters may be transacted at a Board meeting only if the notice of the Board meeting expressly states that such matters shall be transacted at such Board meeting (*i.e.* specific notice of such resolutions is required):

1. As per section 203, a person who is already a managing director or manager of one other company may be appointed as a managing director of the company, only if the specific notice of such appointment is included in the notice of Board meeting.
2. As per section 188, where a company enters into a contract or arrangement with a related party, such related party transaction requires approval at a Board meeting. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars prescribed under Sub-Rule (1) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.
3. Where a person is appointed as a managing director or whole time director or manager, the terms and conditions of his appointment shall be approved by passing a resolution at a Board meeting only. The notice of such Board meeting shall include the terms and conditions of such appointment, remuneration payable to him and other similar matters [Section 196(4)]. However, section 196(4) does not apply to a private company and Government company.

(c) In view of the increased responsibilities of directors and to ensure good corporate governance, the notice of the Board meeting should include details regarding the business to be transacted. Thus, as a matter of good secretarial practice, all the relevant documents and information should also be given along with the notice so that the directors can prepare beforehand the subject matter of the proposed business.

Specific notice may be required by the articles

Where the articles of a company require that the notice of Board meeting shall contain the business to be transacted thereat, such a provision is valid and binding.

8. Penalties for default

Every officer of the company whose duty is to give notice of Board meeting and who fails to do so shall be liable to a penalty of Rs. 25,000.

1. No form of notice of Board meeting has been specified under the Companies Act, 2013.
2. The notice of Board meeting must be definite. A contingent notice is not good at law **[*Alexander* v *Simpson* (1889) 43 Ch D 139 (CA)]**.
3. The notice of Board meeting must be given under the authority of the company.

Theoretical Questions from CA Examinations

Q 2.6A. Elaborate the provisions of the Companies Act, 2013 regarding notice of Board Meeting. [CA (Final) Nov. 2015]

Practical Problems from CA Examinations

Whether notice is required to be served on a director who has waived his right to receive notice?

P 2.6A. Mr. Rohit, a director, states that he will not be able to attend the next Board meeting. Advise whether notice is required to be sent to him. [CA (Final) May 2003, May 1999]

OR

Examine with reference to the provisions of the Companies Act, 2013 whether notice of a board Meeting is required to be sent to a Director who has expressed his inability to attend a particular Board meeting. [CA (Final) May 2013]

Ans. As per section 173(3), a meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Notice is to be sent to a director even if he waives his right to receive the notice **[Re. *Portuguese Consolidated Copper Mines Ltd.* (1889) 42 Ch D 160 (CA)]**. Thus, waiver of right to receive notice by a director does not exempt the company from its duty of serving notice to every director. Accordingly, the notice of Board meeting must be sent to Mr. Rohit.

Whether notice is required to be served on an alternate director?

P 2.6B. Mr. Bipin Ram goes abroad for four months from 4.1.1999 and an alternate director has been appointed in his place. Advice as to sending of notice as required under section 173 of the Companies Act, 2013. [CA (Final) May 2003]

OR

Examine with reference to the provisions of the Companies Act, 2013 whether notice of a board Meeting is required to be sent to Alternative Director. [CA (Final) May 2013]

OR

A director goes abroad for a period of more than 3 months and an alternate director has been appointed in his place under section 161(2). During the period of absence of the original director, a Board meeting was called. In this connection, with reference to the provisions of the Companies Act, 2013, advise whom should the notice of Board meeting be given to the 'original director' or to the 'alternate director'? [CA (Final) May 1999]

Ans. As per section 173(3), a meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. As can be seen, section 173(3) does not specifically state that notice to an alternate director shall be served. However, section 173(3) clearly says that notice shall be sent to 'every director'. Since an alternate director is also a director, he is squarely covered in the term 'every director', and so notice of Board meeting must be sent to alternate director. Also, an alternate director is a director in his own right. He is not a proxy or representative of the original director. The grounds of vacation of office also apply to him as these apply to the original director, *i.e.* an alternate director shall vacate his office if he does not attend all the Board meetings during a period of 12 months as per the provisions of section 167(1)(b). Therefore, notice must be given to an alternate director.

Thus, notice shall be served to both, the alternate director as well as the original director at their addresses registered with the company.

The notice to Mr. Bipin Ram, *i.e.* the original director shall be sent at his address registered with the company. Same way, the notice to the alternate director shall be sent to him at his address registered with the company.

Notice by e-mail and shorter notice in case of foreign collaboration

P 2.6C. Mr. James is a director residing abroad representing the foreign collaborator. The foreign collaborator holds 49% shareholding in the company. The articles of association of the company provides for sending notice to directors by e-mail. Is it permissible to send notice by e-mail? Can the Board meeting be called at shorter notice?

[CA (Final) May 2003, May 1999 (Modified)]

Ans. As per section 173(3), a meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. Thus, notice may be sent to the directors by e-mail since it is permitted by the Act, *i.e.* section 173(3).

Notice sent by e-mail is valid irrespective of any provisions contained in the articles of the company.

Generally, a Board meeting may be called by giving at least 7 days' notice. However, a Board meeting may be called at a shorter notice so as to transact some urgent business provided at least one independent director is present at such Board meeting, or if no independent director is present at such Board meeting, then, the decisions taken at such Board meeting shall be circulated to all the directors, and such decisions shall be final only on ratification thereof by at least one independent director. However, if the company has not appointed any independent director, the shorter notice shall be valid if it is called at a shorter notice so as to transact some urgent business, and in such a case, there is no question of presence of, or ratification by, any independent director.

The provisions with respect to notice of Board meetings apply to companies having foreign collaborator in the same manner as they apply to any other company.

Whether notice is required to be served on an interested director?

P 2.6D. Examine with reference to the provisions of the Companies Act, 2013 whether notice of a Board Meeting is required to be sent to an interested Director. **[CA (Final) May 2013]**

Ans. As per section 173(3), a meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Section 173(3) clearly says that notice shall be sent to 'every director'. Since an interested director is also a director, he is squarely covered in the term 'every director', and so notice of Board meeting must be sent to interested director.

As per section 184, a director shall disclose his concern or interest in the contract or arrangement in which he is interested, and he shall not participate at the time of discussion and voting on such contract or arrangement. However, an interested director is entitled to participate at time of discussion and voting on any other contract or arrangement, *i.e.* any contract or arrangement in which he is not concerned or interested. Thus, an interested director has a right to attend every Board meeting. Therefore, notice must be given to a director even if he is precluded from voting on a proposed business ***[Re, Homer District Consolidated Gold Mines (1888) 39 Ch D 546]***.

Whether notice is required to be served on a director who has gone abroad?

P 2.6E. Examine with reference to the provisions of the Companies Act, 2013 whether notice of a Board Meeting is required to be sent to a director who has gone abroad. **[CA (Final) May 2013]**

Ans. As per section 173(3), a meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Section 173(3) clearly says that notice shall be sent to 'every director'. Since a director who has gone abroad is also a director, he is squarely covered in the term 'every director', and so notice of Board meeting must be sent to a director who has gone abroad (irrespective of the period of his stay outside India and irrespective of the fact that an alternate director has been appointed in his place or not). Notice shall be served on him at his address registered with the company. Notice may be sent to him by hand delivery or by post or by e-mail.

Effect of non-service of notice to directors

P 2.6F. Mr. P and Mr. Q who are the directors of the company informed the company their inability to attend the meeting because the notice of the meeting was not served on them. Discuss whether there is any default on the part of the company and the consequences thereof. **[CA (Final) Nov. 2009]**

Ans. As per section 173(3), a meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

As per section 173(4), every officer of the company whose duty is to give notice of Board meeting and who fails to do so shall be liable to a penalty of Rs. 25,000. However, the Companies Act, 2013 does not contain any provision with respect to validity of resolution passed in a Board meeting of which notice is not sent to one or more directors of the company. As per the judicial decisions, where it is proved that the notice was improper, the meeting shall be void, and consequently, all the resolutions passed at such meeting shall be invalid **[*Parmeshwari Prasad Gupta* v *Union of India* (1974) 44 Comp Cas 1]**. Even an accidental omission to give notice to a single director would render the resolutions passed at that meeting void.

By not sending the notice to the directors Mr. P and Mr. Q, the company has defaulted in compliance of section 173. Accordingly, every officer of the company whose duty was to give notice of Board meeting and who has failed to do so shall be liable to a penalty of Rs. 25,000. Further, the Board meeting as well as the resolutions passed in such Board shall be of no effect.

Whether notice of Board meeting is valid if agenda is not circulated along with such notice

P 2.6G. Examine the following with reference to the provisions of the Companies Act, 2013:

The Chairman of Evergreen Limited convened a Board meeting and two weeks' notice was served on all directors of the company. Two of the independent directors on the Board objected on the grounds that no proper agenda for the meeting was circulated. [CA (Final) May, 2017]

Ans. The given problem relates to section 173(3) of the Companies Act, 2013, as discussed below:

1. Section 173(3) reads as under:

   "A meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means."

2. It is evident that section 173(3) does not require agenda to be given along with the notice of Board meeting. *In other words*, it is not mandatory to circulate agenda along with the notice of Board meeting.
3. In the given case, two weeks' notice was served on all the directors. Since the period of notice is not less than 7 days, this notice is in compliance of the requirements of section 173(3), though it is not accompanied by agenda.
4. Conclusion: There is no contravention of section 173(3), and so the notice of the Board meeting is valid.

Shorter notice for a Board meeting held by way of video conferencing

P 2.6H. Examine the following with reference to the provisions of the Companies Act, 2013:

Sunshine Limited proposes to hold its Board meeting at a shorter notice through video conferencing. [CA (Final) May, 2017]

Ans. The given problem relates to section 173(3) of the Companies Act, 2013 read with section 173(2) and Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014, as discussed below:

1. As per section 173(2), a director may attend a Board meeting in person (*i.e.* being personally present) or through video conferencing or other audio visual means, as may be prescribed. The system of video conferencing or other audio visual means must be capable of –

   (i) recognising and recording the presence of directors; and

   (ii) recording and storing the proceedings of the Board meeting along with date and time.

2. As per section 173(3), not less than 7 days' notice is required for holding a Board meeting. However, a Board meeting may be called at a shorter notice subject to the following provisions:

   Case I. If the company has appointed one or more independent directors, the shorter notice shall be valid, if –

   (i) the Board meeting is called at a shorter notice so as to transact some urgent business; and

   (ii) at least one independent director is present at such Board meeting, or if no independent director is present at such Board meeting, then, the decisions taken at such Board meeting shall be circulated to all the directors, and such decisions shall be final only on ratification thereof by at least one independent director.

   Case II. If the company has not appointed any independent director, the shorter notice shall be valid if the Board meeting is called at a shorter notice so as to transact some urgent business. In such a case, there is no question of presence of, or ratification by, any independent director.

3. Thus, it is possible to hold the Board meeting at a shorter notice by complying with the provisions contained in section 173(2) and 173(3). It is immaterial that the Board meeting called by serving shorter notice is held by video conferencing or otherwise.
4. For holding the Board meeting by video conferencing or other audio visual means, the company shall have to comply with the provisions contained in Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014.

Conditions for calling a Board meeting at a shorter notice, and whether notice sent by e-mail is valid?

P 2.6I. What are the conditions to be fulfilled for calling meetings at shorter notice than is prescribed by Companies Act, 2013? One of the directors, a senior professional, objected to receiving the notice by e-mail. Advise him. [CA (Final) May 2016]

Ans. The given problem relates to section 173(3) of the Companies Act, 2013, as discussed below:

1. As per section 173(3), not less than 7 days' notice is required for holding a Board meeting. However, a Board meeting may be called at a shorter notice subject to the following provisions:

   Case I. If the company has appointed one or more independent directors, the shorter notice shall be valid, if –

   (i) the Board meeting is called at a shorter notice so as to transact some urgent business; and

   (ii) at least one independent director is present at such Board meeting, or if no independent director is present at such Board meeting, then, the decisions taken at such Board meeting shall be circulated to all the directors, and such decisions shall be final only on ratification thereof by at least one independent director.

   Case II. If the company has not appointed any independent director, the shorter notice shall be valid if the Board meeting is called at a shorter notice so as to transact some urgent business. In such a case, there is no question of presence of, or ratification by, any independent director.

2. Thus, it is possible to hold the Board meeting at a shorter notice by complying with the above provisions.
3. As per section 173(3), the notice of every meeting of the Board shall be sent by hand delivery or by post or by electronic means.
4. In the given case, one of the directors has raised an objection that the notice sent by e-mail is not valid. Such objection is not tenable since section 173(3) permits the company to send the notice of Board meeting by e-mail. Even where the articles of a company are silent, or expressly prohibit sending of notice by e-mail, a notice sent by e-mail shall be valid.

Board meetings held at a very short notice and notices of Board meetings sent by e-mail – Consequences

P 2.6J. Woodworth Realtors Ltd. is a foreign collaborator in Jai Shri Realtors Limited. M/s. Jai Shri Realtors Ltd. was incorporated in India under the Companies Act, 2013. The foreign collaborator holds 49% of the shareholding. The Board meetings of Jai Shri Realtors Limited are usually held in India and sometimes meetings of the Board are called at a very short notice for which there is a provision in the Articles of Association that during such situations notices of the meetings of the Board can be sent by email.

State in this connection whether such a provision in the articles of association of a foreign collaborated company is valid within the purview of the provisions of the Companies Act, 2013? [ICAI, Revision Test Paper, Nov. 2018]

Ans. The given problem relates to section 173(3) of the Companies Act, 2013, as discussed below:

The legal position

1. As per section 173(3), not less than 7 days' notice is required for holding a Board meeting. However, a Board meeting may be called at a shorter notice subject to the following provisions:

   Case I. If the company has appointed one or more independent directors, the shorter notice shall be valid, if –

   (i) the Board meeting is called at a shorter notice so as to transact some urgent business; and

   (ii) at least one independent director is present at such Board meeting, or if no independent director is present at such Board meeting, then, the decisions taken at such Board meeting shall be circulated to all the directors, and such decisions shall be final only on ratification thereof by at least one independent director.

   Case II. If the company has not appointed any independent director, the shorter notice shall be valid if the Board meeting is called at a shorter notice so as to transact some urgent business. In such a case, there is no question of presence of, or ratification by, any independent director.

   Thus, it is possible to hold the Board meeting at a shorter notice by complying with the above provisions.

2. As per section 173(3), the notice of every meeting of the Board shall be sent by hand delivery or by post or by electronic means.

The given case and analysis of the case

3. M/s. Jai Shri Realtors Ltd. is a company incorporated in India. The Board meetings of Jai Shri Realtors Limited are usually held in India and sometimes meetings of the Board are called at a very short notice.
4. The issues raised in the given problem are stated as under, along with the analysis of such issues:

   (a) Whether holding of Board meetings at shorter notice is valid?

   The given problem states that sometimes meetings of the Board are called at a very short notice. The words 'very short notice' does not make it clear as to whether the period of notice is of less than 7 days. If the period of notice is 7 days or more, such notice is valid, and no presence of, or ratification by, any independent director is required. However, if the period of notice is less than 7 days, then presence of, or ratification by, at least one independent director shall be required, subject to the condition that such Board meeting was called to transact some urgent business.

   (b) Whether notice of Board meeting can be sent by e-mail?

   Notice of a Board meeting may be sent by e-mail since section 173(3) expressly permits sending of notice of Board meeting by e-mail.

   (c) With respect to matters concerning notice of Board meeting, is it relevant that the company M/s Jai Shri Realtors Ltd. is a foreign collaborated company, and that the foreign collaborator holds 49% of the shareholding of the Indian company?

The provisions of section 173(3), with respect to length of notice of Board meeting, manner of sending notice, shorter notice, etc., apply to all companies, *i.e.* no exemption or exception has been provided for any company or class of companies.

Thus, it is immaterial that Woodworth Realtors Ltd., *i.e.* foreign collaborator, holds 49% of the shareholding of M/s Jai Shri Realtors Ltd., and so all the provisions with respect to notice of Board meeting shall apply to Jai Shri Realtors Ltd.

(d) With respect to matters concerning notice of Board meeting, is it relevant that the articles of association of M/s Jai Shri Realtors Ltd. provide that where a Board meeting is called at a shorter notice, the notice of Board meeting can be sent by e-mail?

Where a Board meeting is called at a shorter notice, the requirements to be fulfilled in such a case are contained in section 173(3) itself. Similarly, the notice of Board meeting can be sent by e-mail, has been expressly provided under section 173(3). Thus, with respect to these matters, it is immaterial that articles contain any provision or not.

Conclusions

5. Sending of shorter notice of a Board meeting shall be valid if the requirement with respect to presence of, or ratification by, at least one independent director is fulfilled, and the Board meeting was held to transact some urgent business.
6. Sending of notice of Board meeting by e-mail is valid.
7. The provisions contained in the articles of association of M/s Jai Shri Realtors Ltd. shall not have any relevance since section 173(3) contains express provisions with respect to shorter notice and sending of notice to directors by e-mail.

A provision contained in the articles specifies a particular day, time and place for holding the Board meetings – Whether it is necessary to give notice of Board meetings?

P 2.6K. Examine the validity of the following with reference to the relevant provisions of the Companies Act, 2013:

The articles of association of Big Limited provide that a meeting of the Board of directors of the company shall be held at 11.00 a.m. on the last day of every quarter ending 31st March, 30th June, 30th September, and 31st December. Relying on such a clause in the articles, the company did not send notices to the directors in respect of the Board meeting held on 30th September, 2015. Some of the directors have questioned the validity of the Board meeting on the ground that individual notices have not been sent to the directors. [CA (Final) Nov. 2005, June 2009]

OR

The articles of association of M/s ABC Ltd. provide that a meeting of the Board of directors shall be held at 11.00 A.M. on the last day of every quarter ending on 31st March, 30th June, 30th September and 31st December. Relying on the said provision, the company has not sent notices to the directors in respect of a Board meeting held on 31.3.2016. Some of the directors have questioned the validity of the Board meeting on the ground that individual notices have not been sent to the directors.

[CA (Final) May 2002]

OR

The articles of association of a company provide that the meeting of the Board of directors of the company will be held on the last Friday of every month. The secretary of the company as a result does not serve the notice to the individual directors of the company. Consequently, a meeting of the Board of directors was held on 23rd February, 2016. The meeting was attended by all the directors with the exception of two directors out of a total of 10 directors and certain resolutions were passed. The two absentee directors object to the meeting and the proceedings of the meeting for want of notice. Referring to the provisions of the Companies Act, 2013 decide:

(i) Whether the objection raised by the two absentee directors is valid?

(ii) Would your answer be the same in case the secretary of the company, instead of sending notice on a usual format to the individual directors, sent a copy of the articles of association to each one of the directors? [CA (Final) May 1996]

Ans. The given problem relates to section 173(3) of the Companies Act, 2013, as discussed below:

1. As per section 173(3), notice of every Board meeting shall be sent in writing to every director of the company.
2. Section 173(3) does not contain any exception or relaxation with respect to serving of notice of Board meeting, *i.e.* no Board meeting can be validly called or held unless notice of such meeting has been served on all the directors.
3. Any provision contained in the articles of a company cannot over-ride any provision contained in the Companies Act, 2013 (Section 6).
4. In the given case, the company has not sent the notice of the Board meeting held on 30th September, 2015. Such non-service of notice amounts to contravention of section 173(3).
5. The consequences of contravention shall be as follows:
   (a) The Board meeting and the resolutions passed thereat shall be invalid **[*Parmeshwari Prasad Gupta* v *Union of India* (1974) 44 Comp Cas 1]**. Even an accidental omission to give notice to a single director would render the resolutions passed at that meeting void.

(b) Every officer of the company whose duty is to give notice of Board meeting and who fails to do so shall be liable to a fine of Rs. 25,000.

A Board meeting is held without giving notice to directors, but the meeting is attended by all the directors and the proceedings of such meeting are later ratified – Consequences

P 2.6L. XYZ Company Limited calls a meeting of the Board of directors without giving notice to directors as required under the Companies Act, 2013. The meeting is attended by all the directors. None of the directors of the company objected to the absence of notice. The proceedings of the meeting are ratified later by the Board of directors at a regularly constituted meeting.

Decide giving reasons for your answer whether:

(i) The meeting and the proceedings are valid?

(ii) The Board of directors is competent to ratify at a later meeting the above proceedings?

[CA (Final) Nov. 1997; CS (Final) June 2000]

Ans. The given problem relates to section 173(3) of the Companies Act, 2013, as discussed below:

1. As per section 173(3), notice of every Board meeting shall be sent in writing to every director of the company.
2. Section 173(3) does not expressly state the consequences where a Board meeting is held without giving any notice. However, in such cases, the Courts have held that such Board meeting and the resolutions passed thereat shall be invalid ***[Parmeshwari Prasad Gupta v Union of India* (1974) 44 Comp Cas 1]**.
3. However, where a Board meeting is held without giving any notice, but is attended by all the directors, or where the absentee directors do not complain of want of notice, the proceedings at the meeting will not be invalid, especially if the proceedings are ratified at a subsequent meeting in which the absentee directors are present. The ratification shall relate back to the date of the act ratified ***[Parmeshwari Prasad Gupta v Union of India* (1974) 44 Comp Cas 1]**.
4. The facts in the given case exactly same as in ***Parmeshwari Prasad Gupta v Union of India* (1974) 44 Comp Cas 1**. Therefore,–
   (i) the Board meeting and the proceedings of the Board meeting shall be valid;
   (ii) the Board of directors are competent to ratify the proceedings of such Board meeting in a subsequently held Board meeting.

2.7 Quorum for a Board meeting (Section 174)

With respect to Board meetings, 'quorum' means the minimum number of directors competent to transact and vote on any business, *i.e.* the minimum number of directors who are authorised to act as a Board and who do not suffer any disability at a duly convened Board meeting. Unless the required quorum is present, no business can be transacted at a Board meeting. The provisions relating to quorum are contained in section 174, as explained below:

1. Required quorum for a Board meeting

(a) Quorum as per Section 174(1). The quorum required for a Board meeting is higher of–

(i) 1/3rd of total strength (any fraction contained in that one-third shall be rounded off as one); or

(ii) 2 directors.

As per Notification No. G.S.R. 466(E) dated 5th June, 2015, in case of a company licenced under section 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the provisions of section 174(1) shall apply as follows:

The quorum required for a Board meeting shall be lesser of–

(i) 8 members; or

(ii) 25% of its total strength.

Provided that the quorum shall not be less than 2.

(b) Quorum as per Section 174(3). Where at any time the number of interested directors (present in the Board meeting) exceeds or is equal to 2/3rd of total strength (any fraction contained in that 2/3rd shall be rounded off as one), then, the quorum, during such time, shall be higher of–

(i) number of remaining directors (*i.e.* disinterested directors) present at the meeting; or

(ii) 2 directors.

In case of a private company, the provisions of section 174(3) shall apply with the exception that the interested director may also be counted towards quorum in such meeting after disclosure of his interest pursuant to section 184, if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 464(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 583(E) dated 13th June, 2017].

2. Higher quorum by the articles

The articles of a company may provide for a higher quorum. However, if the quorum as per the articles is lower than that required under section 174, such provision of the articles shall be void.

3. Meaning of certain terms

(a) Meaning of 'total strength'. 'Total strength' shall not include directors whose places are vacant.

(b) Meaning of 'interested director'. 'Interested director' means a director within the meaning of Section 184(2).

As per Sec. 184(2), interested director means a director who is in anyway, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into –

(i) with a body corporate in which –

- such director in association with any other director, holds more than 2% shareholding of that body corporate; or
- such director is a promoter, manager or Chief Executive Officer; or

(ii) with a firm or other entity in which, such director is a partner, owner or member, as the case may be.

4. Participation by video conferencing to be considered for the purpose of quorum

A director who participates in a Board meeting by video conferencing or by other audio visual means, shall also be counted for the purpose of quorum.

5. Effect of no quorum [Section 174(4)]

(a) Adjournment of Board meeting. If a Board meeting could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned –

- to the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday;
- at the same time;
- at the same place.

(b) No fresh notice. An adjourned meeting is a continuation of the original meeting. Therefore, fresh notice for adjourned Board meeting is not required.

(c) Date of Board meeting. Where a Board meeting could not be held for quorum and is adjourned, and the adjourned Board is held subsequently, it shall be deemed that the Board meeting was held on the date when the original Board meeting was called and not on the date when the adjourned Board meeting was held.

Requirement of quorum at adjourned Board meeting

The Companies Act, 2013 is silent with respect to a situation where a Board meeting is adjourned for want of quorum, and again the quorum is not present at the adjourned Board meeting.

In the opinion of the Author, in such a case, the adjourned Board meeting cannot be held. The Board meeting shall stand dissolved, *i.e.* cancelled.

6. Board may act notwithstanding vacancies [Section 174(2)]

(a) The continuing directors may act notwithstanding any vacancy in the Board.

(b) However, if and so long as the number of directors is reduced below the quorum fixed by the Act, the continuing director(s) cannot act for any purpose other than –

(i) increasing the number of directors to that fixed for the quorum; or

(ii) summoning a general meeting of the company.

1. Quorum to be present throughout the meeting

Quorum has to be present at the time of transacting each and every business. It is not enough that a quorum was present at the commencement of the meeting. Therefore, where quorum is present at the beginning of the meeting, but some of the directors leave the meeting, so that remaining directors do not constitute quorum, any subsequent resolutions shall be invalid.

2. Resolutions passed at an adjourned Board meeting (Section 116 of the Companies Act, 2013)

Where a resolution is passed at an adjourned Board meeting, the resolution shall be treated to have been passed on the date on which it was in fact passed and not on any earlier date. In other words, a resolution passed at an adjourned Board meeting does not relate back to the original Board meeting.

3. Non-applicability [Proviso to Section 173(5)]

Section 174 does not apply to a One Person Company in which there is only 1 director on the Board.

Theoretical Questions from CA Examinations

Q 2.7A. What is the required quorum for holding a Board meeting? [CS (Final) Dec. 1994; June 1999]

Q 2.7B. What is the procedure to be followed, when a Board meeting is adjourned for want of quorum? [CA (Final) Nov. 1998]

Practical Problems from CA Examinations

Validity of resolutions passed after 4 out of 7 directors have left the meeting

P 2.7A. The Board meeting of MNO Ltd. was held on 10th May, 2014 at Chennai at 11 a.m. At the time of starting the Board meeting the number of directors present were 7. The total number of directors were 10. The Board had to transact ten items in the Board meeting. At 12 noon after the completion of four items in the agenda 4 directors left the meeting. Examine the validity of these transactions explaining the relevant provisions of the Companies Act, 2013. [CA (Final) Nov. 2008]

Ans. As per section 174(1), the quorum for a Board meeting shall be *higher of* –

(a) 1/3rd of total strength (any fraction contained in that one-third shall be rounded off as one); *or*

(b) 2 directors.

'Total strength' shall not include directors whose places are vacant.

Quorum has to be present at the time of transacting each and every business. It is not enough that a quorum was present at the commencement of the meeting. Therefore, where quorum is present at the beginning of the meeting, but some of the directors leave the meeting, so that remaining directors do not constitute quorum, any subsequent resolutions will be invalid.

In the given case, total strength is 10. Quorum for the Board meeting held on 10th May, 2014 shall be 1/3rd of 10 directors, *i.e.* 3.33, rounded off to 4. Since 7 directors were present at the time of commencement of the Board meeting, the Board meeting has been validly held.

However, after transacting 4 items on agenda, 4 directors left, because of which the number of directors present has fallen below the quorum required. Since, quorum is required at the time of transacting each and every business, the remaining 6 agenda items cannot be validly discussed and voted upon. Therefore, resolutions passed in respect of these 6 agenda items are void, and have no legal effect.

Other Practical Problems

Quorum required where office of 2 directors out of total 9 directors have fallen vacant, and quorum required in case of a company formed for promotion of sports

P 2.7B. Analyse and advise with reference to the provisions of the Companies Act, 2013, the following situations:

(i) There are 9 directors in a Mona Ltd. and out of which 2 offices of the directors have fallen vacant. What will be the quorum for the Board meeting?

(ii) If Mona Ltd. is a company formed for the promotion of the sports in a remote area of the Jharkhand State, what will be the quorum for the Board meeting?

Ans. The given problem relates to section 174(1) of the Companies Act, 2013, as discussed below:

The legal position

1. As per section 174(1), the quorum for a Board meeting shall be *higher of* –
   (a) 1/3rd of total strength (any fraction contained in that one-third shall be rounded off as one); *or*
   (b) 2 directors.
   'Total strength' shall not include directors whose places are vacant.
2. As per Notification No. G.S.R. 466(E) dated 5th June, 2015, in case of a company licenced under section 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the provisions of section 174(1) shall apply as follows:
   The quorum required for a Board meeting shall be lesser of –
   (a) 8 members; or
   (b) 25% of its total strength.
   Provided that the quorum shall not be less than 2 members.

The given cases are answered as under:

(i) Mona Ltd. had appointed 9 directors. However, the offices of 2 directors have fallen vacant. So, now there are 7 directors in Mona Ltd., and therefore, the 'total strength' for the purpose of section 174(1) shall be 7.
One-third of 7 arrives at 2.33. The fraction 0.33 shall be rounded off as 1, and so the quorum required shall be 3 (being higher of 2 and 3). Thus, the quorum for Board meetings of Mona Ltd. shall be 3 directors.

(ii) If Mona Ltd. is a company formed for the purpose of promotion of sports, it can be fairly assumed that Mona Ltd. would have been incorporated as 'not for profit company' under section 8 of the Companies Act, 2013, and so the quorum required shall be lesser of –

(a) 8 directors; or

(b) 2 directors (being 25% of 7).

Thus, the quorum for Board meetings of Mona Ltd. shall be 2 directors, if Mona Ltd. is a company formed for the purpose of promotion of sports.

Practical Problems from CS Examinations

Whether quorum is present – A few cases

P 2.7C. What is the required quorum for holding a Board meeting? Examine the following cases:

(a) In a Board meeting, only 3 directors were present out of the total of 11 directors. None of the 3 directors was interested in any of the items of the agenda. Examine the validity of meeting. [CS (Final) June 1995]

(b) In a meeting of the Board, out of the total of 11 directors, 7 directors were present of which only 2 directors were not interested in one of the transactions. How should the meeting deal with the matter? [CS (Final) June 1995]

Ans. The provisions relating to quorum for a Board meeting are contained in section 174. Unless the articles provide for a higher quorum, the quorum shall be 1/3rd of the 'total strength' (any fraction contained in that 1/3rd shall be rounded off to one) or two directors whichever is higher [Section 174(1)]. However, section 174(3) states that where at any time the number of interested directors (present in the Board meeting) exceeds or is equal to 2/3rd of the 'total strength' (any fraction contained in that 2/3rd shall be rounded off as one), the number of disinterested directors present at the meeting, being not less than two, shall be the quorum.

(a) In the instant case, 1/3rd of 11 comes to 3.67; the fraction 0.67 shall be rounded off to 1. Thus, at least 4 disinterested directors must be present in the Board meeting. However, only 3 directors are present in the Board meeting.

Moreover, there is no interested director present in the meeting and so the benefit of section 174(3) cannot be availed. Therefore, the quorum was not present and so the meeting has not been validly held.

(b) In the given case, the required quorum comes to 4 directors, but only 2 disinterested directors are present. So, the quorum is not present as per section 174(1).

2/3rd of the 'total strength' comes to 8 (Being 2/3rd of 11 is 7.33; the fraction 0.33 shall be rounded off to 1). Since the number of interested directors (present in the Board meeting) is only 5, section 174(3) is not attracted. Thus, the remaining 2 directors who are not interested do not constitute a quorum, and hence such transaction cannot be discussed and voted upon.

4th Board meeting not held for want of quorum – Whether section 173 is contravened, and whether a director is bound to attend all the Board meetings?

P 2.7D. The Board of directors of ABC Ltd. met thrice in the year 2015 and the 4th meeting, though called, could not be held for want of quorum. Examine with reference to the relevant provisions of the Companies Act, 2013, the following:

(i) Whether any provisions of the Companies Act, 2013 have been contravened?

(ii) Is a director bound to attend the Board meetings and when his frequent absence from the Board meetings may be excused? [CA (Final) Nov. 2005]

OR

Urja Pvt. Limited, a recently emerged company for conducting business of providing solar panels, held 3 Board meetings till 31st October, 2017 during the year 2017. The next Board meeting was due to be held on 27th December, 2017 but for want of quorum the meeting could not be held. A group of shareholders complained that the company has violated the provisions of section 173 of the Companies Act, 2013 in not holding the required number of Board meetings, and section 137 for default in filing of its financial statement. Company contended that they fall under the purview of section 173(5) of the Companies Act, 2013. State as to the validity of the contention of Urja Pvt. Limited in the given above situations. [ICAI, Mock Test Paper, March 2018]

Ans. The present problem relates to sections 173 and 174 of the Companies Act, 2013.

1. As per section 173, at least four Board meetings shall be held in each calendar year and not more than 120 days shall intervene between two consecutive meetings of the Board.
2. As per section 174(4), if a Board meeting could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned –
   (a) to the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday;
   (b) at the same time;
   (c) at the same place.
3. An adjourned Board meeting cannot be held, if the quorum is not present. However, if the required quorum is present in the adjourned Board meeting, the adjourned Board meeting shall be held, and in such a case, it shall be deemed that Board meeting was held on the date on which the original Board meeting was called since an adjourned meeting is a mere continuation of the original meeting.

4. The issues raised in the given problem are answered as under:

(i) In the present case, the 4th Board meeting shall be adjourned as per the provisions contained in section 174(4).

If the required quorum is present in such adjourned Board meeting, the adjourned meeting shall be held. In such a case, it shall be deemed that the 4th Board meeting was held since an adjourned meeting is a mere continuation of the original meeting. Thus, there will be no contravention of the provisions of section 173.

However, if the required quorum is not present in such adjourned Board meeting, the adjourned Board meeting cannot be held, and it shall stand cancelled. In such a case, it would mean that the company has held only three Board meetings during the calendar year 2015, and so it would amount to contravention of the provisions of section 173. Under the Companies Act, 1956, if a Board meeting was duly called but it could not be held for want of quorum, it was not deemed to be a contravention [Sub-section (2) of Section 288 of the Companies Act, 1956].

However, no such provision has been made under section 174(4) or any other provision of the Companies Act, 2013. Therefore, under the Companies Act, 2013, if a Board meeting is duly called but it is not held for want of quorum, and as a consequence the minimum number of 4 Board meetings in a calendar year as required under Section 173 are not held, it would amount to a contravention of section 173.

Difference in answer as compared to the answer given by ICAI

The Author's answer to this question differs from the answer given in the Practice Manual for November, 2016 Exams issued by the Board of Studies, ICAI. The answer given in the Practice Manual is reproduced hereunder:

"Under section 174 (4) of the Companies Act, 2013 Where a meeting of the Board could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned to the same day at the same time and place in the next week or if that day is a national holiday, till the next succeeding day, which is not a national holiday, at the same time and place.

From the above provisions in case a meeting is adjourned, the violation under section 173(1) does not arise as the meeting was started well in time but could not close due to want of quorum. The holding of the adjourned meeting though in the next year will be treated as continuation of the 4th meeting of the previous year and will therefore not count in the meetings held in the next year but in the previous year.

Therefore, the provisions of the Companies Act, 2013 have not been violated or contravened."

However, in the opinion of the Author, the answer to the question as to whether there is any contravention of section 173 or not, depends on the fact as to whether the adjourned meeting was held or not. If the quorum was present in the adjourned Board meeting, and so the adjourned Board meeting was held, there is no contravention of section 173. However, if the adjourned Board meeting could not be held because of lack of quorum, it would amount to contravention of section 173. In the answer given in the Practice Manual, ICAI has not considered these two possible situations, and has answered the question assuming that the quorum was present in the adjourned Board meeting, and so the adjourned Board meeting was held.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

(ii) A director should endeavour to attend the maximum number of Board meetings. But he is not duty bound to attend all the Board meetings.

However, if loss is caused to the company because of continuous absence of a director from the meetings of the Board, it would amount to negligence and breach of duty. Moreover, a director shall vacate his office if he absents himself, with or without obtaining leave of absence from the Board, from all the Board meetings held during a period of 12 months [Section 167(1)(b)].

No Board meeting held for third quarter – Is it a contravention of section 173?

P 2.7E. A meeting of the Board of directors of OPQ Co. Ltd. due to be held on 30.9.2014 did not take place for want of quorum. As a result, the company did not hold any Board meeting for the quarter ended 30.9.2014 and there is a complaint that the company has violated the provisions of the Act in this regard. Advise. [CA (Final) Nov. 2001]

Ans. As per section 173(1), at least four Board meetings shall be held in each calendar year and not more than 120 days shall intervene between two consecutive meetings of the Board.

As per section 174(4), if a Board meeting could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned –

(a) to the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday;

(b) at the same time;

(c) at the same place.

In the present case, the Board meeting scheduled for 3.09.2014 shall be adjourned till 07.10.2014, and if the required quorum is present, the adjourned meeting shall be held. In such a case, it shall be deemed that Board meeting was held on 30.09.2014 since an adjourned meeting is a mere continuation of the original meeting.

Thus, there is no contravention of the provisions of section 173 merely because of the reason that quorum was not present in the Board meeting scheduled for 30.09.2014.

Even if quorum was not present in the adjourned Board meeting, it does not necessarily mean that section 173 has been contravened, since section 173 does not require that at least one Board meeting must be held in each quarter of year.

Whether there is a contravention of section 173 or not in the given case, depends upon the other facts and circumstances, *i.e.* how many Board meetings were held during the calendar year 2014 and what was the time gap between two consecutive Board meetings. Assumingly, the company held 4 Board meetings during the calendar year 2014, and the gap between any two consecutive Board meetings was not more than 120 days, the company has not contravened the provisions of section 173.

Fourth Board meeting not held for want of quorum – Is it a contravention of section 173?

P 2.7F. PQR Limited held three Board meetings till 30th September, 2015. The next board meeting was due to be held on 27th December, 2015, but for want of quorum the meeting could not be held. A group of shareholders complained that the company has violated the provisions of Section 173 of the Companies Act, 2013 in not holding the required board meetings.

[CA (Final) Nov. 2009]

Ans. As per section 173(1), at least four Board meetings shall be held in each calendar year and not more than 120 days shall intervene between two consecutive meetings of the Board.

As per section 174(4), if a Board meeting could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned –

(a) to the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday;

(b) at the same time;

(c) at the same place.

In the present case, the Board meeting scheduled for 27.12.2015 shall be adjourned till 03.01.2016, and if the required quorum is present, the adjourned meeting shall be held. In such a case, it shall be deemed that Board meeting was held on 27.12.2015 since an adjourned meeting is a mere continuation of the original meeting. Thus, there will be no contravention of the provisions of section 173.

However, if the quorum is not present in the adjourned Board meeting on 03.01.2016, the adjourned Board meeting cannot be held, and it shall stand cancelled. In such a case, it means that the company has held only three Board meetings during the calendar year 2015, and so it would amount to contravention of the provisions of section 173. Under the Companies Act, 1956, if a Board meeting was duly called but it could not be held for want of quorum, it was not deemed to be a contravention [Sub-section (2) of Section 288 of the Companies Act, 1956]. However, no such provision has been made under section 174(4) or any other provision of the Companies Act, 2013. Therefore, under the Companies Act, 2013, if a Board meeting is duly called but it is not held for want of quorum, and as a consequence the minimum number of 4 Board meetings in a calendar year as required under section 173 are not held, it would amount to a contravention of section 173.

Difference in answer as compared to the answer given by ICAI

The Author's answer to this question differs from the answer given in the Practice Manual for November, 2016 Exams issued by the Board of Studies, ICAI. The answer given in the Practice Manual is reproduced hereunder:

"It may be noted that on adjournment of a meeting, the meeting having started and not ended will not constitute a contravention of section 173(1) under which a company is required to hold four board meetings in a year and not more than one hundred and twenty days shall elapse between two board meetings. In case of adjournment of the meeting, it shall be deemed to have been held on the date on which it was started and not on the date when the adjourned meeting was held.

Therefore, the provisions of section 173 shall not be deemed to have been contravened merely by reason of the fact that a meeting of the Board which had been called in compliance with the terms of that Section could not be held for want of a quorum.

As the meeting could not be held for want of quorum, it cannot be said that PQR Ltd has violated the provisions of section 173 of the Act."

However, in the opinion of the Author, the answer to the question as to whether there is any contravention of section 173 or not, depends on the fact as to whether the adjourned meeting was held or not. If the quorum was present in the adjourned Board meeting, and so the adjourned Board meeting was held, there is no contravention of section 173. However, if the adjourned Board meeting could not be held because of lack of quorum, it would amount to contravention of section 173. In the answer given in the Practice Manual, ICAI has not considered these two possible situations, and has answered the question assuming that the quorum was present in the adjourned Board meeting, and so the adjourned Board meeting was held.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Position of alternate directors while computing quorum

P 2.7G. The Articles of Association of Amriz Limited provides for a maximum of 15 directors. But the company has only 10 directors and for two of them representing foreign collaborators, alternate directors have been appointed. Board meeting held on 1st August, 2018 was attended by four directors including two alternate directors. Examine with reference to the relevant provisions of the Companies Act, 2013 whether quorum was present at the Board meeting held on 1st August, 2018. Will your answer, be different, if the articles provide for a quorum of six directors? [CA (Final) Nov. 2018]

OR

The articles of association of XYZ Computers Limited provide for a maximum of 15 directors. But the company has only 10 directors and for two of them representing foreign collaborator, alternate directors have been appointed. Board meeting held on 1st August, 2016 was attended by 4 directors including 2 alternate directors.

Examine with reference to the relevant provisions of the Companies Act, 2013 whether quorum was present at the Board meeting held on 1st August, 2016. Will your answer be different, if the articles provide for a quorum of 6 directors?

[CA (Final) May 2004]

Ans. The given problem relates to section 174of the Companies Act, 2013, as discussed below:

The legal position

1. The quorum for a Board meeting shall be higher of –
   (a) 1/3rd of total strength (any fraction contained in that one-third shall be rounded off as one); or
   (b) 2 directors.
2. 'Total strength' shall not include directors whose places are vacant.
3. The articles of a company may provide for a larger quorum than specified under section 174 ***[Amrit Kaur Puri v Kapurthala Flour Oil & General Mills Co. P. Ltd.*, (1984) 56 Comp Cas 194]**.

The given case and analysis of the case

4. Total strength is 10. Quorum for the Board meeting held on 1st August, 2016 shall be 1/3rd of 10 directors, *i.e.* 3.33, rounded off as 4 directors.
5. In the Board meeting of Amriz Limited, 4 directors (including 2 alternate directors) are present.
6. The two alternate directors shall also be included while determining as to whether quorum is present or not.

Conclusions

7. Since the directors present in the Board meeting (*i.e.* 4 directors) are not less than the required quorum (*i.e.* 4 directors), the required quorum is present in the Board meeting held on 1st August, 2018.
8. However, if the articles provide for a quorum of 6 directors, the required quorum shall be 6, and not 4. In such a case, the required quorum is not present in the Board meeting held on 1st August, 2018.

Advanced Practical Problems

Quorum required in case of a company having 9 directors if offices of 2 directors fall vacant

P 2.7H. As on 01.01.2015, a company has 9 directors. On 02.01.2015, the offices of 2 directors have fallen vacant. What is the quorum required for conducting a Board meeting.

Ans. The provisions relating to quorum for a Board meeting are contained in section 174. As per section 174, the quorum shall be 1/3rd of the 'total strength' (any fraction contained in that 1/3rd shall be rounded off to one) or two directors whichever is higher [Section 174(1)]. As per Clause (ii) of Explanation to Sec. 174(4), 'total strength' shall not include directors whose places are vacant.

In the present case, the total strength shall be 9 - 2 = 7 directors. Quorum shall be higher of 2 or 1/3rd of 7. 1/3rd of 7 comes to 2.33. As per Clause (i) of Explanation to Sec. 174(4), any fraction of a number shall be rounded off as one. Accordingly, the quorum shall be 3 directors (being higher of 2 or 3).

If 13 directors out of 15 directors are interested, whether quorum is present?

P 2.7I. A company has 15 directors. At the time of discussion on a particular business, 13 directors are interested as per the provisions of section 184(2). Is the quorum present? What would be your answer, in case 14 directors were interested?

Ans. The provisions relating to quorum for a Board meeting are contained in section 174.

As per section 174(1), the quorum shall be 1/3rd of the 'total strength' (any fraction contained in that 1/3rd shall be rounded off to one) or two directors whichever is higher [Section 174(1)]. As per Clause (ii) of Explanation to Sec. 174(4), 'total strength' shall not include directors whose places are vacant.

As per Clause (i) of Explanation to Sec. 174(4), any fraction of a number shall be rounded off as one.

As per section 174(3), where at any time the number of interested directors (present in the Board meeting) exceeds or is equal to 2/3rd of the 'total strength', the number of disinterested directors present at the meeting, being not less than two, shall be the quorum.

In the instant case, 1/3rd of 15 comes to 5. Thus, a Board meeting can commence only if at least 5 directors are present. Since all the 15 directors are present, the Board meeting has validly commenced. During discussion on a particular item of business, 13 directors are interested. 2/3rd of the 'total strength' comes to 10. Since the number of interested directors (present in the Board meeting) is 13, which is more than 2/3rd of total strength (*i.e.* 10), section 174(3) has become applicable. Thus, the remaining 2 directors who are not interested shall constitute the quorum and hence such item of business can be validly transacted (i.e. discussed and voted upon).

However, if during discussion on a particular item of business, 14 directors were interested, then there would have been only 1 director remaining, *i.e.* only 1 disinterested director. As per section 174(3), quorum is the remaining disinterested directors, but not being less than 2, and, so the requirements of section 174(3) are not satisfied. Accordingly, the remaining one director shall not constitute the quorum in respect of such item of business, and so, such item of business cannot be transacted.

2.8 Recourse when quorum is not present

Where a quorum is not present, the Board meeting cannot commence, and so no business can be transacted at the Board meeting. In such a case, the Board meeting shall be adjourned as per the provisions of section 174. As per section 174, where a Board meeting is not held for want of quorum, it shall automatically stand adjourned to the same day, time and place in the next week, or if that day is a national holiday, then to next succeeding day, which is not a national holiday. However, a company may, by its articles, prescribe the day when the adjourned meeting will be held (Section 174).

Section 174 does not cover a case where a Board meeting is adjourned for want of quorum and in the adjourned meeting also the quorum is not present. In respect of the same position in case of an adjourned general meeting, section 103 of the Companies Act, 2013 provides that the members present in the adjourned meeting shall be the quorum.

In the absence of any statutory provision with respect to absence of quorum in an adjourned board meeting, it is implied that an adjourned Board meeting has not been exempted from the requirement of quorum. Therefore, an adjourned Board meeting without the quorum is not permissible under the Act **[*Maharani Yogeshwari Kumari* v *Lake Shore Palace Hotel Pvt. Ltd.* (1995) 3 Comp LJ 418]**.

Thus, where quorum is not present in the adjourned Board meeting, it cannot be proceeded with.

Situation where quorum is not present for transacting any particular business

Where a board meeting has already commenced, and on some particular business, interested directors exceed or are equal to 2/3rd of total strength, following possibilities are worth considering:

1. If the remaining disinterested directors present in the Board meeting are two or more, section 174(3) shall apply, and the remaining disinterested directors shall be deemed to be the quorum for transacting such particular business.
2. If the remaining disinterested directors present in the Board meeting are less than two, section 174(3) shall not apply. In such a case, the Board may adopt any of the following alternative measures:
   (a) The Board may appoint additional directors, if so authorised by the articles, who are not interested in such business. Such number of additional directors should be appointed who along with the existing disinterested directors would form a quorum for transacting such particular business.
   (b) The Board may summon a general meeting and put such particular business for the consideration of members. Members may, if they deem fit, consider and transact such particular business.

2.9 Passing of resolution by circulation (Section 175 and Rule 5)

Generally, the Board of directors act through meetings. However, the Board is empowered to pass a resolution by circulation in accordance with the provisions contained in section 175 read with Rule 5 of the Companies (Meetings of Board and its Powers) Rules, 2014.

Thus, whenever the Board is required to grant its approval, it may either grant such approval in a Board meeting or by passing a resolution by circulation.

The Board of directors may find it desirable to pass a resolution by circulation instead of passing it in a Board meeting if –

- some important business could not be voted upon at a Board meeting, and such business should not be deferred till the next Board meeting; *or*
- the business relates to a routine matter on which not much deliberation is required; *or*
- the cost of conducting a Board meeting is very high.

The provisions regarding passing of a resolution by circulation may be explained as follows:

1. Conditions for passing a resolution by circulation

   (a) Circulation of draft resolution. The draft resolution along with all the necessary papers, if any, shall be circulated –
   - to all the directors

- at their addresses in India registered with the company
- by hand delivery or by post or by courier, or through such electronic means as may be prescribed (*i.e.* E-mail or Fax as per Rule 5 of the Companies (Meetings of Board and its Powers) Rules, 2014).

Meaning of 'necessary papers'

What amounts to 'necessary papers', is a question of fact. 'Necessary papers' means all such documents as are required to understand the nature of business to be transacted, *i.e.* all such documents as would enable a director to make up his mind as to whether he should vote in favour of the resolution or against the resolution.

(b) ***Approval of the resolution.*** A resolution shall not be deemed to have been passed by circulation unless the resolution is approved by a majority of the directors who are entitled to vote on the resolution.

Interested director not entitled to vote

A director of a company who is interested in a contract or arrangement, and is therefore, not entitled to vote as per the provisions of section 184, shall not be considered for the purpose of ascertaining as to whether the resolution has been approved by a majority of the directors.

(c) ***No demand for decision at a Board meeting.*** If not less than 1/3rd of the total number of directors of the company require that any resolution proposed to be passed by circulation must be decided at a Board meeting (instead of passing it by circulation), then, the chairperson shall put the resolution to be decided at a Board meeting, and the resolution shall not be passed by circulation.

No requirement of quorum

For passing any resolution by circulation, there is no requirement of quorum.

2. Resolution by circulation permitted unless otherwise required by the Act or the articles

The Board may pass any resolution by circulation except those resolutions which are required by the Act to be passed at a Board meeting only. *For example*, following resolutions cannot be passed by circulation:

- Filling a casual vacancy of a director [Section 161(4)].
- Powers of the Board to make calls on shares, issue securities of the company, borrow money, invest funds of the company, making loans etc. [Section 179(3)].
- Making any political contribution (Section 182).
- Making loan, giving guaranty, providing security or making investment (Section 186).

The list is inclusive

The above list (*i.e.* the resolutions which cannot be passed by circulation) is inclusive.

3. Resolution by circulation to be noted and included in the minutes

(i) A resolution passed by circulation shall be noted at a subsequent Board meeting.

(ii) The resolution passed by circulation shall be made part of the minutes of such subsequent Board meeting.

4. Passing of a resolution by circulation by a committee of directors

A committee of directors may also pass a resolution by circulation in accordance with the provisions of section 175.

Duty to hold minimum number of Board meetings not affected

Passing a resolution by circulation does not dispense with the statutory requirement of holding minimum number of Board meetings as required by section 173.

Theoretical Questions from CA Examinations

Q 2.9A. In the course of administration of the affairs of a limited company, Chairman of the Board of directors came across a matter which required the approval by way of a Board resolution. In the prevailing circumstances, it is not possible to convene and hold a Board meeting. The chairman approaches you to advise him of the way and the relevant procedure to obtain such approval without holding the Board meeting. Advise the chairman, taking into account the relevant provisions of the Companies Act, 2013. [CA (Final) May 2012, May 2007]

Q 2.9B. The Board meeting of M/s ABC Company Ltd. was adjourned for want of quorum. Advise whether a resolution can be passed by circulation? If so, how? [CA (Final) Nov. 2002]

Q 2.9C. Chairman of Board of Directors of ABC Ltd. came across a matter, which required the approval by way of a board resolution. In the prevailing circumstances, it is not possible to convene and hold a Board Meeting. The Chairman approaches you to advise him of the way and the relevant procedure to obtain such approval without holding the Board Meeting. You are required to advise him on the matter as per the provisions of the Companies Act, 2013. [CA (Final) June 2009]

Q 2.9D. Explain the procedure for passing the resolution by circulation. [CA (Final) Nov. 2000]

Q 2.9E. What do you understand by the passing of resolutions by circulation? [CA (Final) Nov. 1998]

Q 2.9F. Some urgent items are left over in the agenda of Board meeting concluded and decision cannot be deferred till its next meeting. Advise the chairman. [CS (Final) Dec. 1995]

Q 2.9G. What is meant by 'resolution by circulation'? Enumerate a few matters which the Board can pass by such resolutions. [CS (Final) Dec. 1997]

Practical Problems from CA Examinations

Whether a resolution by circulation is passed where 4 out of 6 directors in India approve the resolution?

P 2.9A.

Case I. Proximo Limited has 9 Directors out of whom 3 Directors have gone abroad. The Chairman had an urgent matter to be approved by the Board of Directors which could not be postponed till the next Board meeting. The Company, therefore, circulated the resolution for approval of the Directors. 4 out of 6 Directors in India approved the resolution. The Company claimed that the resolution was passed. Examine with reference to the provisions of Section 175 of the Companies Act, 2013 the validity of the resolution. [CA (Final) Nov. 2009]

Case II. A company has 8 directors, out of whom 5 directors went abroad. A resolution by circulation approved by the remaining 3 directors is passed and forwarded to the concerned authority. On their return, the directors who were then abroad objected to the resolution. Is the resolution validly passed? [CS (Inter) Dec. 1998]

Ans. As per section 175 read with Rule 5 of the Companies (Meetings of Board and its Powers) Rules, 2014, a resolution may be passed by the Board by circulation if the following conditions are satisfied:

(a) The resolution has been circulated in draft, together with necessary papers, to all the directors at their addresses in India registered with the company, by hand delivery or by post or by courier, or through electronic means.

(b) The resolution has been approved by a majority of the directors as are entitled to vote on such resolution.

(c) No demand has been made by 1/3rd of total number of directors that such resolution shall be decided at a Board meeting.

For passing any resolution by circulation, there is no requirement of quorum.

Answer to Case I.

Proximo Limited has 9 directors. So, a resolution shall be passed by circulation if any of the 5 directors (whether in India or outside India) vote in favour of the resolution.

However, the resolution has been approved by only 4 directors. Since approval by majority of the directors has not been obtained, the resolution has not been passed by circulation.

Answer to Case II.

The company has 8 directors. So, a resolution shall be passed by circulation if any of the 5 directors (whether in India or outside India) vote in favour of the resolution.

However, the resolution has been approved by only 3 directors. Since approval by majority of the directors has not been obtained, the resolution has not been passed by circulation.

Whether a resolution by circulation can be passed for entering into a joint venture agreement?

P 2.9B. M/s Hurybury Builders Limited is contemplating to enter into a joint venture agreement with another construction company for the development of landed properties located at Bangalore. Since it is not possible to convene the Board meeting immediately, as the directors are at different places in connection with various works, the managing director seeks your advice as to whether the resolution pertaining to the joint venture agreement is required to be passed at the Board meeting convened for the purpose or whether it can be passed by means of a circular resolution. What steps are required to be taken to pass a Board resolution by circulation? [CA (Final) May 2002]

OR

M/s Multiplex Builders Limited is contemplating to enter into a joint venture agreement with another construction company for the development of landed properties located at Delhi. Since it is not possible to convene the Board meeting immediately as the directors are at different place in connection with various works, the managing director seeks your advice on the following matters:

(i) Whether the resolution pertaining to the joint venture agreement is required to be passed at the Board meeting convened for this purpose or whether it can be passed by means of a circular resolution?

(ii) The steps that are required to be taken to pass the Board resolution by circulation.

Advise the managing director in the light of the provisions of the Companies Act, 2013. [ICAI, RTP, Nov. 2018]

Ans. As per section 175 read with Rule 5 of the Companies (Meetings of Board and its Powers) Rules, 2014), a resolution may be passed by the Board by circulation if the following conditions are satisfied:

(a) The resolution has been circulated in draft, together with necessary papers, to all the directors at their addresses in India registered with the company, by hand delivery or by post or by courier, or through electronic means.

(b) The resolution has been approved by a majority of the directors as are entitled to vote on such resolution.

(c) No demand has been made by 1/3rd of total number of directors that such resolution shall be decided at a Board meeting.

For passing any resolution by circulation, there is no requirement of quorum.

The Board can pass any resolution by circulation except those resolutions which are required by the Act to be passed only at a Board meeting. For example, powers specified under sections 161(4), 179(3), 182 and 186 can be exercised only by passing a resolution at a duly convened Board meeting.

The Act does not require holding of a Board meeting for entering into a joint venture agreement. Thus, the Board can enter into a joint venture by passing a resolution by circulation provided the joint venture does not contain any matter which is to be compulsorily exercised in a Board meeting. For example, if the terms and conditions contained in the joint venture agreement requires investment in shares of a company, the provisions of section 186 shall get attracted, according to which investment in shares of any body corporate shall require a unanimous resolution to be passed at a Board meeting, and so the decision to make such investment cannot be taken by passing a resolution by circulation.

Also, for passing the resolution by circulation, the Board shall ensure the compliance of all the conditions contained in section 175, as discussed above.

2.10 Place, time and day of a Board meeting

1. Place of a Board meeting

Section 96 requires that an annual general meeting shall be held only at the registered office of the company or at any other place within the city, town or village in which the registered office of the company is situated. However, there is no similar provision in respect of holding of a Board meeting. As such, a Board meeting may be held anywhere in India or even outside India.

2. Day of a Board meeting

(a) Original Board meeting. Section 96 requires that an annual general meeting shall be held only on a day which is not a national holiday. Since, there is no such provision in respect of a Board meeting, a Board meeting may be held even on a national holiday.

(b) Adjourned Board meeting. As per section 174, if a Board meeting could not be held for want of quorum, then unless the articles otherwise provide, the meeting shall automatically stand adjourned to same day, time and place in the next week, or if that day is a national holiday, then to next succeeding day, which is not a national holiday. It means that unless the articles of the company otherwise provide, if a Board meeting is adjourned because of want of quorum, the adjourned Board meeting can be held only on a day which is not a national holiday.

Thus, it is evident that in the following two cases an adjourned Board meeting may be held on a national holiday:

(i) Where the Board voluntarily adjourns a duly convened Board meeting for a day which is a national holiday.

(ii) Where a Board meeting is adjourned for want of quorum, and the articles of the company prescribe some day for holding the adjourned Board meeting, the adjourned Board meeting shall be held in accordance with the provisions contained in the articles. If the day prescribed in the articles happens to be a national holiday, the adjourned Board meeting can be held on such national holiday.

3. Time of a Board meeting

Section 96 requires that an annual general meeting shall be held only during business hours. Since, there is no such provision in respect of a Board meeting, a Board meeting may be held even after business hours.

Unlike an annual general meeting, the time, place and day of a Board meeting have been left to the discretion of the directors.

Theoretical Questions from CA Examinations

Q 2.10A. Can a Board meeting be held at a place far away from the registered office? [CS (Final) June 2001]

Practical Problems from CA Examinations

Holding a Board meeting on a national holiday after business hours – Whether permissible?

P 2.10A. The Board of directors of M/s. Infotech Consultants Limited, registered in Calcutta, proposes to hold the next Board meeting in the month of December, 2014. They seek your advice in respect of the following matters:

(i) Can the Board meeting be held in Chennai, when all the directors of the company reside at Calcutta?

(ii) Whether the Board meeting can be called on a national holiday and that too after business hours as the majority of the directors of the company have gone to Chennai on vacation.

(iii) Is it necessary that the notice of the Board meeting should specify the nature of business to be transacted?

Advise with reference to the relevant provisions of the Companies Act, 2013. [CA (Final) May 2000]

Ans. There is no provision in the Companies Act, 2013 which requires that a Board meeting shall be held –

(a) only on a day that is not a national holiday;

(b) only at the registered office of the company or at any other place within the city, town or village in which the registered office of the company is situated;

(c) only during business hours.

The answer to the given problem is as under:

(i) Section 96 requires that an annual general meeting shall be held only at the registered office of the company or at any other place within the city, town or village in which the registered office of the company is situated. However, there is no similar provision in respect of holding of a Board meeting. As such, a Board meeting can be held anywhere in India or even outside India.

However, the company shall ensure that holding a Board meeting at a place other than the registered office of the company does not result in contravention of section 189. Section 189 requires that after entering the prescribed particulars in the registers of contracts or arrangements in which directors are interested, such registers shall be placed before the next Board meeting, and shall be signed by all the directors present at the Board meeting.

Thus, a company may decide to hold a Board meeting at any place other than the registered office of the company provided the registers of contracts or arrangement maintained under section 189 is moved from the registered office of the company to the venue of the Board meeting, the register is placed before the Board meeting, and is signed by all the directors present at the Board meeting.

(ii) As per section 174, if a Board meeting could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned to the same day, time and place in the next week, or if that day is a national holiday, then to next succeeding day, which is not a national holiday. It means that a Board meeting adjourned for want of quorum can be held only on a day which is not a national holiday. However, there is nothing in the Act which prohibits the holding of an original Board meeting on a national holiday. Further, there is no provision in the Companies Act, 2013 which requires that an original Board meeting shall be held only during business hours.

In the instant case, the directors intend to hold a Board meeting on a national holiday and after business hours, which is permissible.

(iii) No form or contents of notice has been specified by the Act. Agenda of a Board meeting is not required to be sent along with the notice of a Board meeting unless there is some express provision of the Act which requires a specific notice to move a resolution at a Board meeting.

However, as a matter of good secretarial practice, the agenda and all the relevant documents and information should also be given along with the notice so that the directors can prepare beforehand the subject matter of the proposed business.

Therefore, it is not mandatory for the company to specify the nature of business (*i.e.* agenda) in the notice of Board meeting. However, if the articles of the company require that the notice of Board meeting shall contain the business to be transacted thereat, such a provision is valid and binding, and so the agenda must be included in notice or given along with notice.

Advanced Practical Problems

Consequences where a Board meeting due to be held on 19.01.2015 is not held for want of quorum-

P 2.10B. A Board meeting of PQR Limited was called to be held on 19.01.2015 at 3 pm at Shah Auditorium, Delhi. However, due to lack of quorum, the meeting could not be held. Discuss the consequences.

Ans. As per section 174(4), if a Board meeting could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned –

(a) to the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday;

(b) at the same time;

(c) at the same place.

In the instant case, the Board meeting could not be held for want of quorum, and so the provisions of section 174(4) shall become applicable. In the next week, same day happens to be a national holiday (*i.e.* 26.01.2015), and so, the adjourned Board meeting cannot be held on 26.01.2015. The next succeeding day which is not a national holiday is 27.01.2015. Therefore, the adjourned Board meeting shall be held on 27.01.2015 at 3 pm at Shah Auditorium.

In the absence of any information in the question, it has been assumed that the articles of the company do not contain any provision with respect to the consequences where a Board meeting is not held for want of quorum.

Validity of Chairman to adjourn the meeting to next Monday

P 2.10C. A Board meeting of ABC Limited was called to be held on Thursday, 1st January 2015 at 3 pm at Shah Auditorium, Delhi. However, due to lack of quorum, the meeting could not be held. The articles of the company are silent with respect to the consequences where a Board meeting is not held for want of quorum. The Chairman decided with the consent of the directors present that the Board meeting shall be adjourned to next Monday. Discuss the validity of decision of the Chairman.

Ans. As per section 174(4), if a Board meeting could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned –

(a) to the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday;

(b) at the same time;

(c) at the same place.

In the instant case, the Board meeting could not be held for want of quorum, and so the provisions of section 174(4) shall become applicable. As per section 174(4), the adjourned Board meeting shall be held on Thursday, 8th January 2015 at 3 pm at Shah Auditorium (since the articles of the company do not otherwise provide).

Neither section 174(4) nor any other section of the Companies Act, 2013 empowers the Chairman to decide the day of the adjourned Board meeting. Even with the consent of the directors present, the Chairman is not empowered to decide that the adjourned Board meeting shall be held on next Monday. Accordingly, the decision of the Chairman to adjourn the Board meeting till next Monday is not valid. The Board meeting shall be adjourned till Thursday, 8th January 2015.

Whether a Board meeting adjourned for want of quorum can be held on Sunday?

P 2.10D. A meeting of the Board of 'No Holiday Ltd.' was held on a holiday on account of Ganesh Chaturthi. However due to lack of quorum, the proceedings of the meeting could not be held and therefore the Chairman of the meeting decided with the consent of the majority that the Board meeting be adjourned to next week on the same day. However, the date fixed for the adjourned meeting happened to be a Sunday. Whether the adjourned meeting of the Board can be held on a Sunday.

Ans. As per section 174(4), if a Board meeting could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned –

(a) to the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday;

(b) at the same time;

(c) at the same place.

In the instant case, a Board meeting of 'No Holiday Ltd.' was called to be held on Ganesh Chaturthi. However, the quorum was not present, and so the Board meeting could not be held. As a consequence, the provisions of section 174(4) shall become applicable. As per section 174(4), the adjourned Board meeting shall be held on the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday (since the articles of 'No Holiday Ltd.' do not otherwise provide).

In the next week, the 'same day' happens to be a Sunday. However, Sunday is not a National Holiday. Therefore, the adjourned Board meeting can be held on Sunday.

Comment: The question states that the Chairman of the meeting decided with the consent of the majority that the Board meeting be adjourned to next week on the same day. Since section 174(4) expressly provides that in case of lack of quorum in a Board meeting, the Board meeting shall adjourn to the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday, the Chairman is neither required nor empowered to decide with respect to the day on which the adjourned Board meeting shall be held, and so the decision taken by the Chairman in the given case has no relevance.

2.11 Chairperson of the Board meeting

Every meeting of the Board must be presided over by a Chairperson. The provisions relating to appointment of Chairperson, casting vote of Chairperson etc. are explained as follows:

1. Chairperson – The presiding officer of a meeting

The main function of a Chairperson is to preside over the meetings, and conduct them in an orderly manner. A Chairperson is always a part time Chairperson (even if he is the whole time director of the company) since he can occupy the chair only when the meeting is in continuation. His main duties are as follows:

(a) To preserve order at the meeting, and conduct deliberations in an orderly manner.

(b) To ensure that the meeting is duly convened and properly conducted, the business is transacted in accordance with the provisions of the Act and memorandum and articles of the company.

(c) To ensure that sense of the meeting is properly and accurately ascertained.

2. Appointment of a Chairperson

There is no statutory provision (except Regulation 70 of Table F) dealing with the appointment of the Chairperson.

Regulation 70 of Table F. The provisions contained in Regulation 70 of Table F are as follows:

(a) The Board may elect a Chairperson of its meetings and determine the period for which he is to hold office.

(b) If no such Chairperson is elected, or if at any meeting the Chairperson is not present within 5 minutes after the time appointed for holding the meeting, the directors present may choose one of themselves to be Chairperson of the meeting.

Appointment as per articles. The Chairperson is appointed in accordance with the provisions contained in the articles of the company. Regulation 70 of Table F contains the model provisions. A company is free to incorporate in its articles such provisions in a modified form.

3. Who can be the Chairperson?

(a) No proxies are allowed at a Board meeting. As such, only a director of the company can be appointed as a Chairperson.

(b) There is no requirement that only a whole time director shall be appointed as the Chairperson. Even a non-executive director may be elected as a Chairperson.

(c) A director need not be a shareholder and as such a non-shareholder director may also be appointed as a Chairperson at a Board meeting.

4. Casting vote of Chairperson

Casting vote means a second vote or deciding vote exercisable by the Chairperson of the Board. It helps in resolving a deadlock in the Board. In case of equality of votes, the resolution is lost, unless the position is resolved by the use of the casting vote of the Chairperson, if any.

(a) The Chairperson has a casting vote only if such a power is contained in the articles [***Firestone Tyre and Rubber Co.*** v ***Synthetics and Chemicals Ltd.*** **(1971) Comp Cas 377**].

(b) As per Regulation 68 of Table F, the Chairperson of the Board may use his casting vote in case of equality of votes.

(c) The Chairperson of the Board has the discretion to use his casting vote, *i.e.* he may decide not to use it. He may use the casting vote if it is in the interest of the company.

1. Chairperson of the Board vis-a-vis Chairperson of the Board meeting

(a) When the Board elects a Chairperson (whether for a certain period, say 5 years, or otherwise), the Chairperson so elected is called as the Chairperson of the Board.

(b) When the Chairperson of the Board is not elected, or he is not present, or he is not willing to act as a Chairperson, the directors present in the Board meeting may appoint a Chairperson for the conduct of the Board meeting. However, he remains a Chairperson for that particular Board meeting only and therefore he is called as Chairperson of the Board meeting.

2. Casting vote

Regulation 68 of Table F gives a power to the Chairperson of the Board to exercise a casting vote. Accordingly, where a company adopts regulation 68 of Table F in its articles, only the Chairperson of the Board can use a casting vote. The Chairperson of the Board meeting shall not have a casting vote [***Ramjilal Baisiwala*** **v** ***Baiton Cables Ltd.*** **(1964) ILR 14 Raj 135**].

Theoretical Questions from CS Examinations

Q 2.11A. At a Board meeting of the company, the directors are sharply divided in their views on an item involving a major policy decision. The company has adopted 'Table-F' of the Companies Act, 2013 as its articles of association. On a voting on the said item, there was a tie. Advise the course of action open to the Chairperson. [CS (Final) Dec. 1998]

2.12 Minutes (Section 118)

'Minutes' means a written record of the business transacted at a meeting of the company. Minutes contain the decisions made and resolutions passed at the meetings of the company. The statutory requirements relating to preparation of minutes, as contained in section 118, are as follows:

(A) Provisions contained in the Act.

1. Scope of Section 118

Every company shall cause to be prepared, signed and kept minutes of –

(a) proceedings of every general meeting;
(b) proceedings of meeting of any class of shareholders;
(c) proceedings of meeting of any class of creditors;
(d) proceedings of meeting of Board of directors;
(e) proceedings of meeting of any committee of the Board; and
(f) every resolution passed by postal ballot.

2. Manner of preparation and signing

(a) The minutes shall be prepared and signed in such manner as may be prescribed.
(b) All the appointments made at any meeting shall be included in the minutes.
(c) The minutes shall be maintained in the books kept for that purpose.
(d) The pages of the minutes book shall be consecutively numbered.

3. Time limits for preparation and signing

The minutes shall be prepared and signed within 30 days of –

(a) the conclusion of the meeting; or
(b) passing of the resolution by postal ballot.

4. Contents w.r.t. board meetings

In case of a Board meeting or of committee meeting, the minutes shall also contain –

(a) the names of the directors present; and
(b) where any resolution is passed at the meeting, the names of the directors, dissenting from the resolution and the names of the directors not concurring with the resolution.

5. Discretion of Chairman

(a) No matter shall be included in the minutes, if the chairman is of the opinion that it is –
  (i) defamatory of any person; or
  (ii) irrelevant or immaterial; or
  (iii) detrimental to the interests of the company.
(b) The chairman shall exercise absolute discretion with regard to the inclusion or non-inclusion of any matter in the minutes on any of the grounds specified above.

6. Minutes to be correct and fair

Minutes shall contain a fair and correct summary of the proceedings of the meeting.

7. Evidential value

Minutes kept as per Sec. 118 shall be evidence of the proceedings recorded therein.

8. Presumptions drawn from minutes

Where minutes are kept as per Sec. 118, then, until contrary is proved, it shall be presumed that –

(a) the meeting was duly called and held;
(b) all the proceedings at the meeting were duly taken place;
(c) all the resolutions passed by postal ballot were duly passed; and
(d) in particular, all the appointments of directors, key managerial personnel, auditors or company secretary in practice were validly made.

9. Publication of reports of proceedings

No document purporting to be a report of the proceedings of any general meeting of a company shall be circulated or advertised at the expense of the company, unless it includes the matters required by this section (*i.e.* Section 118) to be contained in the minutes of the proceedings of such meeting.

10. Compliance with Secretarial Standards

Every company shall observe secretarial standards with respect to general meetings and Board meetings–

(a) specified by the Institute of Company Secretaries of India; and

(b) approved as such by the Central Government.

11. Punishment for contravention

If any default is made in complying with the provisions of this section, then –

(a) the company shall be liable to a penalty of Rs. 25,000; and

(b) every officer in default shall be liable to a penalty of Rs. 5,000.

12. Punishment for tampering

Any person found guilty of tampering with the minutes shall be punishable with –

(a) imprisonment upto 2 years; and

(b) fine: Minimum: Rs. 25,000; Maximum: Rs. 1 lakh.

(B) Provisions contained in the Rules

1. Distinct minute book for each type of meeting

A distinct minute book shall be maintained for each type of meeting namely:

(i) General meetings of the members (including the resolutions passed by postal ballot since such resolutions are deemed to be passed in general meeting)

(ii) Meetings of the creditors

(iii) Meetings of the Board; and

(iv) Meetings of each of the committees of the Board.

2. Manner of maintenance of minutes

(i) The minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry.

(ii) Every resolution passed by postal ballot shall be entered in the minutes book of general meetings.

(iii) With respect to every resolution passed by postal ballot, the minutes shall contain –

  (a) a brief report on the postal ballot conducted;

  (b) the resolution proposed;

  (c) the result of voting;

  (d) summary of the scrutinizer's report

  (e) date of entry in the minutes book.

3. Manner of signing of minutes

Each page of every minute book shall be initialled or signed, and the last page shall be dated and signed, as follows:

Nature of minutes book	*Signing by whom?*
Minutes of Board meetings and Committee meetings	▪ The chairman of the same meeting or the chairman of the next meeting.
Minutes of GM	▪ The chairman of the same meeting within 30 days of conclusion of such meeting. ▪ In the event of the death or inability of that chairman within that period, by a director duly authorised by the Board for this purpose.
Resolutions passed by postal ballot	▪ The chairman of the Board ▪ If there is no chairman of the Board or in the event of the death or inability of the chairman of the Board, by a director duly authorised by the Board for the purpose.

4. **Preservation of minutes book**

The minute books of general meetings, Board meetings and committee meetings shall be –

(i) kept at the registered office of the company, or at such other place as may be approved by the Board;

(ii) preserved permanently;

(iii) kept in the custody of the company secretary or any director duly authorised by the Board.

Theoretical Questions

Q 2.12A. When are the minutes of the meetings of the Board of directors required to be recorded and signed? [CS (Final) Dec. 1994]

Practical Problems from CA Examinations

Maintenance of minutes in loose leaf form – Whether permissible?

P 2.12A. Accurate Arcs Ltd. maintains the minutes book of the Board meetings in loose-leaf system and get them bound once in three months. Can it do so? **[CA (Final) Nov. 2000]**

Ans. As per section 118, every company shall cause to be prepared, signed and kept minutes of proceedings of Board meetings. The minutes shall be maintained in the books kept for that purpose. Further, the minutes shall be prepared and signed in such manner as may be prescribed.

As per Rule 25 of the Companies (Meetings of Board and its Powers) Rules, 2014, the minutes of proceedings of each meeting shall be entered in the books and each page of every such book shall be initialled or signed and the last page containing the record of proceedings of each meeting in such book shall be dated and signed.

The use of the word 'book' in section 118 and Rule 25 makes it clear that the minutes have to be maintained in the 'book', and so maintenance of minutes in loose leaf form is not permitted. Further, each page of the minutes books shall be consecutively numbered.

Tutorial note:

Under the Companies Act, 1956, a relaxation was given by the Department of Company Affairs (now Ministry of Corporate Affairs) according to which it was permissible for a company to maintain its minutes in loose leaf form, provided the company took adequate safeguards against falsification of minutes, and loose leaves were bound in the books at reasonable intervals, say six months (Extract from Fifth Annual Report, Year Ended 31st March, 1961). In short, companies could maintain the minutes in loose leaf form subject to fulfilment of certain conditions.

However, no such relaxation has been given by the Ministry of Corporate Affairs under the Companies Act, 2013. Further, there are specific provisions given under Rule 25 of the Companies (Meetings of Board and its Powers) Rules, 2014 requiring maintenance of minutes in 'books' (*i.e.* bound books), consecutively numbering the pages of the 'minutes books', etc. In short, because of express provisions contained in Rule 25, it is not permissible to maintain the minutes in loose leaf form under the Companies Act, 2013.

Signing of minutes book – Position where chairman dies

P 2.12B. Board meetings were held on 24th November, 2014 and 15th December, 2014. Mr. Rameshwar, who was the chairman of these two Board meetings died on 20th December, 2014, without signing the minutes. How should the minutes be signed and by whom? **[CA (Final) Nov. 2000]**

Ans. As per section 118, the minutes of a Board meeting may be signed by the chairman of the said meeting or the chairman of the next succeeding meeting. The minutes shall be prepared and signed within 30 days of the conclusion of the Board meeting.

In the present case, the minutes of the meeting held on 24.11.2014 could be signed either by the chairman of the meeting held on 24.11.2014 or by the chairman of the next meeting held on 15.12.2014. Incidentally, the chairman of these two meetings is the same, *i.e.* Mr. Rameshwar, who has died. The result is that the minutes of the two previous Board meetings, held on 24.11.2014 and 15.12.2014, have remained unsigned.

There is no legal provision covering the above situation. Therefore, it is advisable to convene a Board meeting and appoint a chairman who shall be authorised to sign the minutes of both the meetings held on 24.11.2014 and 15.12.2014.

Is the chairman empowered to order exclusion of certain matters from the minutes book?

P 2.12C. 17th Board meeting of Jai Entertainment Ltd. was held at its registered office situated at B-17, Industrial Area, Suncity. While discussing the matter of appointment of Mr. Kaabil as Managing Director of the company, certain defamatory remarks were made by Mr. X, one of the directors. The draft minutes submitted by the Company Secretary also incorporated the indecent remarks of Mr. X. The chairman wants to remove those undesirable remarks from the minutes. Can he do so?

[CA (Final) May, 2017]

Ans. The given problem relates to section 118 of the Companies Act, 2013 as discussed below:

The legal position

1. As per section 118, no matter shall be included in the minutes, if the chairman is of the opinion that it is –
   (i) defamatory of any person; or
   (ii) irrelevant or immaterial; or
   (iii) detrimental to the interests of the company.
2. The chairman shall exercise absolute discretion with regard to the inclusion or non-inclusion of any matter in the minutes on any of the grounds specified above.

The given case and analysis of the case

3. Certain defamatory remarks were made by Mr. X, one of the directors of the company. The chairman, exercising his discretion, intends to exclude such defamatory remarks from the minutes.
4. The decision of the chairman is in accordance with the provisions of section 118, which grants an absolute discretion to the chairman with respect to inclusion or non-inclusion of any matter in the minutes. Thus, if the chairman is of the opinion that certain matters are defamatory of any person and so such matter should not be included in the minutes, the chairman is empowered to make an order for exclusion of such matters from the minutes; no Board resolution or consent of any director is required for this purpose.

Conclusion

5. The decision of the chairman to exclude certain defamatory / indecent remarks from the minutes, is valid.

2.13 Inspection of minutes of general meeting (Section 119)

1. Place of keeping minutes book

The minutes book shall be kept at the registered office of the company.

2. Inspection of minutes book

(a) ***Time of inspection.*** Inspection can be made during business hours (subject to reasonable restrictions through the articles or a resolution passed in the general meeting, so that at least 2 hours in each business day are allowed for inspection).

(b) ***Inspection by whom?*** Any member of the company may make the inspection without any charges.

(c) ***Copies of minute book.*** The copies of the minute book of any general meeting shall be made available by the company to any member within 7 working days of the request made on payment of prescribed fees, *i.e.* –
   (i) such sum as is prescribed in the articles of the company, but not exceeding Rs. 10 per page or part of a page;
   (ii) free of cost, in case the member has made a request for obtaining soft copy of minutes of any general meeting held during immediately preceding 3 financial years.

(d) ***Punishment for default.*** If inspection is refused or copy is not furnished, the company shall be liable to a penalty of Rs. 25,000 and every officer in default shall be liable to a penalty of Rs. 5,000 for each such refusal or default.

(e) ***Powers of the Tribunal.*** If inspection is refused or copy is not furnished, the Tribunal may direct the company to allow immediate inspection or direct the company to forthwith send the copy.

Practical Problems from CS Examinations

Inspection of minutes of Board meeting by a member – Whether permissible?

P 2.13A. A member wants to inspect the minutes book of the meetings of the Board. Advise. **[CS (Final) Dec. 1995; June 1999]**

Ans. Section 119 confers a right on the members of the company to inspect and obtain the copies of the minutes of a general meeting. However, this right does not extend to the minutes of a Board meeting.

The Companies Act, 2013 contains no provision either specifically permitting or prohibiting inspection by the shareholders of the minutes of the Board meeting. Unless the articles of the company otherwise provide, a shareholder has no right of inspection or of taking copies of the minutes of the Board meetings [*Department Letter No. 8/15 (169)/63-PR, dated 11.2.1963*].

In the given case, if the articles of the company give a right to the members to inspect the minutes, the inspection cannot be declined; otherwise the member has no right to make the inspection.

2.14 Validity of acts of directors (Section 176)

Section 176 seeks to give protection to the company and third parties where certain acts are done by a director in good faith and without notice that these are done wrongly or illegally. Thus, section 176 validates the *bona fide* acts of *de facto* directors. These provisions may be explained as follows:

1. **Acts of a director – Validated**

   No act done by a person as a director shall be deemed to be invalid, notwithstanding that it was subsequently noticed that –

   (a) his appointment was invalid by reason of any defect or disqualification; *or*

   (b) his appointment was terminated by virtue of any provision contained in the Act or in the articles.

2. **Acts of managing director – Not validated**

   Acts done by a director in his capacity as managing director are not validated under section 176. Accordingly, where a managing director ceased to hold his office, all his subsequent acts were held to be invalid. It was not an irregular exercise of power, but exercise of power by a person who had no authority at all **[*Varkey Souriar* v *Keraleeya Banking Co. Ltd.* AIR 1957 Ker 97]**.

3. **Acts of a director – Not validated in certain cases**

   In the following cases, the acts of a director shall not be valid:

   (a) Where his appointment is illegal or there is no appointment at all;

   (b) Where his appointment is noticed by the company to be invalid or to have terminated (*i.e.* where it is shown to the company that his appointment was invalid or has terminated), all subsequent acts done by such a director shall be invalid;

   (c) Where the acts of a director are *ultra vires* the Companies Act, 2013.

4. **Acts of a chairman – Not validated**

   The provision of validity of acts is not applicable to chairman. Therefore, the resolutions passed by casting vote of chairman are not valid, if his appointment is invalid.

5. **Action by third parties – When permissible?**

   Persons who deal with the directors after having notice of the defect or disqualification of the directors are not protected by section 176. A person cannot take advantage of the protection given by the section if he is aware of some defect or disqualification.

Where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, no prior act done by him shall be deemed to be invalid [Section 196(5)].

Practical Problems from CA Examinations

Acts of a managing director after expiry of his term – Whether valid?

P 2.14A. Mr. Smart was appointed as the managing director of a public limited company for a period of 5 years effective from 1.4.1993. It is noticed that he performed certain acts on behalf of the company after the expiry of his term. Some of the aggrieved parties have questioned the validity of the managing director's acts. Advise. [CA (Final) May 1998]

Ans. Section 176 validates the acts of a director if it is subsequently discovered that –

- his appointment was invalid by reason of any defect or disqualification; *or*
- his appointment was terminated by virtue of any provision contained in the Act or in the articles.

However, the acts done by a director in his capacity as a managing director are not validated under section 176, except the acts done in the capacity of a director.

Where a managing director ceased to hold his office, all his subsequent acts were held to be invalid. It was not an irregular exercise of power, but exercise of power by a person who had no authority at all **[*Varkey Souriar* v *Keraleeya Banking Co. Ltd.* AIR 1957 Ker 97]**.

The facts in the present case are identical to the facts referred to in the above case. Thus, the acts done by Mr. Smart, after the expiry of his term of office shall not be valid.

Whether acts done by a director are valid if his appointment is subsequently declared as invalid?

P 2.14B. MTP was appointed as a director at the Annual General Meeting of a limited company held on 30th September, 2013 and he carried on his duties and functions as a director. In the month of August, 2014, it was found out that there were certain irregularities in his appointment and on 31st August, 2014, his appointment was declared invalid. But Mr. MTP continued to act as director even after 31st August, 2014. You are required to state, with reference to the provisions of the Companies Act, 2013 whether the acts done by Mr. MTP are valid and binding upon the company? [CA (Final) May 2007]

Ans. Section 176 validates the acts of a director if it is subsequently discovered that –

– his appointment was invalid by reason of any defect or disqualification; *or*

– his appointment was terminated by virtue of any provision contained in the Act or in the articles.

However, where it is noticed by the company that the appointment of a director was invalid or has terminated, all subsequent acts done by such a director shall be invalid.

In the given case, the appointment of Mr. MTP was invalid, but this fact was not in the knowledge of the company at the time of his appointment, and so Mr. MTP acted as a director, exercised some powers, performed certain functions and fulfilled his duties as a director. Subsequent to his appointment, the fact that his appointment was invalid was noticed by the company on 31st August, 2014.

As per section 176, the acts done by Mr. MTP upto 31st August, 2014 shall be valid. However, any act done by Mr. MTP after 31st August, 2014 shall not be valid as per the provisions of section 176.

Practical Problems from CS Examinations

Whether acts done by a director are valid if his appointment is subsequently declared as invalid?

P 2.14C. Z was appointed as director of the company in an annual general meeting. He took over the office and carried on his functions as director. Subsequently, it was found that there were some irregularities in voting and hence the appointment was declared invalid. Would the act done by Z, while in office as director, be binding upon the company?

[CS (Final) Dec. 1995, Dec. 1999]

Ans. Section 176 validates the acts of a director if it is subsequently discovered that –

– his appointment was invalid by reason of any defect or disqualification; *or*

– his appointment was terminated by virtue of any provision contained in the Act or in the articles.

However, where it is noticed by the company that the appointment of a director was invalid or has terminated, all subsequent acts done by such a director shall be invalid.

In the given case, the appointment of Mr. Z was invalid, but this fact was not in the knowledge of the company at the time of his appointment, and so Mr. Z acted as a director, exercised some powers, performed certain functions and fulfilled his duties as a director. Subsequent to his appointment, the fact that his appointment was invalid was noticed by the company.

As per section 176, the acts done by Mr. Z upto the date when his appointment was noticed by the company as invalid, shall be binding on the company. However, any act done by Mr. Z after that date shall not be binding on the company as per the provisions of section 176.

2.15 Audit committee (Section 177 and Rules 6 and 6A)

1. Mandatory constitution of audit committee by certain companies

Constitution of an audit committee is mandatory for the following companies:

(a) Listed public companies.

(b) Public companies having paid up share capital of Rs. 10 crore or more.

(c) Public companies having turnover of Rs. 100 crore or more.

(d) Public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 crore.

However, the following classes of unlisted public companies shall not be required to constitute the audit committee:

(a) A joint venture

(b) A wholly owned subsidiary

(c) A dormant company as defined under section 455 of the Act.

The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

2. Mandatory constitution of audit committee by existing companies

Public companies which are covered under Rule 6, but which were not required to constitute the Audit Committee under section 292A of the Companies Act, 1956 shall constitute the Audit Committee within 1 year from the commencement of these rules or appointment of independent directors by them, whichever is earlier.

3. Composition of audit committee

(a) The Audit Committee shall consist of a minimum of 3 directors.

(b) The majority of members of the Audit Committee shall be the independent directors.

As per Notification No. G.S.R. 466(E) dated 5th June, 2015, in the case of a company licenced under section 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, this requirement (*i.e.* the majority of members of the Audit Committee shall be the independent directors) shall not apply.

(c) Majority of members of the Audit Committee (including the Chairperson of the Audit Committee) shall be persons with ability to read and understand the financial statement.

(d) Every Audit Committee of a company existing immediately before the commencement of this Act shall, within 1 year of such commencement (*i.e.* on or before 31.03.2015), be reconstituted as per the aforementioned provisions.

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 the Audit Committee considers the auditor's report, but they shall not have any right to vote.

4. Functions of the audit committee

Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall include the following:

(i) The recommendation for appointment, remuneration and terms of appointment of auditors of the company

As per Notification No. G.S.R. 463(E) dated 5th June, 2015, in case of a Government company which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, this clause shall be read as follows:

"The recommendation for remuneration of auditors of the company"

(ii) Review and monitor the auditor's independence and performance, and effectiveness of audit process

(iii) Examination of the financial statement and the auditors' report thereon

As per Rule 4 of the Companies (Meetings of Board and its Powers), Rules, 2014, any meeting of the Audit Committee for consideration of financial statement, including consolidated financial statement, if any, to be approved by the Board under section 134(1) shall not be held by way of video conferencing or other audio visual means.

(iv) Approval or any subsequent modification of transactions of the company with related parties

1. However, the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed.
2. Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014 makes the following provisions in this regard:

   All related party transactions shall require approval of the Audit Committee. The Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to the following conditions:

   (i) 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:
      (a) Maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a financial year.
      (b) 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.

   (ii) The Audit Committee shall consider the following factors while specifying the criteria for making omnibus approval:
      (a) Repetitiveness of the transactions (in past or in future).
      (b) Justification for the need of omnibus approval.

   (iii) 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.

   (iv) The omnibus approval shall contain or indicate the following:
      (a) Name of the related parties.
      (b) Nature and duration of the transactio...
      (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.
      (e) Any other information relevant or important for the Audit Committee to take a decision on the proposed transaction.

      However, if the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval for such transactions subject to their value not exceeding rupees 1 crore per transaction.

   (v) 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.

(vi) Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

(vii) The Audit Committee may impose such other conditions as it may deem fit.

3. In case of transaction, other than transactions referred to in section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board.
4. In case any transaction involving any amount not exceeding Rs. 1 crore is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within 3 months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.
5. The above provisions shall not apply to a transaction, other than a transaction referred to in section 188, between a holding company and its wholly owned subsidiary company.

(v) Scrutiny of inter-corporate loans and investments

(vi) Valuation of undertakings or assets of the company, wherever it is necessary

(vii) Evaluation of internal financial controls and risk management systems

(viii) Monitoring the end use of funds raised through public offers and related matters.

5. Powers of the audit committee

(a) The Audit Committee shall have the power to call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors.

(b) It shall have the power to review the financial statement before their submission to the Board.

(c) It shall have the power to discuss any issues with respect to financial statement with the internal and statutory auditors and the management of the company.

(d) It shall have the authority to investigate into any matter relating to any of the aforementioned matters or referred to it by the Board.

(e) For the purpose of carrying out any investigation, it shall have –

(i) the power to obtain professional advice from external sources; and

(ii) full access to information contained in the records of the company.

(f) Where the company is required to establish the vigil mechanism, the audit committee shall oversee such vigil mechanism.

6. Disclosure requirements

(a) The Board's report shall disclose the composition of an Audit Committee

(b) Where the Board does not accept any recommendation of the Audit Committee, the same shall be disclosed in the Board's report along with the reasons therefor.

7. Punishment for contravention [Section 178(8)]

In case of any contravention of the provisions of section 177, the punishment shall be as follows:

(i) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh.

(ii) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh, or with both.

Theoretical Questions from CA Examinations

Q 2.15A. Explain briefly the provisions of the Companies Act, 2013 regarding constitution of 'Audit Committee'. [CA (Final) May, 2012]

Q 2.15B. Which company is required to constitute an audit committee? What are the powers and functions of the audit committee? [CA (Final) May 2016]

Practical Problems from CA Examinations

Likely turnover or capital of a company which has constituted audit committee, and role of audit committee vis-a-vis the statutory auditor

P 2.15A. X Ltd. wants to constitute an Audit Committee.

(i) What would be the minimum likely turnover or capital of this company?

(ii) What is the role of the Audit Committee vis-a-vis the statutory auditor when the company wishes to engage them to perform certain engagements not restricted under section 144? [CA (Final) May 2016]

Ans.

(i) Minimum likely turnover or capital

The given problem relates to section 177 of the Companies Act, 2013 read with Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014. As per section 177 and Rule 6, constitution of an audit committee is mandatory for the following companies:

(a) Listed public companies.

(b) Public companies having paid up share capital of Rs. 10 crore or more.

(c) Public companies having turnover of Rs. 100 crore or more.

(d) Public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 crore.

However, the following classes of unlisted public companies shall not be required to constitute the audit committee:

(a) A joint venture

(b) A wholly owned subsidiary

(c) A dormant company as defined under section 455 of the Act.

The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

In the given case, X Ltd. intends to constitute the audit committee. So, the likely turnover of X Ltd. shall be Rs. 100 crore or more or the likely paid up share capital of X Ltd. shall be Rs. 10 crore or more. However, if X Ltd. is a listed public company or the aggregate of outstanding loans, debentures and deposits of X Ltd. exceeds Rs. 50 crore, it shall be mandatory for X Ltd. to constitute the audit committee irrespective of its paid up share capital and turnover.

(ii) Role of the Audit Committee vis-a-vis the statutory auditor performing non-audit services

(a) As per section 144, if the company has constituted the audit committee, the auditor shall provide to the company only such other services as are approved by the audit committee.

(b) The audit committee shall perform the following functions:

(i) Recommend the appointment, remuneration and terms of appointment of statutory auditors.

(ii) Review and monitor the auditor's independence and performance, and effectiveness of audit process.

(iii) Examine the financial statements and the auditors' report thereon.

(c) The Audit Committee shall exercise the following powers:

(i) Power to call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors.

(ii) Power to review the financial statements before their submission to the Board.

(iii) Power to discuss any issues with respect to financial statements with the internal and statutory auditors and the management of the company.

Whether audit committee consisting of 5 members and having 2 independent directors is validly constituted?

P 2.15B. Referring to the provisions of the Companies Act, 2013, examine the following:

XYZ Limited, a listed company has constituted an audit committee consisting of five members out of whom two are independent directors. Subsequently, the company increased the composition of audit committee to six members with three independent directors. [CA (Final) Nov. 2016]

Ans. The given problem relates to section 177 of the Companies Act, 2013, as explained below:

(a) The Audit Committee shall consist of a minimum of 3 directors.

(b) The majority of members of the Audit Committee shall be the independent directors.

(c) Majority of members of the Audit Committee (including the Chairperson of the Audit Committee) shall be persons with ability to read and understand the financial statements.

In the given case, XYZ Limited has constituted an audit committee consisting of 5 members, out of whom 2 are independent directors. The number of members of the audit committee (*i.e.* 5, in this case) is in compliance with the provisions of section 177. However, the number of independent directors is only 2, whereas section 177 requires that majority of directors (i.e. 3, in this case) shall be independent directors. Thus, XYZ Limited has contravened the provisions of section 177.

Subsequent to constitution of the audit committee, XYZ Limited increased the number of members to 6, out of whom 3 are independent directors. After such reconstitution, the number of directors are only 3, whereas as per section 177, the number of independent directors have to be in majority, i.e. 4 in this case. Thus, even after increasing the number of directors to 6 with 3 independent directors, there is a contravention of section 177.

Whether a listed company having a paid up capital of Rs. 4 crores is required to constitute an audit committee?

P 2.15C. MNC Ltd., a company, whose paid up capital was Rs. 4.00 crores, has issued rights shares in the ratio of 1:1. The said company is listed with Mumbai Stock Exchange. Whether the company is required to appoint any Audit Committee?

[CA (Final) Nov. 2016]

Ans. The given problem relates to section 177 of the Companies Act, 2013 read with Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014. As per section 177 and Rule 6, constitution of an audit committee is mandatory for the following companies:

(a) Listed public companies.

(b) Public companies having paid up share capital of Rs. 10 crore or more.

(c) Public companies having turnover of Rs. 100 crore or more.

(d) Public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 crore.

However, the following classes of unlisted public companies shall not be required to constitute the audit committee:

(a) A joint venture

(b) A wholly owned subsidiary

(c) A dormant company as defined under section 455 of the Act.

The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

In the given case, the paid up capital of MNC Ltd., after issue of rights shares, is Rs. 8 crores, which is less than Rs. 10 crores (being the minimum amount of paid up capital, for the purpose of mandatory constitution of audit committee). However, the fact that the paid up capital of MNC Ltd. is less than Rs. 10 crore is irrelevant, since MNC Ltd. is a listed company, and as per section 177 read with Rule 6, every listed company is required to constitute an audit committee, irrespective of its paid up share capital, turnover, aggregate of its outstanding loans, debentures and deposits, etc.

Thus, it is mandatory for MNC Ltd. to constitute an audit committee.

Whether Board is empowered not to accept the recommendations of the Audit Committee?

P 2.15D.

Case I. MNC Ltd. constituted an audit committee as required by the said Act. The committee in its report dated 30th April 2012 has pointed out various irregularities in the financial transactions entered into by the company. The management of the company does not agree with the contents of the audit committee report. Explain the action that can be taken in this regard.

[CA (Final) May 2012]

Case II. An Audit Committee of a listed company constituted under section 177 of the Companies Act, 2013 submitted its report of its recommendation to the Board. The Board, however, did not accept the recommendations. In the light of the situation, analyse whether:

(a) The Board is empowered not to accept the recommendations of the Audit Committee.

(b) If so, what alternative course of action, would be Board resort to? **[ICAI, Questions for Practice]**

Ans. The given problem relates to section 177 of the Companies Act, 2013, as discussed below:

The legal position

As per section 177, if the Board does not accept any recommendation of the Audit Committee, the same shall be disclosed in the Board's report along with the reasons therefor.

Case I.

The Audit Committee has pointed out some irregularities in the financial transactions entered into by the company. However, the Board is of the view that there are no such irregularities. Thus, it is evident that the Board does not agree with the recommendations made by the Audit Committee.

The Board is not bound to accept the recommendations made by the Audit Committee. The Board may decide not to accept the recommendations made by the Audit Committee provided the following disclosures are made in the Board's report:

(a) The recommendation made by the Audit Committee which was not accepted by the Board.

(b) Reason for non-acceptance of such recommendation made by the Audit Committee.

Case II.

(i) Section 177 gives discretion to the Board with respect to acceptance or non-acceptance of recommendations made by the Audit Committee. Thus, the Board may decide not to accept the recommendations of the Audit Committee.

(ii) In case the Board does not accept the recommendations made by the Audit Committee, the Board shall ensure that following disclosures are made in the Board's report:

   (a) The recommendation made by the Audit Committee which was not accepted by the Board.

   (b) Reason for non-acceptance of such recommendation made by the Audit Committee.

2.16 Vigil mechanism for directors and employees (Section 177 and Rule 7)

1. Establishment of vigil mechanism by certain companies

Establishment of vigil mechanism is mandatory for the following companies:

(a) Listed companies.

(b) The companies which have accepted deposits from the public.

(c) The companies which have borrowed money from banks and public financial institutions in excess of Rs. 50 crore.

2. Requirements for vigil mechanism

(a) The vigil mechanism shall provide an opportunity to the directors and employees to report genuine concerns in such manner as may be prescribed.

(b) The vigil mechanism shall provide adequate safeguards so as to prevent victimisation of employees and directors.

The vigil mechanism shall make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.

3. Manner of establishment of vigil mechanism

The procedural requirements with respect to vigil mechanism are contained in Rule 7 of the Companies (Meetings of Board and its Powers) Rules, 2014, as explained below:

(a) In case the company is required to constitute an audit committee, the audit committee shall oversee the vigil mechanism. If any of the members of the audit committee has a conflict of interest in a given case, he should recuse himself, and the others on the committee would deal with such case.

(b) In case the company is not required to constitute an audit committee, the Board of directors shall nominate a director to play the role of the audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.

(c) The vigil mechanism shall provide adequate safeguards so as to prevent victimisation of employees and directors.

(d) The vigil mechanism shall provide direct access to the Chairperson of the Audit Committee or the director nominated to play the role of the Audit Committee, as the case may be, in exceptional cases.

If frivolous complaints are repeatedly 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 reprimanding him.

4. Disclosure requirements

The details of establishment of vigil mechanism shall be disclosed by the company –

(a) on its website, if any; and

(b) in the Board's report.

5. Punishment for contravention [Section 178(8)]

In case of any contravention of the provisions of section 177, the punishment shall be as follows:

(i) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh.

(ii) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh, or with both.

Whether it is mandatory for the company to establish the vigil mechanism and penalties for contravention

P 2.16A. M/s Dreamworks Limited (an unlisted company) without any public deposits as per the audited financial statements of the company as at March, 31st 2018 gives you the following information:

Paid up Share Capital	Rs. 20 Crores
Gross Turnover	Rs. 500 Crores
Bank Borrowings	Rs. 40 Crores (from a Nationalized Bank)
Other Borrowings	Rs. 40 Crores (from a Public Financial Institution)

Mr. Gupta, a Chartered Accountant employed in the finance and audit department of the company wants to form a Vigil Mechanism for directors and employees of the company.

(1) Advise whether it is mandatory for M/s Dreamworks Limited to formulate a Vigil Mechanism under the provisions of the Companies Act, 2013 and rules framed thereunder.

(2) Are there any penalties that could be imposed on the company for not formulating the Vigil Mechanism?

[CA (Final) May 2018]

Ans. The given problem relates to section 177 of the Companies Act, 2013 read with Rule 7 of the Companies (Meetings of Board and its Powers) Rules, 2014, as discussed below:

1. Establishment of vigil mechanism is mandatory for the following companies:
   (a) Listed companies.
   (b) The companies which have accepted deposits from the public.
   (c) The companies which have borrowed money from banks and public financial institutions in excess of Rs. 50 crore.
2. In case a company fails to establish the vigil mechanism, the punishment shall be as follows:
   (i) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh.
   (ii) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh, or with both.
3. In the given case, M/s Dreamworks Limited is not a listed company. Also it has not accepted any deposits from the public. However, M/s Dreamworks Limited has borrowed Rs. 40 crores from a bank and Rs. 40 crores from a public financial institution. Thus, the aggregate of borrowings of M/s Dreamworks Limited from banks and public financial institutions is Rs. 80 crores, i.e. exceeding Rs. 50 crores. Since M/s Dreamworks Limited satisfies one of the three criteria contained in section 177 read with Rule 7, it is required to establish the vigil mechanism in accordance with the requirements contained in section 177.
4. In case a company is required to establish the vigil mechanism, but it fails to establish the vigil mechanism, the punishment shall be as follows:
   (i) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh.
   (ii) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh, or with both.

2.17 Nomination and Remuneration Committee (Section 178 and Rule 6)

1. Mandatory constitution of Nomination and Remuneration Committee by certain companies [Section 178(1)]

Constitution of Nomination and Remuneration Committee is mandatory for the following companies:

(a) Listed public companies.
(b) Public companies having paid up share capital of Rs. 10 crore or more.
(c) Public companies having turnover of Rs. 100 crore or more.
(d) Public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 crore.

However, the following classes of unlisted public companies shall not be required to constitute the Nomination and Remuneration Committee:

(a) A joint venture
(b) A wholly owned subsidiary
(c) A dormant company as defined under section 455 of the Act.

The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

2. Composition of Nomination and Remuneration Committee [Section 178(1) and Proviso to Section 178(1)]

(a) The Nomination and Remuneration Committee shall consist of 3 or more non-executive directors.
(b) Not less than one-half of the members of Nomination and Remuneration Committee shall be independent directors.

(c) The chairperson of the company shall not be the chairperson of the Nomination and Remuneration Committee. However, the chairperson of the company may be appointed as a member of the Nomination and Remuneration Committee.

(d) Any director, whether executive or non-executive, may be appointed as the chairperson of the Nomination and Remuneration Committee.

3. Functions of Nomination and Remuneration Committee [Section 178(2), (3) and (4)]

(a) The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board their appointment and removal.

The expression 'senior management' means personnel of the company who are members of its core management team excluding Board of directors comprising all members of management one level below the executive directors, including the functional heads.

(b) It shall specify the manner for effective evaluation of performance of Board, its committees and individual directors.

Such evaluation may be carried out either by the Board, or by the Nomination and Remuneration Committee or by an independent external agency, as may be specified by the Nomination and Remuneration Committee. The Nomination and Remuneration Committee shall review its implementation and compliance.

(c) It shall formulate the criteria for determining qualifications, positive attributes and independence of directors.

(d) It shall recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.

(e) While formulating such policy, the Nomination and Remuneration Committee shall ensure that –

(i) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

(ii) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

(iii) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.

(f) Such policy shall be placed on the website of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the Board's report.

As per Notification No. G.S.R. 463(E) dated 5th June, 2015, in case of a Government company which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, sub-sections (2), (3) and (4) of section 178 shall not apply except with regard to appointment of 'senior management' and other employees.

4. Duty to attend the general meetings [Section 178(7)]

The chairperson of Nomination and Remuneration Committee or, in his absence, any other member of such committee authorised by him in this behalf shall attend the general meetings of the company.

5. Punishment for contravention [Section 178(8)]

In case of any contravention of the provisions of section 178, the punishment shall be as follows:

(i) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh.

(ii) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh, or with both.

The provisions of section 178 shall not apply to a company licenced u/s 8 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015].

Theoretical Questions from CA Examinations

Q 2.17A. Referring to the provisions of the Companies Act, 2013, answer the following:

(A) Which companies are required to constitute a 'Nomination and Remuneration Committee'?

(B) What is the composition of the above committee? [CA (Final) May 2015]

2.18 Stakeholders Relationship Committee (Section 178)

1. **Establishment of Stakeholders Relationship Committee by certain companies**

   Constitution of Stakeholders Relationship Committee is mandatory for every company having more than 1,000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year.

2. **Composition of Stakeholders Relationship Committee**

   (a) The Stakeholders Relationship Committee shall consist of a chairperson who shall be a non-executive director.

   (b) It shall have such other members as may be decided by the Board.

3. **Functions of Stakeholders Relationship Committee**

   The Stakeholders Relationship Committee shall consider and resolve the grievances of security holders of the company.

   Inability to resolve or consider any grievance by the Stakeholders Relationship Committee in good faith shall not constitute a contravention of this section.

4. **Duty to attend the general meetings**

   The chairperson of Stakeholders Relationship Committee or, in his absence, any other member of such committee authorised by him in this behalf shall attend the general meetings of the company.

The provisions of section 178 shall not apply to a company licenced u/s 8 if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 466(E) dated 5th June, 2015].

2.19 Powers of the Board (Section 179 and Rule 8)

Section 179 has given wide powers to the Board of directors by allowing them to exercise all the powers of the company except those powers which are reserved for the shareholders to be exercised at the general meetings. *In other words*, the powers of management are vested in the Board of directors. The powers of the Board may be explained as follows:

1. **General powers of the Board or Role of the Board**

   The general powers of the Board may be discussed as follows:

   (a) Supremacy of the Board, i.e. Powers exercisable by the Board. The Board is entitled to exercise all such powers as the company is authorised to exercise. Similarly, the Board is authorised to do all such acts and things as the company is authorised to do [Section 179(1)].

   The Companies Act, 2013 has established the Board as the supreme governing organ of a company. Accordingly, it may be said that the Board is the custodian of the interests of the company and its shareholders.

   (b) Limitations on supremacy of the Board. The supremacy of the Board is subject to the following two limitations:

   (i) Exercise of powers to be in conformity with certain provisions. The Board shall exercise its powers subject to the provisions of the Companies Act, 2013, memorandum or articles of the company or otherwise [First Proviso to section 179(1)].

   (ii) Powers not exercisable by the Board. The Board shall not exercise any power required to be exercised in general meeting, whether by the Companies Act, 2013, memorandum or articles of the company or otherwise [Second Proviso to section 179(1)].

   (c) No retrospective effect of regulations made in general meeting. Regulations made in a general meeting shall not invalidate any prior act of Board, which was otherwise valid [Section 179(2)]

2. Powers of the Board are co-extensive with the powers of the company

The Board of directors while exercising its powers does not act as an agent for the minority or even all the members, and so the members cannot by a resolution passed by a majority or even unanimously supersede the Board's powers, or instruct it as to how it shall exercise its powers. The powers of management are vested in the Board of directors. The Board alone can exercise such powers.

3. Division of powers amongst shareholders and directors

Shareholders are the ultimate owners of the company. However, they cannot interfere in day-to-day management of the company. Their decision making power is limited to the extent specified in the Companies Act, 2013.

Except where the law expressly provides that certain powers of a company are to be exercised only by the shareholders in general meeting, the Board is entitled to exercise all the powers of the company. Thus, overall control and supervision of affairs of the company lies in the hands of directors.

The Board has the absolute power to do all things other than those that are expressly required to be done by the company in general meeting.

4. Restrictions on powers of the Board

(a) The members are empowered to impose such restrictions and conditions (through the articles or by passing a resolution at a general meeting) on the exercise of any of the powers of the Board, as the members may deem fit.

(b) However, no such restriction shall invalidate any act done by the Board before such restriction was placed on their powers. It means that the restrictions can be imposed prospectively, but not retrospectively.

5. Supremacy of the Board

- The Board is the supreme body having the management of the company, *i.e.* the powers of management lies in the hands of Board of directors.
- The shareholders cannot interfere in the day to day management of the company.
- The shareholders cannot supersede or usurp the Board's powers, or instruct it as to how it shall exercise its powers.
- The powers of management are vested in the Board of directors. The Board alone can exercise such powers. Even a unanimous resolution of the shareholders will not enable the shareholders to exercise the powers of the Board.
- However, the shareholders shall be authorised to exercise all the powers of the Board in the following cases:
  (a) Where the Board has been acting *malafide*.
  (b) Where the Board is incompetent to act, *e.g.* where on a particular resolution, all the directors are interested, and so, quorum is not present for discussion and voting on such resolution.
  (c) If there is a deadlock in the Board, *i.e.* a situation of serious conflicts between the directors, such that no discussions take place and no resolutions are passed in any Board meeting.

6. Power to institute a suit

(a) Initiating legal proceedings is within the powers of the Board. Shareholders cannot question the decision of the Board to institute legal proceedings.

(b) A director, managing director or whole time director has no implied authority to institute legal proceedings on behalf of the company. A director may have such a power in any of the following ways:
- Authorisation by a resolution of the Board of directors.
- Where such a power is conferred upon him by the articles.
- Where he holds a power of attorney authorising him to institute a suit.

7. Board's power to ratify

(a) The Board can ratify all such acts and things done by others, which the Board could have done itself.

(b) However, the Board cannot ratify anything which the company in general meeting alone, by ordinary or special resolution, could have done. In such cases, the general meeting may ratify such acts and things, whether done by the Board or any committee of directors or any director or officer.

(c) An act which is *ultra vires*, cannot be ratified whether by the Board or by the members in general meeting.

8. Powers exercisable by passing a resolution at a Board meeting only

As per section 179(3), the Board shall exercise the following powers only by means of a resolution passed at a meeting of the Board:

(a) Power to make calls on shares.

(b) Power to authorise buy-back of securities under section 68.

Resolution for buy-back

As per section 68, the legal requirements for buy-back are as follows:

(a) The buy-back must be authorised by the articles.

(b) The buy-back must be authorised by a special resolution passed at a general meeting.

However, a company may buy-back its own securities without being authorised by a special resolution, if –

(i) the buy-back is upto 10% of aggregate of paid up equity share capital and free reserves; and

(ii) the buy-back is authorised by a resolution passed in a Board meeting.

(c) Power to issue securities, including debentures, whether in India or outside India.

(d) Power to borrow money.

(e) Power to invest the funds of the company.

(f) Power to grant loans or give guarantee or provide security in respect of loans.

In case of a company licenced u/s 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the matters referred to in clauses (d), (e) and (f) of section 179(3) may be decided by the Board by circulation instead of at a meeting [Notification No. G.S.R. 466(E) dated 5th June, 2015].

(g) Power to approve financial statement and the Board's report.

(h) Power to diversify the business of the company.

(i) Power to approve amalgamation, merger or reconstruction.

(j) Power to takeover a company or acquire a controlling or substantial stake in another company.

(k) Any other matter which may be prescribed.

As per Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014, the following powers shall be exercised by the Board by passing a resolution at a Board meeting only:

(1) Power to make political contributions.

(2) Power to appoint or remove key managerial personnel (KMP).

(3) Power to appoint internal auditors and secretarial auditor.

1. **Filing of Board resolution**

   Any resolution passed by the Board at a Board meeting exercising any of the powers enumerated under section 179(3) read with Rule 8 shall be filed with the Registrar in Form MGT 14 within 30 days of passing of such Board resolution [Section 117(3)(g)].

2. **Section 179(3) is not exhaustive**

   Apart from section 179(3), other provisions of the Act also require exercise of certain powers at a Board meeting only, *e.g.* power of the Board to fill casual vacancy in the office of director [Section 161(4)].

9. Delegation of powers

As per proviso to section 179(3), the Board may delegate the powers referred to in (d), (e) and (f) above, subject to the following conditions:

(a) Manner of delegation. The delegation shall be made by passing a resolution at a Board meeting only.

(b) Delegation to whom. These powers may be delegated to –

- Committee of directors
- Managing director
- Manager
- Principal officer of the company
- Principal officer of the branch office.

No restriction on power of the principal officer of branch office to borrow money

Section 179 is silent as to the purpose for which the moneys borrowed by the principal officer of the branch office shall be utilised. Therefore, in the opinion of the Author, where the power to borrow money is to be delegated to the principal officer of the branch office, it is not necessary that such borrowings must be related to the requirements of such branch office.

However, a contrary view has been taken in the Practice Manual for November, 2016 Exams issued by the Board of Studies, ICAI. As per the Practice Manual, the power to borrow monies on behalf of the company cannot be delegated to a branch officer (principal officer of the branch) unless the borrowing is related to the requirements of the functioning of the branch office.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

(c) ***Delegation subject to conditions.*** The Board may delegate such powers subject to such conditions as it may deem fit. For example, the resolution passed at the Board meeting *may* specify –

Where powers under section 179(3)(d) are delegated	*Where powers under section 179(3)(e) are delegated*	*Where powers under section 179(3)(f) are delegated*
The total amount outstanding at any one-time upto which moneys may be borrowed.	(a) The total amount upto which funds may be invested. (b) The nature of investments that may be made.	(a) The total amount upto which loans may be granted, or guarantee may be given or security may be provided. (b) The purpose for which loans may be made, or guarantee may be given or security may be provided.

No delegation of power to make loans, give guarantee or security or make investment in certain cases

Proviso to section 179(3) entitles the Board to delegate the power to make loans, give guarantee or security or make investment. However, section 186 requires that the resolution for making loans, giving guarantee or security or making investment shall be passed in a Board meeting only.

Section 186 shall over-ride the proviso to section 179(3). Accordingly, where section 186 is attracted, the power to make loans, giving guarantee or security or making investment shall not be delegated.

10. Provisions applicable to a banking company

(a) Acceptance of deposits of money from the public by a banking company shall not be deemed to be 'borrowing of money', whether such money is repayable on demand or otherwise.

(b) Borrowings by a banking company from any other banking company or from the Reserve Bank of India, the State Bank of India or any other bank established by or under any Act shall not be deemed to be 'borrowing of money'.

(c) Deposit of money by a banking company with another banking company shall not be deemed to be 'making of loans'.

11.Meaning of 'borrowing of money' in case of overdraft etc.

In respect of dealings between a company and its bankers, 'borrowing of money' shall mean the arrangement made by the company with its bankers for the borrowing of money by way of overdraft or cash credit or otherwise and not the actual day-to-day operation on overdraft, cash credit or other accounts by means of which the arrangement so made is actually availed of.

1. **Decisions by majority**
   Unless otherwise provided by the Act, questions arising at any Board meeting shall be decided by a majority of votes (Regulation 68 of Table F).
2. **Delegation of powers by the Board**
   As per section 179(1), all the powers of the company (except those powers as are required to be exercised in the general meeting) may be exercised by the Board. The Board shall exercise such powers collectively. However, such powers may be delegated by the Board to a committee of directors, the managing director or any other office or employee of the company, unless such powers are required to be exercised in Board meeting only.
3. **Power to alter the articles**
   The Board has no power to alter the articles. The shareholders alone have the power to alter the articles by passing a special resolution (Section 14).
4. **Member's injunction**
   A member of the company may apply to the Court for obtaining an injunction to restrain the Board from acting beyond its powers.

Theoretical Questions

Q 2.19A. Out of the powers exercisable by the Board under section 179, the Board wants to delegate to the managing director of the company the power to borrow monies otherwise than on debentures. Advise whether such a delegation is possible? Would your answer be different, if the delegation is given to the manager or any other principal officer including a branch officer of the company?

[ICAI, Questions for Practice]

Practical Problems from CA Examinations

Certain powers exercisable by the Board or not – A few cases

P 2.19A. Advise the Board of directors of a public company about their powers in respect of the following proposals explaining the relevant provisions of the Companies Act, 2013:

Buy-back of shares of the company upto 10% of the paid up equity share capital. [CA (Final) May 2003 (Modified)]

OR

Advise the Board of directors to Spectra Papers Limited regarding validity and extent of their powers, under the provisions of the Companies Act, 2013 in relation to buy-back of the shares of the company upto 10% of the paid up equity share capital without passing a special resolution. [CA (Final) May 2010 (Modified)]

Ans. As per section 179(1), the Board is entitled to exercise all such powers as the company is authorised to exercise. Similarly, the Board is authorised to do all such acts and things as the company is authorised to do. However, the provisions of section 179(1) are subject to the other provisions of the Companies Act, 2013 (e.g. Sections 179(3), 180, 181 and 182 of the Companies Act, 2013).

The Board shall exercise the powers mentioned under section 179(3) only by means of a resolution passed at a meeting of the Board. Among other powers, the power to buy-back as referred to in section 68 is also included in section 179(3).

As per section 68(2), no company shall buy-back its own shares or other specified securities, unless –

(a) the buy-back is authorised by the articles; and

(b) a special resolution is passed at a general meeting authorising such buy-back.

However, a company may buy-back its own shares or other specified securities without being authorised by a special resolution, if –

(i) the buy-back is 10% or less of aggregate of paid up equity share capital and free reserves; and

(ii) the buy-back is authorised by a resolution passed in a Board meeting.

Therefore, in the present case, the Board is authorised to buy-back the shares of the company upto 10% of the paid up equity share capital, provided the resolution authorising the buy-back is passed at a Board meeting and not by circulation.

Legal effect of borrowings made by a director without any authorisation

P 2.19B. A is the Director of M & Co. Ltd. A has borrowed Rs. 50/- lacs on reasonable terms from X for company's benefit and business. A has no power to borrow. What will be the legal position? Please explain. [CA (Final) Nov. 2010]

Ans. As per section 179(3), the power to borrow money shall be exercised by the Board at a Board meeting. However, such power may be delegated by the Board, subject to the following:

(a) The power to borrow money may be delegated to a committee of directors, managing director, manager, a principal officer of the company or a principal officer of the branch office.

(b) The delegation of power is made by passing a resolution at a Board meeting.

(c) The Board may delegate such powers subject to such conditions as it may deem fit.

A director is a principal officer of the company. Thus, as per section 179(3), the power to borrow money may be delegated to any director of the company.

Whether the power to borrow money has been delegated by the Board or not, is a question of fact. However, if a director acting on behalf of the company, borrows money even though he is not authorised to borrow money on behalf of the company, then, any *bonafide* lender may take the benefit of doctrine of indoor management, and enforce the recovery of such money.

This is so, because borrowing of money falls within the implied or ostensible authority of a director, and so the outsiders dealing with the company are entitled to assume that every director is authorised to borrow money on behalf of the company.

The company shall be held liable if the money borrowed by the Board is used for the benefit of the company. Even if the director borrowing the money was not so authorised, the company shall be liable to repay, if it is shown that the money has gone into the hands of the company **[*Lakshmi Rattan Cotton Mills Co. Ltd.* v *J. K. Jute Mills Co. Ltd.* (1957) 27 Comp Cas 660]**.

2.20 Restrictions on powers of the Board (Section 180)

Section 180 imposes certain restrictions on the powers of the Board. As per Section 180, the Board of directors of a company shall exercise the following powers only with the consent of the company by a special resolution:

(a) Sell, lease or otherwise dispose of the whole, or substantially the whole, of one or more undertakings of the company [Section 180(1)(a)].

1. **Meaning of 'undertaking'**

   'Undertaking' means –

   (a) an undertaking in which the investment of the company is more than 20% of its net worth as per the audited balance sheet of the preceding financial year; or

   (b) an undertaking which generates 20% of the total income of the company during the previous financial year.

2. **Meaning of 'net worth'**

   As per Clause (57) of Section 2, 'net worth' means the aggregate value of the paid up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

3. **Meaning of 'substantially the whole of the undertaking'**

   'Substantially the whole of the undertaking' shall mean 20% or more of the value of the undertaking as per the audited balance sheet of the preceding financial year.

4. **Discretion of members to impose conditions**

   The special resolution passed at the general meeting may stipulate the conditions regarding the use, disposal, or investment of the sale proceeds, which may result from the transaction.

5. **Effect of contravention on title of buyer or lessee**

   Where a buyer or a lessee exercises due care and caution, and buys or takes a lease of the undertaking of the company in good faith, his title shall not be affected even if the Board sells or grants the lease without obtaining any authorisation by way of a special resolution, *i.e.* the title of a *bonafide* buyer or lessee shall be free from any defect.

6. **Non-applicability**

   No approval by way of a special resolution is required if the ordinary business of the company consists of selling or leasing of properties.

7. **Postal ballot – mandatory**

   A company shall, instead of passing the special resolution in the general meeting, pass the special resolution by postal ballot, if the provisions of section 110 are applicable to such company.

(b) Invest the compensation received by the company as a result of any merger or amalgamation [Section 180(1)(b)].

The consent of the members is not required if the compensation received by the company is invested in the trust securities as specified under section 20 of the Indian Trust Act.

(c) Borrow moneys, if money already borrowed, together with moneys to be borrowed will exceed the aggregate of paid up share capital, free reserves and securities premium account [Section 180(1)(c)].

1. **What does not amount to borrowings?**

   Temporary loans obtained from the company's bankers in the ordinary course of business are not considered as borrowings.

2. **Meaning of 'temporary loans'**

   'Temporary loans' means –

   – loans repayable on demand; or

   – loans repayable within 6 months of the date of the loan.

   However, 'temporary loans' does not include loans raised for financing capital expenditure.

3. **Meaning of 'free reserves'**

   The term 'free reserves' has been defined under Clause (43) of Section 2, as follows:

   'Free reserves' means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend.

   Provided that –

   (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

   (ii) any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

   shall not be treated as free reserves.

4. **Mandatory for members to specify the overall limit**

   The special resolution passed by the members shall specify the total amount upto which moneys may be borrowed by the Board; otherwise such special resolution shall be void. Therefore, it is evident that the members cannot grant an unlimited power to the directors to borrow money.

5. **Ratification of excess borrowings**

   If the Board borrows money in excess of the limits imposed under section 180(1)(c), the members may ratify such excess borrowings.

6. **Effect of contravention on lender**

   Any borrowings in contravention of this section cannot be enforced by the lender unless he proves that he advanced the loan in good faith and without knowledge that the limit imposed under this section had been exceeded.

7. **Provisions applicable in case of a banking company**

   In case of a banking company, accepting deposits from the public does not amount to 'borrowing'.

(d) Remit, or give time for, the repayment of any debt due by a director [Section 180(1)(d)].

The provisions of section 180 shall not apply to a private company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 464(E) dated 5th June, 2015].

Theoretical Questions from CS Examinations

Q 2.20A. *What powers the Board of directors can exercise subject to approval at the general meeting?* [CS (Final) Dec. 1997]

Q 2.20B. *What items are normally excluded from the borrowing powers of the Board of directors?* [CS (Final) June 2001]

Practical Problems from CA Examinations

Extension of time for repayment of a loan payable by a director – Legal Requirements and drafting of notice of general meeting for this purpose

P 2.20A. Big Ben Ltd, a reputed public company, had advanced certain sum of money to one of its directors, namely Mr. Tanmay on certain terms and conditions and fixing the time limit for repayment thereof. Now, Mr. Tanmay has approached the company with a request to extend the time limit for repayment of balance of loan amounting to Rs. 12 Lakhs by another six months. Who is authorized to grant the extension as requested by Mr. Tanmay? [CA (Final) June 2009, May 2012]

Ans. The given problem relates to section 180(1)(d) of the Companies Act, 2013.

Section 180 contains certain powers which the Board may exercise, but only after obtaining the consent of the members by passing a special resolution. Clause (d) of sub-section (1) of section 180 specifies one of such powers, which is as follows:

"To remit, or give time for the repayment of any debt due by a director."

Thus, it is evident that if it is desired to remit or give time for the repayment of any debt due by a director, the Board is required to exercise such power, but the Board shall have to obtain the consent of the members by way of a special resolution.

In the given case, the proposal is to extend the time limit for repayment of loan of Rs. 12 lakhs payable by Mr. Tanmay, a director of the company. The unpaid amount of Rs. 12 lakhs amounts to a debt payable by the director. So, this case is covered under section 180(1)(d). Therefore, such extension can be granted by the Board, but with the consent of the members by way of a special resolution passed in general meeting.

Borrowings by Board exceeding paid up share capital, free reserves and securities premium account – Requirements of resolution passed by shareholders

P 2.20B. The paid up share capital and free reserves of XYZ Co. Ltd., a public company is Rs. 100 crores as on 1st April, 2014. The shareholders of the company at their general meeting held on 4th April, 2014, by a special resolution authorised the Board of directors of the company to borrow money 'exceeding the paid up share capital and free reserves of the company, to the extent required by the Board of directors'. The Board of directors as a result borrowed money to an extent of Rs. 130 crores, including Rs. 20 crores as short-term loan and Rs. 25 crores as temporary loan for financing the construction of a building of the company. Referring to the provisions of the Companies Act, 2013 examine the validity of the following:

(i) The Board's exercising the powers for borrowing money to an extent of Rs. 130 crores?

(ii) What would be your answer in case the company's paid up share capital and free reserves increased to Rs. 150 crores and the Board of directors borrow money to an extent of Rs. 140 crores which neither include any short-term loan nor temporary loan for financing of the construction of a building of the company? [CA (Final) May 1998]

Ans. As per section 180(1)(c), without the prior consent of the members in general meeting by way of a special resolution, the Board of directors of a company shall not borrow moneys where the borrowings (already made plus proposed) exceed the aggregate of the paid up share capital, free reserves and securities premium account. The total amount upto which moneys may be borrowed by the Board of directors must be specified in the special resolution passed by the company in the general meeting. However, temporary loans obtained from the company's bankers in the ordinary course of business shall not be considered as borrowings.

'Temporary loans' means loans repayable on demand or *within 6 months* from the date of the loan. But loans raised for the purpose of financial expenditure of a capital nature shall not be treated as temporary loans and will be included in borrowings.

The given case may be discussed as follows:

(i) In the first case, the aggregate of paid up share capital, free reserves and securities premium account amounts to Rs. 100 crores. The directors have borrowed Rs. 130 crores out of which 20 crores is not to be considered as borrowings since it amounts to temporary loan in terms of section 180(1)(c), assuming that this amount of Rs. 20

crores has been borrowed from the company's bankers in the ordinary course of business. Also included in Rs. 130 crores, is an amount of Rs. 25 crores which has been borrowed for financing the construction of building (*i.e.* for financing capital expenditure), and so, this amount of Rs. 25 crores does not amount to temporary loan in terms of section 180(1)(c), and therefore, it shall be included in the borrowings.

The Board could borrow money exceeding Rs. 100 crores only with the consent of the shareholders in general meeting by way of a special resolution. Moreover, the special resolution passed at the general meeting must specify the total amount upto which moneys could be borrowed by the Board of directors. It is evident that the special resolution passed by the members in the general meeting does not specify the total amount that could be borrowed by the Board and is thus defective. Therefore, the borrowings made by the Board is violative of provisions of section 180(1)(c) of the Companies Act, 2013.

(ii) In the second case, the paid up share capital, free reserves and securities premium account of the company amount to Rs. 150 crores. As such, the Board can borrow money upto Rs. 150 crores without the consent of the members in the general meeting by way of a special resolution.

Since an amount of Rs. 140 crores only has been borrowed by the Board, borrowings are well within the limits specified under section 180(1)(c) of the Companies Act, 2013 and therefore the exercise of borrowing powers by the Board is valid.

The maximum permissible borrowings permissible without the approval of shareholders

P 2.20C. The last three years' Balance Sheets of RBS Ltd. contains the following information and figures:

	As at 31.03.2002 (Rs.)	As at 31.03.2003 (Rs.)	As at 31.03.2004 (Rs.)
Paid up Capital	50,00,000	50,00,000	75,00,000
General Reserve	45,00,000	50,00,000	60,00,000
Debenture Redemption Reserve	15,00,000	20,00,000	25,00,000
Secured Loans	10,00,000	15,00,000	30,00,000
Net Profit for the year	12,50,000	19,00,000	34,50,000

In the ensuing Board Meeting scheduled to be held on 5th November, 2004, among other items of agenda, following item is also appearing:

"To decide about borrowing from financial institutions on long-term basis."

Based on above information, you are required to find out as per the provisions of the Companies Act, 2013 the amount upto which the Board can borrow from financial institutions without seeking the approval in general meeting. [CA (Final) *Nov. 2004*]

Ans. As per section 180(1)(c) of the Companies Act, 2013, without the prior consent of the members in the general meeting by a special resolution, the Board of directors of a company shall not borrow moneys where the borrowings (already made plus proposed) exceed the aggregate of the paid up share capital, free reserves and securities premium account. However, temporary loans obtained from the company's bankers in the ordinary course of business shall not be considered as borrowings.

'Temporary loans' means loans repayable on demand or *within 6 months* from the date of the loan. But loans raised for the purpose of financial expenditure of a capital nature shall not be treated as temporary loans and will be included in borrowings.

In the given case, the aggregate of paid up share capital, free reserves and securities premium account comes to Rs. 1,35,00,000. It is to be noted that 'net profit for the year' amounting to Rs. 34,50,000 would already have been added while arriving at the figure of 'General Reserve', and accordingly, it shall not be again added at the time of determining the aggregate of paid up share capital, free reserves and securities premium account. Debenture Redemption Reserve is not free for distribution of dividend and is therefore not considered as free reserves.

The borrowings already made by the company is Rs. 30,00,000. Therefore, without requiring any consent of shareholders, the long term borrowings from financial institutions shall not exceed a sum of Rs. 1,05,00,000. However, fresh borrowings exceeding Rs. 1,05,00,000 may be made without the consent of the members by a special resolution, provided such borrowings qualify as 'temporary loans' obtained from the company's bankers in the ordinary course of business. It has been assumed that secured loan of Rs. 30,00,000 (as on 31.3.2004) is not a temporary loan obtained from the company's bankers in the ordinary course of business.

Illegal borrowings by the Board – Consequences

P 2.20D. The Board of directors of Stepping Stones Publications Ltd. at a meeting held on 15.1.2001 resolved to borrow a sum of Rs. 15 crores from a nationalised bank. Subsequently the said amount was received by the company. One of the directors, who opposed the said borrowing as not in the interest of the company has raised an issue that the said borrowing is outside the powers of the Board of directors. The company seeks your advice and the following data is given for your information:

(i) Share capital: Rs. 5 crores

(ii) Reserves and surplus: Rs. 5 crores

(iii) Secured loans: Rs. 15 crores

(iv) Unsecured loans: Rs. 5 crores

Advise the management of the company. **[CA (Final) May 2001]**

Ans. As per section 180(1)(c) of the Companies Act, 2013, without the prior consent of the members in general meeting by a special resolution, the Board shall not borrow money if moneys already borrowed, together with moneys to be borrowed will exceed the aggregate of the paid up share capital, free reserves and securities premium account of the company. Any borrowings in contravention of this section cannot be enforced by the lender unless he proves that he advanced the loan in good faith and without knowledge that the limit imposed under this section had been exceeded.

In the present case the aggregate of paid up share capital, free reserves and securities premium account amount to Rs. 10 crores. But, the company has borrowed Rs. 20 crores (*i.e.* exceeding the limit of Rs. 10 crores), without the consent of members by a special resolution. Therefore, the borrowings have been made by the Board without proper authority. However, the members have the power to ratify those acts of the Board which are *intra vires* the company even though such acts are beyond the powers of the Board. Accordingly, the Board should take steps to convene a general meeting and the members may ratify the excess borrowings by passing a special resolution. On such ratification, the borrowings will become valid and binding on the company.

If the members do not ratify the acts of the Board, the position will be as follows:

- The debt incurred by the company in excess of the limits imposed by section 180(1)(c) of the Companies Act, 2013 shall not be valid or effectual, unless the lender proves that he advanced the loan in good faith and without knowledge that the limit imposed had been exceeded [Section 180(5) of the Companies Act, 2013].
- The company shall be held liable if the money borrowed by the Board is used for the benefit of the company. Even if the borrowing is unauthorised, the company will be liable to repay, if it is shown that the money has gone into the hands of the company **[*Lakshmi Rattan Cotton Mills Co. Ltd.* v *J.K. Jute Mills Co. Ltd.* (1957) 27 Comp Cas 660]**.
- The directors may be held personally liable in damages to the lender, on the ground of breach of implied warranty of authority.

Eligibility for borrowings by the managing director

P 2.20E. The Balance Sheet of International Operators Ltd. as at 31-03-2014 discloses the following position:

	Rs. (in crores)
Share Capital	100
Reserves & Surplus	300
Secured Loans	150
Unsecured Loans	100
Current Liabilities	70

Mr. X, the Managing Director of the company approaches the Royal Bank for a secured loan of Rs. 600 crores to finance the new projects to be taken up shortly. The Bank seeks your advice whether it can grant the loan of Rs. 600 crores on the application of Mr. X. Advise the Royal Bank having regard to the provisions of the Companies Act, 2013. **[CA (Final) May 2011 (Modified)]**

Ans. The given problem relates to section 179 and 180 of the Companies Act, 2013.

As per section 179(3)(d) of the Companies Act, 2013, the power relating to borrowing of money shall be exercised by the Board by passing a resolution at a Board meeting only. However, as per First Proviso to Section 179(3), such power may be delegated by the Board, subject to the following 3 *conditions*:

(a) Such power may be delegated to a committee of directors, managing director, manager, a principal officer of the company or a principal officer of the branch office.

(b) The delegation of power can be made by the Board by passing a resolution at a Board meeting only.

(c) The Board may delegate such power subject to such conditions as it may deem fit.

As per section 180(1)(c) of the Companies Act, 2013, consent of the company by way of a special resolution shall be required for borrowing of money if moneys already borrowed, together with moneys to be borrowed will exceed the aggregate of paid up share capital, free reserves and securities premium account of the company. However, temporary loans obtained from the company's bankers in the ordinary course of business shall not be considered as borrowings.

In the given case, the aggregate of paid up share capital, free reserves and securities premium account comes to Rs. 400 crores (Rs. 100 crores + Rs. 300 crores). The company has already borrowed Rs. 250 crores (Rs. 150 crores + Rs. 100 crores). It has been assumed that secured loans of Rs. 150 crores and unsecured loans of Rs. 100 crores are not temporary loans. Current liabilities shall not be included in the amount already borrowed. Thus, the Board is entitled to borrow Rs. 150 crores only without obtaining the consent of the company by way of a special resolution.

The aggregate of the amount already borrowed (Rs. 250 crores) and the amount proposed to be borrowed (Rs. 600 crores) would exceed the aggregate of paid up share capital, free reserves and securities premium account (Rs. 400 crores). Therefore, the Board is entitled to borrow Rs. 600 crores only after obtaining the consent of the company by way of a special resolution.

Accordingly, our advice to the Royal Bank is as follows:

(a) The Bank should ensure that the Board has obtained the consent of the company by way of a special resolution. The special resolution must specify the maximum amount upto which moneys may be borrowed by the Board, and the amount so specified must be Rs. 850 crores or more [Section 180(1)(c) of the Companies Act, 2013].

(b) The Bank should ensure that the power to borrow money has been delegated to the managing director by passing such resolution in Board meeting only [First Proviso to Section 179(3) of the Companies Act, 2013].

(c) Since the loan to be made by Royal Bank is a secured loan, a charge shall be created on some asset or property or undertaking of International Operators Ltd. So, Royal Bank should ensure that the particulars of the charge are filed by International Operators Ltd. within 30 days of creation of charge [Section 77 of the Companies Act, 2013].

Borrowings by the Board – Whether approval of members is required?

P 2.20F. Following is data relating to Prince Company Limited:

Authorised Capital (Equity Shares)	-	**Rs. 100 crores**
Paid up Share Capital	-	**Rs. 40 crores**
General Reserves	-	**Rs. 20 crores**
Debenture Redemption reserve	-	**Rs. 10 crores**
Provision for Taxation	-	**Rs. 5 crores**
Loan (Long Term)	-	**Rs. 10 crores**
Short-Term Creditors	-	**Rs. 3 crores**

Board of Directors of the company by a resolution passed at its meeting decide to borrow an additional sum of Rs. 90 crores from the company's Bankers. You being the company's financial advisor, advise the Board of Directors the procedure to be followed as required under the Companies Act, 2013. [CA (Final) Nov. 2014]

Ans. The given problem relates to section 180(1)(c) of the Companies Act, 2013.

As per section 180(1)(c) of the Companies Act, 2013, without the prior consent of the members in general meeting by a special resolution, the Board of directors of a company shall not borrow moneys where the borrowings (already made plus proposed) exceed the aggregate of the paid up share capital, free reserves and securities premium account. However, temporary loans obtained from the company's bankers in the ordinary course of business shall not be considered as borrowings.

In the given case, paid up share capital of the company is Rs. 40 crores and free reserves are Rs. 20 crores. Debenture Redemption Reserve and Provision for Taxation are not free reserves. The aggregate of paid up share capital, free reserves and securities premium account comes to Rs. 60 crores. The company has already borrowed Rs. 10 crores. The amount payable to creditors (Rs. 3 crores in the given case) does not amount to borrowings. Thus, further borrowings by the Board, without obtaining the consent of the members by way of a special resolution, shall not exceed Rs. 50 crores. Since, the Board intends to borrow Rs. 90 crores, prior approval of the members by way of a special resolution is required. The special resolution passed by the members shall specify the total amount upto which moneys may be borrowed by the Board.

Can the members usurp the powers vested in the directors?

P 2.20G. M/s ABC Ltd. had power under its memorandum to sell its undertaking to another company having similar objects. The Articles of the company contained a provision by which directors were empowered to sell or otherwise deal with the property of the company. The Shareholders passed a special resolution for the sale of its assets on certain terms and required the directors to carry out the sale. The Directors refused to comply with the wishes of the shareholders where upon it was contended on behalf of the shareholders that they were the principal and directors being their agents were bound to give effect to their decision. Based on the above facts, decide the following issues, having regard to the provisions of the Companies Act, 2013.

(i) Whether the contention of shareholders against the non-compliance of their wishes by the directors is tenable?

(ii) Can shareholders usurp the powers which by the articles are vested in the directors by passing a special resolution?

[CA (Final) Nov. 2007 (modified)]

OR

One of the Objects Clauses of the Memorandum of Association of Info Company Limited conferred upon the company power to sell its undertaking to another company with identical objects. Company's Articles also conferred upon the directors whereby power was conferred upon them to sell or otherwise deal with the property of the company. At an Extraordinary General Meeting of the company, members passed a special resolution for the sale of its assets on certain terms and authorized the directors to carry out the sale. Directors refused to comply with the wishes of the members where upon it was contended on behalf of the members that they were the principals and directors being their agents, were bound to give effect to their (members') decisions. Examining the provisions of the Companies Act, 2013, answer the following:

(i) Whether the contention of members against the non-compliance of members' decision by the directors is tenable?

(ii) Whether it is possible for the members to usurp the powers which by the Articles are vested in the directors by passing a resolution in the general meeting? [CA (Final) Nov. 2015]

Ans. The given problem relates to section 180(1)(a) of the Companies Act, 2013.

The legal position

1. As per Section 180(1)(a), the Board of directors of a company shall exercise the power to sell, lease or otherwise dispose of the whole, or substantially the whole, of one or more undertakings of the company only with the consent of the company by a special resolution.

The given case and analysis of the case

2. The members have passed a special resolution for sale of assets of the company, and require the Board to implement the same. The Board has refused to act on the special resolution passed by the members.
3. The language used in section 180(1)(a) makes it evident that the Board cannot, on its own, decide to sell the undertaking of the company, since before such sale, the consent of the members must be obtained by passing a special resolution. Thus, sale of undertaking requires at the first place, approval by the Board of directors, and then the consent of the members by passing a special resolution.
4. Where the Board has not approved the decision to sell the undertaking of the company, and the members have passed a special resolution for sale of undertaking of the company, such special resolution does not have any force of law, since the decision to sell the undertaking in such case has not been first approved by the Board of directors. Therefore, such special resolution is not binding on the Board of directors.
5. The members, even if acting unanimously, cannot supersede the Board of directors or instruct the directors as to how they shall exercise the powers vested in them. Accordingly, the members have no authority to pass a resolution for sale of the undertaking of the company, and require the Board to implement it.
6. The contention of the members that the members are the principal and the directors are the agents, is not correct. The directors are the agent of the company, and not of the members.

Conclusions

(i) The contention of the members that the Board is bound to sell the undertaking of the company as per the decision taken by the members, is not correct.

(ii) Though the members are empowered to alter the articles and make regulations in the general meeting so as to regulate and restrict the powers of the Board, yet the members cannot usurp the powers vested in the Board of directors. The powers of the directors can be exercised by the directors alone. The members cannot supersede the Board of directors or instruct the directors as to how they should exercise their powers.

Nature of resolution required for exercising the borrowing powers under 3 different case scenarios

P 2.20H. The following information is provided in respect of M/s. Fortune Limited under three different case scenarios on the borrowing powers of the Board of directors of the company. Mr. Murli, the CFO seeks your advice with explanations as to the nature of resolution which needs to be passed under each of the case scenarios as per the provisions of section 180(1)(c) of the Companies Act, 2013.

Detailed workings should form part of your answer.

Particulars	Case I (Rs. in Crores)	Case II (Rs. in Crores)	Case III (Rs. in Crores)
Equity Share Capital (Paid- up)	150	150	150
Preference Share Capital (Paid-up)	50	50	50
Securities Premium Account	50	50	50
Free Reserves	20	20	20
Total:	270	270	270
Working Capital Loan (repayable on demand-Existing) from Sigma Capital Limited	50	50	50
Cash Credit Limit from a scheduled bank (repayable on demand-Existing)	120	120	120
6 months loan for purchase of Plant & Machinery from scheduled bank-(proposed)	30	40	130
24 months loan for purchase of Plant & Machinery from scheduled bank- (proposed)	10	20	150
Total	210	230	450

[CA (Final) May 2019]

Ans. As per section 180(1)(c) of the Companies Act, 2013, without the prior consent of the members in the general meeting by a special resolution, the Board of directors of a company shall not borrow moneys where the borrowings (already made plus proposed) exceed the aggregate of the paid up share capital, free reserves and securities premium account. However, temporary loans obtained from the company's bankers in the ordinary course of business shall not be considered as borrowings.

'Temporary loans' means loans repayable on demand or *within 6 months* from the date of the loan. But loans raised for the purpose of financial expenditure of a capital nature shall not be treated as temporary loans and will be included in borrowings.

Paid up share capital shall include paid up equity share capital as well as paid up preference share capital.

The information given in the question is presented in the following format so as to determine the nature of resolution required:

Particulars	**Case I (Rs. in crores)**	**Case II (Rs. in crores)**	**Case III (Rs. in crores)**
Equity Share Capital (Paid- up)	150	150	150
Preference Share Capital (Paid-up)	50	50	50
Paid up share capital (*i.e.* Paid-up Equity Share Capital + Paid up Preference Share Capital)	200	200	200
Free reserves	20	20	20
Securities Premium Account	50	50	50
Aggregate of paid up share capital, free reserves and securities premium account –	270	270	270
Borrowings already made for the purpose of section 180(1)(c): Working Capital Loan from Sigma Capital Limited (It shall be included in 'borrowings' since it has not been obtained from company's bankers)	50	50	50
Borrowings already made for the purpose of section 180(1)(c): Cash Credit Limit from a Scheduled Bank repayable on demand (It shall not be included in 'borrowings' since it is temporary loan obtained from company's bankers, assuming that the Scheduled Bank from whom Cash Credit Limit is availed is the Company's Banker)	Nil	Nil	Nil
Borrowings proposed to be made for the purpose of section 180(1)(c): 6 months loan for purchase of Plant and Machinery from Scheduled Bank (It shall be included in 'borrowings' since such loan is to be utilised for financing capital expenditure)	30	40	130
Borrowings proposed to be made for the purpose of section 180(1)(c): 24 months loan for purchase of Plant and Machinery from Scheduled Bank (It shall be included in 'borrowings' since such loan is to be utilised for financing capital expenditure and also because the loan is repayable after 6 months)	10	20	150
Borrowings already made and borrowings proposed to be made for the purpose of section 180(1)(c)	90	110	330
Whether 'borrowings already made and borrowings proposed to be made for the purpose of section 180(1)(c)' exceeds 'the aggregate of the paid up share capital, free reserves and securities premium account'	No	No	Yes
Whether the consent of the members by way of a special resolution is required for exercising the borrowing powers?	No	No	Yes

Conclusions:

(a) In Case I and Case II, section 180(1)(c) is not attracted, and so consent of the members by way of a special resolution is not required. But, as per section 179(3), the power to borrow money shall be exercised by the Board by passing a resolution in a Board meeting. However, as per proviso to section 179(3), the Board may delegate the power to borrow money subject to the following conditions:

  (i) The delegation shall be made by passing a resolution at a Board meeting only.

  (ii) The power may be delegated to Committee of directors, managing director, manager, principal officer of the company or principal officer of the branch office.

(b) In Case III, the consent of the members by way of a special resolution shall be required before obtaining loan of Rs. 280 crore (being Rs. 130 crore for loan for 6 months and Rs. 180 crore for loan for 24 months). However, if the company decides to first obtain only one loan (whether loan of Rs. 130 crore for 6 months or loan of Rs. 180 crore for 24 months), consent of the members by way of a special resolution shall not be required for obtaining such loan, but the consent of the members by way of a special resolution shall be required subsequently for obtaining the second loan.

  For obtaining the loan of Rs. 130 crore as well as of Rs. 180 crore, a resolution in the Board meeting shall be required in terms of section 179(3). However, such power may be delegated in accordance with proviso to section 179(3), as explained above.

Advanced Practical Problems

'Relevant date' for reckoning borrowings

P 2.20I. Consider the following information:

(a) Aggregate of paid up share capital, free reserves and securities premium account: Rs. 100 crore

(b) Moneys already borrowed as on 31.03.2014: Rs. 70 crore

(c) Moneys already borrowed as on 14.11.2014: Rs. 80 crore

As on 14.11.2014, you are required to determine the maximum amount that may be borrowed without requiring a special resolution?

Ans. As per section 180(1)(c), a special resolution is required if the moneys already borrowed along with the moneys proposed to be borrowed exceed the aggregate of paid up share capital, free reserves and securities premium account.

Section 180 does not expressly state as to whether the 'moneys already borrowed' shall be taken as at the date of latest balance sheet or as at the date when the company proposes to borrow more money. In the opinion of the Author, the use of the words 'moneys already borrowed' makes it clear that all the moneys borrowed should be considered and not only moneys borrowed upto the date of latest balance sheet.

In the given case, the aggregate of paid up share capital, free reserves and securities premium account is Rs. 100 crores. Moneys already borrowed is Rs. 80 crore. Therefore, the Board may, without requiring a special resolution, borrow a maximum of Rs. 20 crores.

The Author's interpretation of the words 'moneys already borrowed' as explained above differs from the interpretation given in the Practice Manual for November, 2016 Exams (Question No. 21, Chapter No. 5) issued by the Board of Studies, ICAI.

As per the Practice Manual, 'moneys already borrowed' shall mean the moneys borrowed as per the latest Balance Sheet.

However, in the opinion of the Author, the words 'moneys already borrowed' shall mean all moneys borrowed as on the date when fresh borrowings are proposed by the company. But, if in some question, the figure of 'moneys already borrowed' as on the date when fresh borrowing are proposed by the company, is not given, and the figure of 'moneys already borrowed' as on the date of latest Balance Sheet is given, the students should assume that there was no change in the 'moneys already borrowed' as on the date of latest Balance Sheet and the date when borrowing are proposed by the company.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

2.21 Company to contribute to bonafide and charitable funds, etc. (Section 181)

1. Charitable contribution permitted

The Board of directors of a company may contribute to *bonafide* charitable and other funds.

2. Limit on charitable contribution

Prior permission of the company in the general meeting shall be required (*i.e.* an ordinary resolution is required to be passed in the general meeting) if the charitable contribution exceeds 5% of average net profits during immediately preceding 3 financial years.

Section 181 applies to all companies, whether public or private.

Practical Problems from CA Examinations

Computation of maximum amount of borrowings and charitable contribution by the Board without seeking approval in general meeting

P 2.21A. The last three years' balance sheets of PTL Ltd. contain the following information and figures:

	As at 31.03.2003 (Rs.)	*As at 31.03.2004 (Rs.)*	*As at 31.03.2005 (Rs.)*
Paid up capital	50,00,000	50,00,000	75,00,000
General Reserve	40,00,000	42,50,000	50,00,000
Credit Balance in Profit & Loss Account	5,00,000	7,50,000	10,00,000
Debenture Redemption Reserve	15,00,000	20,00,000	25,00,000
Secured Loans	10,00,000	15,00,000	30,00,000

On going through other records of the company, the following is also determined:

Net profit for the year

Rs. 12,50,000 – As at 31.03.2003

Rs. 19,00,000 – As at 31.03.2004

Rs. 34,50,000 – As at 31.03.2005 **[CA (Final) May 2008, Nov. 2005]**

In the ensuing Board meeting scheduled to be held on 5th November, 2005, among other items of agenda, following items are also appearing:

(i) To decide about borrowings from financial institutions on long-term basis.

(ii) To decide about contributions to be made to charitable funds.

Based on above information, you are required to find out as per the provisions of the Companies Act, 2013 the amount upto which the Board can borrow from financial institutions and the amount upto which the Board of directors can contribute to charitable funds during the financial year 2005-06 without seeking the approval in general meeting.

Ans. The given problem relates to sections 180(1)(c) and 181 of the Companies Act, 2013.

(i) As per section 180(1)(c) of the Companies Act, 2013, without the prior consent of the members in general meeting by a special resolution, the Board of directors of a company shall not borrow moneys where the borrowings (already made plus proposed) exceed the aggregate of the paid up share capital, free reserves and securities premium account. However, temporary loans obtained from the company's bankers in the ordinary course of business shall not be considered as borrowings.

In the given case, the aggregate of paid up share capital, free reserves and securities premium account comes to Rs. 1,35,00,000 (75,00,000 ÷ 50,00,000 + 10,00,000). It is to be noted that 'net profit for the year' amounting to Rs. 34,50,000 would already have been added while arriving at the figures of 'General Reserve' and 'Credit Balance in Profit and Loss Account', and accordingly, it shall not be again added at the time of determining the aggregate of paid up share capital, free reserves and securities premium account. Debenture Redemption Reserve is not a free reserve since it is not available for distribution of dividend.

Since the company has already borrowed Rs. 30,00,000 (it has been assumed that secured loans of Rs. 30,00,000 is not a temporary loan, i.e. it is not a loan obtained from the company's bankers in the ordinary course of business), the long term borrowings from financial institutions shall not exceed Rs. 1,05,00,000 without the consent of the members by way of a special resolution.

(ii) As per section 181 of the Companies Act, 2013, without the prior consent of the members in general meeting, the Board shall not contribute to bonafide charitable and other funds exceeding 5% of average net profits during immediately preceding 3 financial years.

The average net profits during immediately preceding 3 financial years comes to Rs. 22,00,000, i.e., 1/3rd of (Rs. 12,50,000 + Rs. 19,00,000 + Rs. 34,50,000). 5% of Rs. 22,00,000 comes to Rs. 1,10,000. Therefore, the Board may make contributions to charitable funds upto Rs. 1,10,000 during the financial year 2005-06 without prior permission of the company in general meeting.

Legal requirements for making contribution to a school and hospital for the benefit of employees

P 2.21B. The Board of directors of a company in the private sector propose to donate during the current year Rs. 1,00,000 to a school run exclusively for the benefit of employees;

Advise the Board of directors about their powers in respect of the above explaining the relevant provisions of the Companies Act, 2013. **[CA (Final) May 1995 (Modified)]**

OR

Advise the Board of directors of a company about their powers in respect of the following proposals explaining the relevant provisions of the Companies Act, 2013:

Donation of Rs. 5,00,000 to a hospital established exclusively for the benefit of employees. **[CA (Final) May 2003 (Modified)]**

OR

Decide in the light of the provisions of the Companies Act, 2013 the validity and extent of powers of Board of Directors and the procedure to be complied with in the following matters:

Donation of Rs. 5 lakhs to a hospital established exclusively for the benefit of employees. **[CA (Final) June 2009]**

OR

The Board of directors of LM Limited propose to donate Rs. 3,00,000 to a school established exclusively for the benefit of children of employees during the financial year ending 31st March, 2015. The average net profits during the three immediately preceding financial years is Rs. 40,00,000.

Examine with reference to the provisions of the Companies Act, 2013 whether the proposed donation is within the powers of the Board of directors of the company. **[CA (Final) Nov. 2009 (Modified)]**

OR

Srajan Ltd. is a company incorporated in July 2015. The Board of directors of Srajan Ltd. proposed to donate Rs. 2,00,000 to a school established exclusively for the benefit of the employees of the company. The net profit during the financial year 2017 - 2018 was Rs. 35,00,000. In the light of the stated facts under the relevant provisions of the Companies Act, 2013, decide whether the contribution by Srajan Ltd. to a school established for the benefit of employees is charitable contribution.

[ICAI, Mock Test Paper, October 2018]

Ans. As per section 181 of the Companies Act, 2013, without the prior consent of the members in the general meeting, the Board shall not contribute to bona fide charitable and other funds, if the amounts contributed in a financial year will exceed 5% of average net profits during immediately preceding 3 financial years.

Any contribution made by a company shall amount to charitable contribution only if it is not intended to result in any benefit for the company or for its employees, and does not have any direct relation with the business of the company.

In the given case, donation of Rs. 1,00,000 to a school run exclusively for the benefit of employees amounts to welfare expenses for the employees by which the employees are likely to receive benefits. By making such donation, the company has not made any charity; the facilities in the hospital cannot be used by any member of the public, but only by the employees of the company. Such donation may be equated to staff welfare. As such, the donation of Rs. 1,00,000 is outside the purview of charitable contribution, and so the provisions of section 181 of the Companies Act, 2013 are not at all attracted. Therefore, donation of Rs. 1,00,000 to the school established exclusively for the benefit of employees is within the powers of the Board, and so the permission of the members in general meeting is not required.

Author's Note:

The author is of the view that any amount spent / contributed by the company for the exclusive benefit of the employees does not amount to charitable contribution within the meaning of section 181, and accordingly the provisions of section 181 are not attracted.

Under the Companies Act, 1956, the provisions with respect to charitable contribution were contained in section 293(1)(e). Section 293(1)(e) of the Companies Act, 1956 provided that any contribution made by a company to charitable and other funds not directly relating to the business of the company or the welfare of its employees amounted to charitable contribution. *In other words*, section 293(1)(e) of the Companies Act, 1956 contained an express provision that any amount contributed by a company for the welfare of its employees does not amount to charitable contribution. However, in section 181 of the Companies Act, 2013, there is no mention of the words 'welfare of its employees'. *Prima facie*, by comparing section 181 of the Companies Act, 2013 with section 293(1)(e) of the Companies Act, 1956, it appears that 'any amount spent / contributed by a company for the welfare of employees' amounts to charitable contribution under section 181 of the Companies Act, 2013. However, the author is of the view that such interpretation is not correct. Section 181 of the Companies Act, 2013 should be read without comparing it with section 293(1)(e) of the Companies Act, 1956. The main criterion to determine whether 'any amount spent / contributed by a company for the welfare of employees' is a charitable contribution or not, is to check whether a particular amount spent / contributed by a company falls under the words 'charitable and other funds' as used in section 181 of the Companies Act, 2013. Here, the term 'other funds' shall mean such funds as are similar to, or related to, charitable funds. Since 'any amount spent / contributed by a company for the welfare of employees' neither amounts to contribution to any charitable fund nor amounts to contribution to any fund similar to, or related to, any charitable fund, such amount cannot be termed as charitable contribution under section 181.

Even if a comparison of section 181 of the Companies Act, 2013 is made with section 293(1)(e) of the Companies Act, 1956, it is important to understand that the words 'welfare of its employees' were used in section 293(1)(e) of the Companies Act, 1956, to provide a clarification only. Therefore, by omitting these words in section 181 of the Companies Act, 2013, the legislature did not intend to bring any change in the concept of charitable contribution.

One more reason to support this view is discussed as follows. Suppose, the legislature while drafting the Companies Act, 2013, deliberately omitted the words 'not directly relating to the business of the company or the welfare of its employees' as were used in section 293(1)(e) of the Companies Act, 1956. This would mean that any amount spent for the welfare of its employees shall amount to charitable contribution. However, this would result in an anomaly, as any amount spent in relation to the business of the company would also amount to charitable contribution, and thus, each and every paisa spent by the company will be covered under section 181. This proves that even though the words 'not directly relating to the business of the company or the welfare of its employees' have not been used in the Companies Act, 2013, any amount spent in relation to the business of the company or any amount spent for the welfare of the employees does not amount to charitable contribution.

Questions asked in May, 2003 and June 2009 Examination were based on the same issue as discussed above. The answers to these questions, as given by ICAI in the Suggested Answers and Practice Manual, provided that 'any amount spent / contributed by a company for the welfare of employees' does not amount to charitable contribution. These answers were based on section 293(1)(e) of the Companies Act, 1956. However, after section 181 of the Companies Act, 2013 has become applicable, these questions have been omitted from the Practice Manual.

The students are advised to confirm from ICAI as to whether 'any amount spent / contributed by a company for the welfare of employees' amounts to charitable contribution or not under the provisions of the Companies Act, 2013.

In the answer to a question included in Mock Test Paper of October 2018, ICAI has given the same answer as given above by the Author.

Whether Board is entitled to make a contribution of Rs. 40,000 to general charitable fund?

P 2.21C. The Board of directors of a public company in the private sector having made an average profit of Rs. 1 crore during the last 3 financial years propose to donate during the current year Rs. 40,000 to a general charitable fund.

Advise the Board of directors about their powers in respect of the above explaining the relevant provisions of the Companies Act, 2013.

[CA (Final) May 1995]

Ans. As per section 181 of the Companies Act, 2013, prior permission of the company in general meeting shall be required, if the amount of charitable contribution exceeds 5% of average net profits during preceding 3 financial years.

The donation of Rs. 40,000 to general charitable fund is not related to the business of the company and is therefore subject to the restrictions imposed under section 181 of the Companies Act, 2013. Accordingly, the donation shall not exceed 5% of average net profits during immediately preceding 3 financial years, unless prior permission of the company in general meeting is obtained. In the given case, donation upto Rs. 5,00,000 (being 5% of Rs. 1 crore) is permissible without obtaining prior permission of the company in general meeting. Since, the Board has donated only Rs. 40,000, such donation is within the limits and does not require the prior permission of the company in general meeting.

Whether Board is entitled to make a contribution of Rs. 5 lakh to a charitable trust?

P 2.21D. Decide in the light of the provisions of the Companies Act, 2013 the validity and extent of powers of Board of directors and the procedure to be complied with in the following matters:

A donation of Rs. 5 lakhs to a charitable trust registered under Section 12A and exempted under Section 80G of the Income-tax Act, 1961. **[CA (Final) June 2009]**

Ans. As per section 181 of the Companies Act, 2013, prior permission of the company in general meeting shall be required, if the amount of charitable contribution exceeds 5% of average net profits during preceding 3 financial years.

The donation of Rs. 5,00,000 to a charitable trust registered under Section 12A and exempted under Section 80G of the Income-tax Act, 1961, is not related to the business of the company and is therefore subject to the restrictions imposed under section 181 of the Companies Act, 2013. Accordingly, such donation shall not exceed 5% of average net profits during immediately preceding 3 financial years, unless prior permission of the company in general meeting is obtained.

Thus, contribution of Rs. 5 lakhs by the Board (without obtaining prior permission of the members) shall be within the powers of the Board only if the company has made average net profits of Rs. 1 crore or more (*i.e.* Rs. 5,00,000 x 100/5) during immediately preceding 3 financial years.

Practical Problems from CS Examinations

Whether Board is entitled to make a contribution of 10% of average net profits of past 5 years to a charitable fund?

P 2.21E. The Board of directors of Laxmi Ltd. decides to contribute to charitable funds, a sum of 10% of the company's average profits earned for the 5 years immediately preceding the financial year 2015-16. Referring to the provisions of the Companies Act, 2013 examine the validity of the decision of the Board. **[CS (Final) June 2016]**

Ans. As per section 181 of the Companies Act, 2013, prior permission of the company in general meeting shall be required, if the amount of charitable contribution exceeds 5% of average net profits during preceding 3 financial years.

In the given case, the Board of directors of Laxmi Ltd. has decided to contribute to charitable funds a sum of 10% of average net profits of immediately preceding 5 financial years. The amount of profits earned by the company in any of the preceding 5 financial years has not been given. So, if the amount proposed to be contributed to the charitable funds (*i.e.* 10% of average net profits of immediately preceding 5 financial years) is not more than 5% of average net profits of preceding 3 financial years, the Board is authorised to contribute the said amount without requiring prior permission of the company in general meeting.

However, if the amount proposed to be contributed to charitable funds (*i.e.* 10% of average net profits of immediately preceding 5 financial years) is more than 5% of average net profits of preceding 3 financial years, the Board is authorised to contribute the said amount only after obtaining prior permission of the company in general meeting.

Advanced Practical Problems

Loss in current financial year – Whether charitable contribution is permitted?

P 2.21F. Big Heart Ltd. has been contributing Rs. 75,000 to a general charitable trust every financial year. During the first 9 months of the financial year 2014-15, the company has incurred a loss of Rs. 40 lakh. However, the Board desires to contribute Rs. 75,000 to a general charitable trust as in the past years. Advise.

Ans. As per section 181 of the Companies Act, 2013, without the prior consent of the members in the general meeting, the Board shall not contribute to bona fide charitable and other funds, if the amounts contributed in a financial year will exceed 5% of average net profits during immediately preceding 3 financial years.

In the given case, if the amount proposed to be paid to the general charitable trust (*i.e.* Rs. 75,000) does not exceed 5% of the average net profits during immediately preceding 3 financial years, then, the Board may contribute such amount without requiring any approval of the members. Thus, if the average net profits of Big Heart Ltd. during preceding 3 financial years were Rs. 15 lakhs or more, then, no approval of the members is required.

However, if the average net profits of Big Heart Ltd. during preceding 3 financial years were less than Rs. 15 lakh, then, charitable contribution of Rs. 75,000 can be made only with the approval of the members in the general meeting.

It is immaterial that the company is incurring losses during the financial year in which charitable contribution is proposed to be made.

Whether contribution of Rs. 2.25 crore made by the Board is valid?

P 2.21G. M/s Jai Industries Limited earned net profit for last three years as under:

Financial year	Net Profit (Rs. in Crores)
2013-14	30
2014-15	40
2015-16	50

During the financial year 2016-17, the Board of directors of the company contributed to a charitable fund Rs. 1.25 crores in July, 2016. Again in January 2017, the Board of directors passed resolution to contribute to another charitable fund Rs. 1.00 crore.

Decide the validity of the decision of the Board of directors regarding the contribution on both the occasions with reference to the provisions of the Companies Act, 2013. **[CA (Final) Nov. 2017]**

Ans. As per section 181 of the Companies Act, 2013, prior permission of the company in general meeting shall be required, if the amount of charitable contribution exceeds 5% of average net profits during preceding 3 financial years.

The average net profits of M/s Jai Industries Ltd. during the preceding 3 financial years is Rs. 40 crore. 5% of the average net profits amounts to Rs. 2 crore. Thus, the Board may, without obtaining prior permission of the company in general meeting, contribute to charitable funds any amount not exceeding Rs. 2 crore. But, charitable contribution exceeding Rs. 2 crore may be made by the Board only if the prior permission of the members is obtained.

The donation of Rs. 1.25 crore and of Rs. 1 crore (totalling Rs. 2.25 crore) to charitable funds are not related to the business of the company and are therefore subject to the restrictions imposed under section 181 of the Companies Act, 2013. The donation of Rs. 1.25 crore made in July, 2016 is in accordance with the provisions of section 181. However, the charitable contribution made in January, 2017 is in contravention of section 181, since the Board could only contribute 0.75 crore without obtaining the prior permission of the members in the general meeting, but the Board has contributed Rs. 1 crore. Thus, the excess contribution of Rs. 0.25 crore is *ultra vires* the provisions of section 181.

Other Practical Problems

Whether the Board can contribute Rs. 60,000 to a charitable organisation if the company has suffered loss during a particular year?

P 2.21H. The Board of directors of Very Well Ltd., are contributing every year to a charitable organisation a sum of Rs. 60,000/-. In a particular year, the company suffered losses and the directors are contemplating to contribute the said amount in spite of the losses. In this connection, state whether the directors can do so? **[ICAI, Study Material]**

Ans. As per section 181 of the Companies Act, 2013, prior permission of the company in general meeting shall be required, if the amount of charitable contribution exceeds 5% of average net profits during preceding 3 financial years.

In the given case, the Board intends to contribute a sum of Rs. 60,000 to a charitable organisation in spite of the fact that the company has incurred losses during the financial year in which such charitable contribution is proposed to be made.

As per section 181, for making any charitable contribution, there is no such condition that the company should have earned profits during the financial year in which such charitable contribution is to be made.

During any financial year, a company can, without the approval of the members, make a charitable contribution upto 5% of average net profits of preceding 3 financial years. Any charitable contribution exceeding 5% of average net profits of preceding 3 financial years requires prior permission of the company in general meeting.

Thus, the Board of directors can, without the approval of the members, make a charitable contribution of Rs. 60,000 if the company has earned average net profits of Rs. 12 lakhs during preceding 3 financial years (*i.e.* total profits of Rs. 36 lakhs during preceding 3 financial years).

However, if the average net profits during the preceding 3 financial years were less than Rs. 12 lakhs, the Board can contribute Rs. 60,000 to the charitable organisation only after taking prior permission of the members in general meeting.

2.22 Prohibitions and restrictions regarding political contributions (Section 182)

A company may make a political contribution only if it is in accordance with the provisions of section 182, as explained hereunder:

1. Meaning of political contribution

(i) Political contribution means any contribution made, directly or indirectly, to any political party.

(ii) Any donation made by a company to a person who carries on any activity which is likely to affect public support for a political party shall also be deemed to be a political contribution.

(iii) Any expenditure incurred by a company on any advertisement in any publication amounts to a political contribution, where –

- such publication is by or on behalf of a political party; or
- such publication is not by or on behalf of a political party, but for the advantage of a political party.

'Political contribution' in simple terms

(a) Political contribution includes any contribution, donation, subscription or payment made to a political party, or to any other person for the benefit of a political party.

(b) Where any payment is made by a company to a political party through the agency of one or more persons, or any expense is paid to a third person on behalf of a political party, it amounts to 'indirect' political contribution.

(c) Any facilities provided by a company (*e.g.* vehicles, posters or manpower for the purpose of campaigning) to a political party also amounts to political contribution since political contribution can be in kind also.

(d) Where any payment is made by a company to any person for a political purpose (*i.e.* any payment made for the benefit of a political party), it also amounts to political contribution.

(e) Any expenditure incurred by a company on any advertisement in any publication amounts to political contribution, if such publication is owned by a political party.

(f) Any expenditure incurred by a company on any advertisement in any publication also amounts to political contribution, if such advertisement is for the advantage of a political party, even though such publication is not owned by a political party.

2. Meaning of 'political party'

For the purposes of section 182, 'political party' means a political party registered under section 29A of the Representation of the People Act, 1951 [Explanation to Section 182(4)].

As per section 29A of the Representation of the People Act, 1951, an association or body of individual citizens of India may make an application to the Election Commission for its registration as a political party. If the Election Commission registers such association or body as a political party, then, said association or body of individual citizens shall be termed as 'political party'.

3. Prohibition on certain companies with respect to political contribution

Following companies are prohibited from making any political contribution:

(a) A Government company.

(b) Any company which has been in existence for less than 3 financial years.

Any other company may make a political contribution provided the conditions given under this section are complied with.

4. No limit on amount of political contribution

There is no limit on the amount of political contribution. *In other words*, a company may make political contribution of such amount as it may deem fit.

Section 182 was amended by the Finance Act, 2017 with effect from 31st March, 2017. Before such amendment, the political contribution by any company was restricted to a maximum of 7.5% of average net profits during immediately preceding 3 financial years.

Since this amendment has been made applicable by ICAI, the aforesaid limit of 7.5% has no relevance for exams.

5. Conditions for making political contribution

(a) The power to make political contribution shall be exercised only by way of passing a resolution at a Board meeting.

(b) The political contribution shall not be made except –

(i) by an account payee cheque drawn on a bank; or

(ii) by an account payee bank draft; or

(iii) by use of electronic clearing system through a bank account; or

(iv) through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

(c) The company shall disclose in its profit and loss account, the amount contributed by it to any political party.

MCA Circular on contributions made to 'Electoral Trust Companies' [General Circular No. 19/2013 dated 10.12.2013]

With the coming into force of the scheme relating to 'Electoral Trust Companies' in terms of section (24AA) of the Income Tax Act, 1961 read with Ministry of Finance Notification No. S.O. 309(E) dated 31st January, 2013 it will be expedient to explain the requirements of disclosure on part of a company of any amount or amounts contributed by it to any political parties under section 182(3) of the Companies Act, 2013.

It is hereby clarified as under:

(i) Companies contributing any amount or amounts to an 'Electoral Trust Company' for contributing to a political party or parties are not required to make disclosures required under section 182(3) of Companies Act, 2013. It will suffice if the Accounts of the company disclose the amount released to an Electoral Trust Company.

(ii) Companies contributing any amount or amounts directly to a political party or parties will be required to make the disclosures laid down in section 182(3) of the Companies Act, 2013.

(iii) Electoral Trust Companies will be required to disclose all amounts received by them from other companies/sources in their Books of Accounts and also disclose the amount or amounts contributed by them to a political party or parties as required by section 182(3) of Companies Act, 2013.

6. Penalty for contravention

Any political contribution made in contravention of section 182 shall be punishable as follows:

(a) The company shall be punishable with fine upto 5 times the amount so contributed.

(b) Every officer of the company who is in default shall be punishable with imprisonment upto 6 months and shall also be liable to fine upto 5 times the amount so contributed.

Justification for political contribution

Where a company makes a political contribution by passing a resolution in the Board meeting and complying with all other requirements contained in section 182, such resolution shall be deemed to be justification in law for the making of such political contribution.

Theoretical Questions from CA Examinations

Q 2.22A. X Ltd. was registered in the year 2014 under the Companies Act, 2013. As on 1st May, 2018, the management of the company decides to make donation to a recognized political party. Advise the management about the restrictions and the extent upto which such donation can be made under the said Act. Will it make any difference if X Ltd. was registered in the year 2017? [CA (Final) May 2011]

Practical Problems from CA Examinations

Various cases of political contribution

P 2.22A. Answer the following cases:

Case I. Papa Group of Companies known for their business repute have been advocating for payment of donations to political parties as one of the methods of funding election. The group has recently floated a company by name M/s. Papa Computers Ltd., and in the very first year of its working made a net profit of Rs. 6 crores. Examine with reference to the provisions of the Companies Act, 2013 whether the said company can make political donations and what is the maximum limit upto which a company can make political donations. [CA (Final) Nov. 1999]

Case II. State with reference to the provisions of the Companies Act, 2013 whether the following companies can make donations (as on 1.12.2014) to political parties and if so the conditions to be complied with in this regard:

(i) ABCD Ltd., a Government company registered in 2009 wants to donate a sum of Rs. 10 lakhs.

(ii) EFG Ltd., a public company registered in 2008 wishes to contribute a sum of Rs. 5 lakhs.

(iii) RST Ltd., a company incorporated in the year 2014, decides to contribute a sum of Rs. 3 lakhs.

[CA (Final) Nov. 1996 (Modified)]

Case III. Decide in the light of the provisions of the Companies Act, 2013, the validity and extent of powers of Board of Directors and the procedure to be complied with in the following matters:

Donation of Rs. 5 lakhs to a political party registered with the appropriate authority. [CA (Final) June 2009]

Case IV. The Board of directors of a public company in the private sector having made an average profit of Rs. 1 crore during the last 3 financial years propose to donate during the current year Rs. 4,00,000 to a political party.

Advise the Board of directors about their powers in respect of the above explaining the relevant provisions of the Companies Act, 2013. [CA (Final) May 1995]

Case V. Sunrise Industries Ltd. has paid Rs. 1,00,000 to a political party as its contribution to fight elections. Can it do so under the provisions of the Companies Act, 2013? Will it make any difference if the company has advertised its products in the monthly magazine published by the political party? [CA (Final) May 2005]

Case VI. The Board of Directors of LM Limited propose to donate Rs. 50,000 to a political party during the Financial year ending 31st March, 2015. The average net profits during the three immediately preceding financial years is Rs. 40,00,000.

Examine with reference to the provisions of the Companies Act, 2013 whether the proposed donations are within the powers of the Board of Directors of the Company. [CA (Final) Nov. 2009 (Modified)]

Case VII. Win Ltd. is a company incorporated 15 years ago and during the last three consecutive financial years it earned profits of Rs 5.00 lakhs, 8.00 lakhs and 11.00 lakhs. In order to augment its business prospects, it wants to make donations to political parties. State with reference to the provisions of the Companies Act, 2013 whether the company can make such donations and if yes to what extent. [CA (Final) May 2012]

Case VIII. Sewak Cycles Limited is a company incorporated four years ago. It has earned profits amounting to Rs. 5 lakh, Rs. 8 lakh and Rs. 11 lakh respectively during the last three financial years. The Board of Directors of the company propose to donate a sum of Rs. 50,000 to a political party. Examine with reference to the provisions of the Companies Act, 2013 whether the proposed donation is within the powers of the Board of Directors of the company. [CA (Final) May 2015]

Case IX. State with reference to the provisions of the Companies Act, 2013 whether the following companies can make donations to political parties on 1st November, 2018, and if so the conditions to be complied with in this regard.

(i) ABCD Ltd., a Government company registered in 1991, wants to donate a sum of Rs. 10 lakhs.

(ii) EFG Ltd., a public company registered in 2013, wishes to contribute a sum of Rs. 5 lakhs.

(iii) RST Ltd., a company incorporated in the year 2014, decides to contribute a sum of Rs. 3 lakhs.

(iv) Rama Ltd. wants to make political contribution of Rs. 2,000 in cash. [CA (Final) Nov. 2018]

Case X. XYZ Ltd. was incorporated on 1st January, 2016. On 1st November, 2018 a political party approaches the company for a contribution of Rs. 10 lakhs for political purpose. Advise in respect of the following:

(i) Is the company legally authorised to give this political contribution?

(ii) Will it make any difference, if the company was in existence on 1st October, 2015?

(iii) Can the company be penalised for defiance of provisions in this regard? [ICAI, RTP, May 2015]

Ans. As per section 182 of the Companies Act, 2013, a company shall not make a political contribution unless the following conditions are satisfied:

(a) The company is not a Government company.

(b) The company has been in existence for 3 or more financial years.

(c) The political contribution shall be made by passing a resolution at a Board meeting only.

(d) The company shall disclose in its profit and loss account, the amount contributed by it to any political party.

(e) The political contribution shall not be made except–

- (i) by an account payee cheque drawn on a bank; or
- (ii) by an account payee bank draft; or
- (iii) by use of electronic clearing system through a bank account; or
- (iv) through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

Answer to Case I. In this case, M/s. Papa Computers Ltd. cannot make any political donation because the company is not in existence for a period of 3 financial years.

Answer to Case II.

In this case –

(i) ABCD Ltd. is a Government company and so it is prohibited from making any political contribution.

(ii) EFG Ltd. has been in existence for more than 3 financial years and so it can make political contribution without any limit, provided –

- (a) the political contribution is made by passing a resolution at a Board meeting only;
- (b) the company shall disclose in its profit and loss account, the amount contributed by it to any political party;
- (c) the political contribution shall not be made except –
  - ❑ by an account payee cheque drawn on a bank; or
  - ❑ by an account payee bank draft; or
  - ❑ by use of electronic clearing system through a bank account; or
  - ❑ through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

(iii) RST Ltd. cannot make any political contribution because the company has not been in existence for a period of 3 financial years.

Answer to Case III. In this case, the Board has made a political contribution of Rs. 5 lakh. Such political contribution shall be valid, provided –

(a) the political contribution is made by passing a resolution at a Board meeting only;

(b) the company shall disclose in its profit and loss account, the amount contributed by it to any political party;

(c) the political contribution shall not be made except–

- ❑ by an account payee cheque drawn on a bank; or
- ❑ by an account payee bank draft; or
- ❑ by use of electronic clearing system through a bank account; or
- ❑ through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

Answer to Case IV. In this case, the company is not prohibited from making political contribution since it is not a Government company, and it has been in existence for more than 3 financial years. Accordingly, it may make the political contribution without any limit, provided –

(a) the political contribution is made by passing a resolution at a Board meeting only;

(b) the company shall disclose in its profit and loss account, the amount contributed by it to any political party;

(c) the political contribution shall not be made except–

- ❑ by an account payee cheque drawn on a bank; or
- ❑ by an account payee bank draft; or

- by use of electronic clearing system through a bank account; or
- through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

Answer to Case V. The term 'political contribution' shall include any expenditure incurred by a company on advertisement in any publication. If such publication is by or on behalf of a political party, it shall be deemed to be a political contribution to a political party. If such publication is not by or on behalf of a political party, but for the benefit of a political party, it shall be deemed to be a political contribution to the person publishing it.

In the given case, Sunrise Industries Ltd. has made a political contribution of Rs. 1 lakh. Such political contribution shall be valid, provided –

(a) the company is in existence for 3 or more financial years;

(b) the political contribution is made by passing a resolution at a Board meeting only;

(c) the company shall disclose in its profit and loss account, the amount contributed by it to any political party;

(d) the political contribution shall not be made except–
- by an account payee cheque drawn on a bank; or
- by an account payee bank draft; or
- by use of electronic clearing system through a bank account; or
- through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

Even if Sunrise Industries Ltd. pays Rs. 1,00,000 as consideration for advertisement in the monthly magazine published by the political party, the payment of Rs. 1,00,000 shall be regarded as political contribution, since as per section 182 of the Companies Act, 2013, payment made as a consideration for advertisement in any publication brought by a political party shall amount to a political contribution made to such political party. Therefore, all the conditions of section 182 of the Companies Act, 2013, as explained before, must also be complied with in case Rs. 1,00,000 is paid by Sunrise Industries Ltd. as consideration for advertisement in the monthly magazine published by the political party.

Answer to Case VI. In this case, assuming that LM Limited is not a Government company, it may make political contribution without any limit, provided –

(a) the political contribution is made by passing a resolution at a Board meeting only;

(b) the company shall disclose in its profit and loss account, the amount contributed by it to any political party;

(c) the political contribution shall not be made except –
- by an account payee cheque drawn on a bank; or
- by an account payee bank draft; or
- by use of electronic clearing system through a bank account; or
- through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

Answer to Case VII. In this case, Win Ltd. is not prohibited from making political contribution since it is not a Government company, and it has been in existence for more than 3 financial years. It may make political contribution without any limit, provided –

(a) the political contribution is made by passing a resolution at a Board meeting only;

(b) the company shall disclose in its profit and loss account, the amount contributed by it to any political party;

(c) the political contribution shall not be made except –
- by an account payee cheque drawn on a bank; or
- by an account payee bank draft; or
- by use of electronic clearing system through a bank account; or
- through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

Answer to Case VIII. In this case, Sewak Cycles Limited is not prohibited from making political contribution since it is not a Government company and it has been in existence for more than 3 financial years. It may make political contribution without any limit, provided –

(a) the political contribution is made by passing a resolution at a Board meeting only;

(b) the company shall disclose in its profit and loss account, the amount contributed by it to any political party;

(c) the political contribution shall not be made except –
- by an account payee cheque drawn on a bank; or
- by an account payee bank draft; or
- by use of electronic clearing system through a bank account; or
- through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

Answer to Case IX.

In this case –

(i) ABCD Ltd. is a Government company and so it is prohibited from making any political contribution.

(ii) and (iii) EFG Ltd. and RST Ltd. have been in existence for more than 3 financial years and so these companies can make political contribution without any limit, provided –

(a) the political contribution is made by passing a resolution at a Board meeting only;

(b) each company shall disclose in its profit and loss account, the amount contributed by it to any political party;

(c) the political contribution shall not be made except –

- by an account payee cheque drawn on a bank; or
- by an account payee bank draft; or
- by use of electronic clearing system through a bank account; or
- through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

(iv) Rama Ltd. cannot make any political contribution in cash since political can be made only by the following means:

- By an account payee cheque drawn on a bank; or
- By an account payee bank draft; or
- By use of electronic clearing system through a bank account; or
- Through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

Answer to Case X.

(i) XYZ Ltd. was incorporated on 1st January, 2016. The period of first financial year of XYZ Ltd. would have been 1.1.2016 to 31.3.2017. The period of second financial year would have been 1.4.2017 to 31.3.2018. As on 1st November, 2018, XYZ Ltd. has not been in existence for 3 financial years, and so it cannot make any political contribution.

(ii) Had XYZ Ltd. been in existence on 1st October, 2015, it would have been in existence for more than 3 financial years as on 1st November, 2018 (First financial year: 1.10.2015 to 31.3.2016; Second financial year: 1.4.2016 to 31.3.2017; Third financial year: 1.4.2017 to 31.3.2018), and so it can make political contribution without any limit, provided –

(a) the political contribution is made by passing a resolution at a Board meeting only;

(b) it shall disclose in its profit and loss account, the amount contributed by it to the political party;

(c) the political contribution shall not be made except –

- by an account payee cheque drawn on a bank; or
- by an account payee bank draft; or
- by use of electronic clearing system through a bank account; or
- through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

(iii) In case XYZ Ltd. makes any political contribution in contravention of the provisions of section 182, XYZ Ltd. shall be punishable with fine upto 5 times the amount so contributed, and every officer of XYZ Ltd. who is in default shall be punishable with imprisonment upto 6 months and shall also be liable to fine upto 5 times the amount so contributed.

Practical Problems from CS Examinations

Various cases of political contribution

P 2.22B. The Board of directors of MNR Ltd. incorporated on 2nd April, 2015 decides to pay 10% of the profit of the company earned during the period of 6 months in the financial year 2015-16, towards political contribution to some political parties.

Ans. As per section 182 of the Companies Act, 2013, a company shall not make a political contribution if it has been in existence for less than 3 financial years.

In this case, MNR Ltd. cannot make any political contribution because the company is not in existence for a period of 3 financial years.

Advanced Practical Problems

Political contribution by a company incorporated on 1st January, 2015

P 2.22C. A Ltd. (not a Government Company) was incorporated on 1st January, 2015. Till what date A Ltd. cannot make any political contribution?

Ans. As per section 182 of the Companies Act, 2013, the following companies shall not make a political contribution:

(a) A Government company.

(b) A company which has been in existence for less than 3 financial years.

As per Clause (41) of section 2 of the Companies Act, 2013, 'financial year' means the period ending on the 31st day of March every year, and where a company is incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year.

In the given case, the first financial year of the company shall end on 31st March, 2016. The second and third financial years shall end on 31st March, 2017 and 31st March, 2018 respectively.

Upto 31st March, 2018, the company shall not be in existence for 3 financial years, and so it can make a political contribution only on or after 1st April, 2018.

Political contribution by a company incorporated on 31st December, 2014

P 2.22D. B Ltd. (not a government company) was incorporated on 31st December, 2014. Till what date B Ltd. cannot make any political contribution?

Ans. As per section 182 of the Companies Act, 2013, the following companies shall not make a political contribution:

(a) A Government company.

(b) A company which has been in existence for less than 3 financial years.

As per Clause (41) of section 2 of the Companies Act, 2013, 'financial year' means the period ending on the 31st day of March every year, and where a company is incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year.

In the given case, the first financial year of the company shall end on 31st March, 2015. The second and third financial years shall end on 31st March, 2016 and 31st March, 2017 respectively.

Upto 31st March, 2017, the company shall not be in existence for 3 financial years, and so it can make a political contribution only on or after 1st April, 2017.

2.23 Contributions to National Defence Fund, etc. (Section 183)

1. **Contribution to approved funds**

   A company is empowered to contribute such amount as it thinks fit to –

   (a) the National Defence Fund; or

   (b) any other fund approved by the Central Government for the purpose of National Defence (*e.g.* Prime Minister's National Relief Fund).

2. **Exercise of powers**

   The power to make contribution to the approved funds may be exercised by –

   (a) the Board of directors (whether, by passing a resolution in a Board meeting or by circulation); *or*

   (b) any person or authority exercising the powers of the Board of directors, or of the company in general meeting.

3. **No limit on contribution**

   There is no limit on the amount that a company may contribute under section 183.

4. **Disclosure of contribution**

   Every company shall disclose in its profit and loss account the total amount contributed by it to any of the funds approved under section 183.

Overriding effect of section 183

The company has the power to make contribution under section 183 notwithstanding anything contained in –

(a) sections 180, 181 and 182 or any other provision of the Companies Act, 2013; or

(b) memorandum, articles or any other instrument relating to the company.

Theoretical Questions from CS Examinations

Q 2.23A. Can a company contribute Rs. 5 lakhs to Prime Minister's Relief Fund? [CS (Final) June 1996]

Practical Problems from CA Examinations

Contribution to National Defence Fund, a charitable fund and a political party – Various issues

P 2.23A. The articles of association of M/s DEF Limited (Non-Government Company) restricts the company to contribute to National Defence Fund in any financial year for a sum not exceeding Rs. 5 lakhs. The articles are silent about contribution to bonafide charitable fund and to a political party. The company earned net profit during the last five financial years as under:

Financial years	Net profit (Rs. in lakhs)
2018-19	45
2017-18	25

2016-17	20
2015-16	15
2014-15	10

The Board of directors proposes to contribute in July 2019 for the first time during the financial year 2019-20:

(i) Rs. 7 lakhs to National Defence Fund

(ii) Rs. 3 lakhs to a bonafide charitable fund

(iii) Rs. 5 lakhs to a political party

The company seeks your advice on the following matters in respect of each of the above proposals under the provisions of the Companies Act, 2013.

(i) The appropriate approving authority;

(ii) The quantum of contribution that can be made;

(iii) The mode of payment of such contribution. **[CA (Final) Nov. 2019]**

Ans. The given problem relates to sections 181, 182 and 183 of the Companies Act, 2013. The questions asked in the given problem are answered as under:

Contribution of Rs. 7 lakhs to National Defence Fund (Section 183)

1. The relevant provisions of section 183, with respect to contribution to National Defence Fund, are explained as follows:
   (a) A company is empowered to contribute such amount as it thinks fit to –
      (i) the National Defence Fund; or
      (ii) any other fund approved by the Central Government for the purpose of National Defence (*e.g.* Prime Minister's National Relief Fund).
   (b) The power to make contribution to the approved funds may be exercised by –
      (i) the Board of directors (whether, by passing a resolution in a Board meeting or by circulation); or
      (ii) any person or authority exercising the powers of the Board of directors, or of the company in general meeting.
   (c) There is no limit on the amount that a company may contribute under section 183.
   (d) The company has the power to make contribution under section 183 notwithstanding anything contained in –
      (a) sections 180, 181 and 182 or any other provision of the Companies Act, 2013; or
      (b) memorandum, articles or any other instrument relating to the company.
2. The articles of association of M/s DEF Limited restricts it from contributing more than Rs. 5 lakh to the National Defence Fund. However, despite such provision in the articles, M/s DEF Limited is authorised to make any contribution (*i.e.* without any limit) to the National Defence Fund since section 183 overrides the provisions contained in the articles of a company.
3. (i) The contribution of Rs. 7 lakh to the National Defence Fund may be made by the Board of directors or by any person or authority exercising the powers of the Board of directors, or of the company in general meeting
   (ii) There is no limit on the amount of contribution that can be made to the National Defence Fund. Accordingly, M/s DEF Ltd. can make contribution of such amount to National Defence Fund as it may deem fit. Therefore, contribution of Rs. 7 lakhs to the National Defence Fund by M/s DEF Limited is permissible.
   (iii) There is no condition under the Companies Act, 2013 or rules prescribed thereunder that the contribution to the National Defence Fund can be made only by cheque or any other specific mode.

Contribution of Rs. 3 lakhs to a bonafide charitable fund (Section 181)

1. The relevant provisions of section 181, with respect to charitable contribution, are explained as follows:
   (a) In any financial year, the Board is authorised to contribute to *bonafide* charitable and other funds not exceeding 5% of average net profits during immediately preceding 3 financial years.
   (b) In case a company intends to contribute more than 5% of average net profits during immediately preceding 3 financial years, prior consent of the members in the general meeting shall be required, *i.e.* approval of members by way of an ordinary resolution shall be required.
2. The average net profits of M/s DEF Ltd. during immediately preceding 3 financial years are Rs. 30 lakh [(Rs. 45 lakh + Rs. 25 lakh + Rs. 20 lakh) divided by 3]. 5% of average net profits during immediately preceding 3 financial years arrives at Rs. 1.5 lakh.
3. (i) The charitable contribution of Rs. 3 lakh shall exceed 5% of average net profits during immediately preceding 3 financial years (*i.e.* Rs. 1.5 lakh). Therefore, the appropriate approving authority to make charitable contribution of Rs. 1.5 lakh shall be the members, *i.e.* approval of members by way of an ordinary resolution shall be required to make charitable contribution of Rs. 1.5 lakh.
   (ii) The company shall be authorised to make charitable contribution upto such amount as may be authorised by the members by passing an ordinary resolution.

(iii) There is no condition under the Companies Act, 2013 or rules prescribed thereunder that the charitable contribution can be made only by cheque or any other specific mode.

Contribution of Rs. 5 lakhs to a political party (Section 182)

1. The relevant provisions of section 182, with respect to political contribution, are explained as follows:
   (a) Following companies are prohibited from making any political contribution:
      (i) A Government company.
      (ii) Any company which has been in existence for less than 3 financial years.
   (b) There is no limit on the amount of political contribution. *In other words*, a company may make political contribution of such amount as it may deem fit.
   (c) The power to make political contribution shall be exercised only by passing a resolution at a Board meeting.
   (d) The political contribution shall not be made except –
      (i) by an account payee cheque drawn on a bank; or
      (ii) by an account payee bank draft; or
      (iii) by use of electronic clearing system through a bank account; or
      (iv) through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.
   (e) The company shall disclose in its profit and loss account, the amount contributed by it to any political party.
2. M/s DEF Ltd. is not a Government company. Also, M/s DEF Ltd. satisfies the condition of being in existence for 3 financial years. So, M/s DEF Ltd. is authorised to make political contribution.
3. (i) The appropriate approving authority to make political contribution of Rs. 5 lakh shall be the Board of directors of M/s DEF Ltd. Such power cannot be delegated by the Board to any other person or committee of the Board or any other authority.
   (ii) There is no limit on making the political contribution. Accordingly, the Board of directors of M/s DEF Ltd. can make political contribution of such amount as the Board may deem fit. Therefore, political contribution of Rs. 5 lakh by M/s DEF Ltd. is permissible.
   (iii) The political contribution can be made in any of the following modes only:
      (a) By an account payee cheque drawn on a bank; or
      (b) By an account payee bank draft; or
      (c) By use of electronic clearing system through a bank account; or
      (d) Through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

2.24 Loans to directors, etc. (Section 185)

1. Certain loans, guarantees and securities prohibited [Section 185(1)]

No company shall, directly or indirectly –

(a) advance any loan, including any loan represented by a book debt, to –
   (i) a director of the lending company or of a company which is its holding company; or
   (ii) a relative of any such director; or
   (iii) a partner of any such director; or
   (iv) a firm in which any such director or relative is a partner.
(b) give any guarantee in connection with a loan taken by –
   (i) a director of the lending company or of a company which is its holding company; or
   (ii) a relative of any such director; or
   (iii) a partner of any such director; or
   (iv) a firm in which any such director or relative is a partner.
(c) provide any security in connection with a loan taken by –
   (i) a director of the lending company or of a company which is its holding company; or
   (ii) a relative of any such director; or
   (iii) a partner of any such director; or
   (iv) a firm in which any such director or relative is a partner.

2. Certain loans, guarantees and securities permitted only upon fulfilment of certain conditions [Section 185(2)]

(a) Permitted transactions. A company may –

(i) advance any loan, including any loan represented by a book debt, to any person in whom any of the director of the company is interested; or

(ii) give any guarantee in connection with any loan taken by any person in whom any of the director of the company is interested; or

(iii) provide any security in connection with any loan taken by any person in whom any of the director of the company is interested.

(b) Conditions. The above transactions shall be permitted only if the following conditions are satisfied:

(i) A special resolution is passed by the company in general meeting.

(ii) The explanatory statement annexed to the notice of the general meeting shall disclose –

- full particulars of the loans to be given, or guarantee to be given or security to be provided;
- 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.

(iii) The loans are utilised by the borrower for its principal business activities.

The expression 'any person in whom any of the director of the company is interested' means –

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

(b) a body corporate at a general meeting of which 25% or more total voting power may be exercised or controlled by any such director, or by two or more such directors together.

(c) a body corporate, the Board of directors or managing director or manager whereof is accustomed to act in accordance with the directions or instructions of the Board or any director of the lending company.

3. Non-applicability of section 185 [Section 185(3)]

The provisions contained in section 185(1) and 185(2) shall not apply in the following cases:

(a) Where –

(i) loan is given to a managing director or whole-time director; and

(ii) such loan forms part of the conditions of service extended by the company to all its employees.

Simply speaking, where the conditions of service extended by a company to its employees includes any loan facility (*e.g.* housing loan or car loan or education loan or any other loan), and any loan is given to a managing director or whole-time director in pursuance of such conditions of service, there is no prohibition or restriction on such loan, if such loan facility is provided to all the employees.

(b) Where –

(i) loan is given to a managing director or whole-time director; and

(ii) such loan is given pursuant to any scheme approved by the members by a special resolution.

Simply speaking, where a company formulates a scheme for providing any loan (*e.g.* housing loan or car loan or education loan or any other loan), and any loan is given to a managing director or whole-time director in pursuance of such scheme, there is no prohibition or restriction on such loan, if such scheme is approved by the members by a special resolution.

(c) Where –

(i) a company, in the ordinary course of its business, provides loans or gives guarantees or securities for the due repayment of any loan; and

(ii) in respect of such loans, an interest is charged at a rate not less than the rate of prevailing yield of 1 year, 3 years, 5 years or 10 years Government security closest to the tenor of the loan.

Where a loan is given by a banking company to any person specified in section 185(1) or 185(2) and the rate of interest charged is not less than the rate of prevailing yield of 1 year, 3 years, 5 years or 10 years Government security closest to the tenor of the loan, the provisions of section 185(1) and (2) are not attracted, since a banking company gives loans in the ordinary course of its business. Similarly, where a loan is given by any Non-banking Financial Company (NBFC) or any other company, which in the ordinary course of its business gives loans, the provisions of section 185(1) and (2) are not attracted, if such company gives loans in the ordinary course of its business, and the rate of interest charged is not less than the rate of prevailing yield of 1 year, 3 years, 5 years or 10 years Government security closest to the tenor of the loan.

(d) Where –

(i) loan is made by a holding company to its wholly owned subsidiary; and

(ii) such loan is to be utilised by such subsidiary company for its principal business activities.

(e) Where –

(i) any guarantee is given or security is provided by a holding company in respect of any loan made to its wholly owned subsidiary company; and

(ii) such loan is to be utilised by such subsidiary company for its principal business activities.

(f) Where –

(i) any guarantee is given or security is provided by a holding company in respect of any loan made to its subsidiary company;

(ii) such loan is made by any bank or financial institution; and

(iii) such loan is to be utilised by such subsidiary company for its principal business activities.

4. Effects of contravention of section 185(1) or 185(2) [Section 185(4)]

(a) The company shall be punishable with fine which shall not be less than Rs. 5 lakh but which may extend to Rs. 25 lakh.

(b) Every officer of the company who is in default shall be punishable with imprisonment upto 6 months or with fine which shall not be less than Rs. 5 lakh but which may extend to Rs. 25 lakh.

(c) The director or the other person to whom loan has been given, or for whom the guarantee has been given or security has been provided, in contravention of section 185, shall be punishable with imprisonment upto 6 months or with fine which shall not be less than Rs. 5 lakh but which may extend to Rs. 25 lakh, or with both.

1. Exemptions to certain private companies and Government companies

(a) As per Notification No. G.S.R. 464(E) dated 5th June, 2015, the provisions of section 185 shall not apply to a private company –

(i) in whose share capital no other body corporate has invested any money;

(ii) 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 o. Rs. 50 crore, whichever is lower;

(iii) no default in repayment of such borrowings is subsisting at the time of making any transaction under this section; and

(iv) it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

(b) As per Notification No. G.S.R. 463(E) dated 5th June, 2015, the provisions of section 185 shall not apply to a Government company if –

(i) such company obtains prior approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government; and

(ii) such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92

2. No retrospective application of section 185 of the Companies Act, 2013

Where a loan is made by a company to a person who is not a person specified in section 185(1) or 185(2) as on the date of making of such loan, but afterwards, such person becomes a person specified in section 185(1) or 185(2) (for example, in September, 2018 X Ltd. made a loan of Rs. 10 crore to Mr. A, and in November, 2018, Mr. got married to Ms. B, who is a director in X Ltd.), section 185 is not attracted. However, after such person has become a person specified in section 185(1) or 185(2), any further loan may be made to him only if permitted under section 185 and in accordance with the conditions contained in section 185.

3. Advances made in the ordinary course of business not covered

Directors are often provided with advance money for expenses for the purpose of business of the company. Such advances are outside the scope of section 185, since the director uses the advance as an agent of the company and for the purpose of business of the company. *In other words*, section 185 is not attracted where an advance is made to a director in the ordinary course of business (*i.e.* for the purpose of business of the company).

4. Meaning of 'Loan'

The term 'loan' was explained by the Court in ***Dr. Fredie Ardeshir Mehta* v *Union of India* (1991) 70 Comp Cas 210**. This case was decided under the provisions of Section 295 of the Companies Act, 1956, but the decision in this case shall continue to apply under the provisions of Section 185 of the Companies Act, 2013. The facts and decision in this case were as follows:

'Loan' means an advance of money (*i.e.* financial assistance) upon the understanding that it shall be paid back. Loan may or may not carry interest. Where a company sells its flat to a director and the director agrees to pay the sale consideration to the company in instalments, it does not amount to a 'loan to director'. It simply amounts to a credit sale resulting in a debt (but such debt does not amount to a loan). Therefore, section 295 of the Companies Act, 1956 (corresponding to section 185 of the Companies Act, 2013) is not attracted.

Sale of a flat in the aforesaid case does not amount to an indirect loan also. The word 'indirectly' used under section 295 of the Companies Act, 1956 (corresponding to section 185 of the Companies Act, 2013) only means that company shall not give a loan to a director through the agency of one or more intermediaries. The word 'indirectly' cannot be read as converting 'what is not a loan' into 'a loan'.

5. **Salary advance to wife of managing director – Whether a loan?**

   Whether salary advance given to the wife of a director amounts to a 'loan' or not was considered by the Court in ***M.R. Electronics Components Ltd. and Others* v *Assistant Registrar* (1986) 3 Comp LJ 28**. This case was decided under the provisions of Section 295 of the Companies Act, 1956, but the decision in this case shall continue to apply under the provisions of Section 185 of the Companies Act, 2013. The facts and decision in this case were as follows:

   If salary advance is given to the wife of managing director, and such salary advance is given *bonafide*, section 295 of the Companies Act, 1956 (corresponding to section 185 of the Companies Act, 2013) is not attracted. In determining whether the salary advance is *bonafide* or not, the facts that need to be considered are the rate of interest, whether the amount of salary advance is reasonable having regard to the salary of the employee, terms of repayment of advance, laxity in recovery of such advance, whether similar salary advance has been made to other employees, and other relevant facts of the case.

6. **Security deposit is not a loan**

   Security deposit made by a company in respect of a house taken on lease by the company for residential accommodation of a director does not result in a loan to a director.

7. **Whether section 185 applies to a guarantee given or security provided by a company in connection with a loan given by any person specified in section 185?**

   Where a company gives any guarantee or security in connection with a loan given by any person specified in section 185(1) or 185(2) to any other person, section 185 is not attracted and consequently there is no prohibition or restriction on giving of such guarantee or providing such security.

8. **Definition of relative [Section 2(77) of the Companies Act, 2013]**

   'Relative', with reference to any person, means anyone who is related to another, if –

   (i) they are members of a Hindu Undivided Family;

   (ii) they are husband and wife; or

   (iii) one person is related to the other in such manner as may be prescribed.

   As per Rule 4 of the Companies (Specification of definitions details) Rules, 2014, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner:

   (1) Father (including step-father)

   (2) Mother (including step-mother)

   (3) Son (including step-son)

   (4) Son's wife

   (5) Daughter

   (6) Daughter's husband

   (7) Brother (including step-brother)

   (8) Sister (includes step-sister)

9. **No vacation of office in case of contravention of section 185**

   Where any loan is taken by any person specified in section 185(1) or 185(2) in contravention of the provisions of section 185, it does not result in vacation of office of the director, since such a ground is not covered under section 167 or section 185 or any other provision of the Act.

Theoretical Questions from CA Examinations

Q 2.24A. In what ways does the Companies Act, 2013 prohibit a company from making any loan to its directors.

[CA (Final) Nov. 1985 (Modified)]

Practical Problems from CA Examinations

Sale of a flat to a director on credit – Whether amounts to a loan?

P 2.24A. Following transaction is made by a public company. You are required to examine whether this transaction can be termed as loan to directors:

Sale of company's flat to a director at prevailing market price, out of which the director pays 50% (fifty per cent) immediately and contracts to pay balance amount in 10 equal annual instalments. [CA (Final) Nov. 2005]

OR

In the light of the conditions laid down under the Companies Act, 2013 examine if the following transaction can be considered as loans to directors.

A sale of flat of the company at the current market rate and price. The director pays sixty per cent cash immediately and contracts to pay the balance in ten monthly instalments. [CA (Final) Nov. 2002]

OR

M/s. International Carrier Limited purchased a flat in Mumbai to give residential accommodation to Shri Ravi Mehta, the managing director. At the time of purchase of flat, the managing director was given an option to buy the flat during the course of his employment. The managing director exercised his option and paid the company half of the purchase price and requested for time to pay the balance amount in three equal half yearly instalments at 10% interest per annum. Examine whether the arrangement would amount to a loan to the managing director and if so, whether the loan was in order.

[CA (Final) May 1997]

OR

A Public Company purchases a flat which is subsequently sold to a director at the prevailing market price, out of which the director pays 50% immediately and contracts to pay the balance in 10 equal annual instalments. Does it amount to a loan to a director under the Companies Act, 2013? [CA (Final) Nov. 1999]

OR

A company sold one of its flats to one of the directors and received 50% of the price in cash and agreed to receive the balance in instalments. Would you consider this as a loan granted to director? [CS (Final) June 1995; June 1999]

Ans. As per section 185(1) of the Companies Act, 2013, *no company* shall, directly or indirectly, give any loan to a director.

In the given case, the company sold a flat to a director, and the director paid to the company 50% of the price of the flat and balance 50% was to be paid by the director in installments, resulting in a debt payable by the director to the company. The debt arose not out of an advance given by the company to the director, but out of a transaction of sale of a flat by the company to its director. The company gave time to the director to pay a part of the purchase price.

The facts in the given case are exactly similar to the facts in ***Fredie Ardeshir Mehta* v *Union of India* (1991) 70 Comp Cas 210**, as discussed below:

The essential requirement of a 'loan' is the advance of money upon the understanding that it shall be returned back and it may or may not carry interest. Where a company sells a flat to one of its directors and receives half the price in cash and agrees to receive the balance in instalments, the transaction amounts to a credit sale; it does not amount to even an 'indirect loan'.

The word 'indirectly' used in section 185 of the Companies Act, 2013 only means that company shall not give a loan to a director through the agency of one or more intermediaries. The word 'indirectly' cannot be read as converting 'what is not a loan' into 'a loan'. Therefore, in the given case, there is no contravention of Section 185 of the Companies Act, 2013 **[*Dr. Fredie Ardeshir Mehta* v *Union of India* (1991) 70 Comp Cas 210]**.

Tutorial Note:

The decision given in Freedie Ardeshir Mehta v Union of India was given under section 295 and 296 of the Companies Act, 1956. Sections 295 and 296 of the Companies Act, 1956 dealt with the provisions relating to loans, guarantees and securities by a company to specified persons.

Section 185 of the Companies Act, 2013 corresponds to sections 295 and 296 of the Companies Act, 2013. Just as 'loan represented by a book debt' was covered under sections 295 and 296 of the Companies Act, 1956, same way it is covered under section 185 of the Companies Act, 2013. In Fredie Ardeshir Mehta v Union of India, sale of a flat by a company to a director was held to be a credit sale, and neither a 'loan' nor a 'loan represented by a book debt' as per the provisions contained in sections 295 and 296 of the Companies Act, 1956. To conclude, the decision given in Fredie Ardeshir Mehta v Union of India shall continue to apply under the Companies Act, 2013. Accordingly, applying the provisions of section 185 of the Companies Act, 2013 and the decision given in Fredie Ardeshir Mehta v Union of India, it can be said that sale of a flat by a company to a director shall be held to be a credit sale, and neither a 'loan' nor a 'loan represented by a book debt'.

Deposit made by a company for house taken for a director – Whether amounts to a loan to a director?

P 2.24B. Following transaction is made by a public company. You are required to examine whether this transaction can be termed as loan to directors under the Companies Act, 2013:

Making a deposit with the landlord under a licence arrangement for securing a residential accommodation for the managing director of the company. [CA (Final) Nov. 2005]

OR

A Public Company secures residential accommodation for the use of its managing director by entering into a license arrangement under which the company has to deposit a certain amount with the landlord to secure compliance with the terms of the license agreement. Can it be considered as a loan to a director? [CA (Final) Nov. 1999]

OR

ASP Limited, a listed company secured residential accommodation for the use of its managing director by entering into a lease arrangement with the landlord. As per the terms of the agreement, ASP Limited deposited a sum of Rs. 10,00,000 as rental advance with landlord. Referring to the provisions of the Companies Act, 2013, decide whether the said deposit amount be considered as a loan given to the managing director. [CA (Final) Nov. 2019]

Ans. As per section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, make any loan to a director.

In the present case, the company has provided the managing director with a housing accommodation. It does not amount to a loan because of the following reasons:

- The company has not given any deposit or advance to the managing director. The amount deposited with the landlord cannot be said to be an 'indirect loan' to the managing director.
- It is a usual practice to give a security deposit to the landlord with whom a rent or lease agreement is entered into. Thus, the company has made the security deposit on account of *bonafide* business considerations.
- It is of no concern of the managing director as to the terms on which the company secures residential accommodation for him.
- It is the company and not the director who has entered into the lease agreement. Therefore, the company can at anytime use the accommodation for any other purpose and the managing director shall have to vacate it, as and when desired by the company.

Loan to a firm in which a director is a partner – Legal requirements

P 2.24C. In the light of the conditions laid down under the Companies Act, 2013 examine if the following transaction can be considered as a loan to directors:

A loan to a firm in which the director of the company is a partner. [CA (Final) Nov. 2002]

Ans. As per section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, make a loan to any person specified under section 185(1) of the Companies Act, 2013. Amongst the persons specified under section 185(1), a firm in which any director or relative of a director is a partner is also covered. Accordingly, loan cannot be made to a firm, in which the director of the company is a partner.

Does advance against salary amount to a loan?

P 2.24D. Following transaction is made by a public company. You are required to examine whether this transaction can be termed as loan to directors under the Companies Act, 2013:

A salary advance of Rs. 5,000 to an employee, who is the wife of the managing director of the company. [CA (Final) Nov. 2005]

OR

In the light of the conditions laid down under the Companies Act, 2013 examine if the following transaction can be considered as a loan to directors:

An advance payment of salary to the employee, who is also the spouse of the managing director of the company. [CA (Final) Nov. 2002]

OR

Does an advance payment of salary of Rs. 10,000 to an employee who is the wife of the managing director amount to a loan to a director under the Companies Act, 2013? [CA (Final) Nov. 1999]

OR

Wife of the managing director is employed in the company as an administrative officer. She wants an advance equal to six months' salary deductible in 24 equal instalments in accordance with the rules applicable to company's employees. [CS (Final) Dec. 1998]

Ans. No company shall, directly or indirectly, make any loan to a person specified under section 185(1) of the Companies Act, 2013.

The same issue as in the given case, was discussed in ***M.R. Electronics Components Ltd. and Others* v *Assistant Registrar* (1986) 3 Comp LJ 28**. The wife of the managing director was employed by the company on a monthly salary. The company paid her an advance of Rs. 5,000. It was held that, merely because she is the wife of the managing director, it cannot be said that Rs. 5,000 paid as advance, is in the nature a loan to the managing director. The advance payment of salary does not *per se* amount to a loan.

The burden of proving otherwise lies with the prosecution. The Court had to find out whether it was a genuine advance against salary or a loan disguised as salary advance. For this purpose, facts of the case shall be considered and in particular the following:

- Whether the beneficiary is a *bonafide* employee.
- Whether the advance falls in the general scheme of advances given by the company to other employees.
- Whether the amount paid is disproportionate to the salary of the employee.
- The conditions of repayment, like the rate of interest.
- Whether there was laxity in the recovery of advance.
- What is the capacity of the person receiving the advance.

Therefore, if the advance is paid to the wife of the managing director in her capacity of an employee as per the rules applicable to other employees of the company, and the bona fides of the advance are established, it cannot be treated as a loan and as such, the provisions of section 185(1) of the Companies Act, 2013 will not be attracted. Accordingly, salary advance to the wife of a director does not per se amount to a loan so as to violate section 185(1) of the Companies Act, 2013. The burden of proving that such transaction is a sham lies on the prosecution.

Whether a company can give guarantee w.r.t. a loan advanced to a director by a housing finance company?

P 2.24E. Mr. OK is a director of VRS Ltd. He intends to construct a residential building for his own use. The cost of construction is estimated at Rs. 1.35 crores, which Mr. OK proposes to finance partly from his own sources to the tune of Rs. 60 lacs and the balance Rs. 75 lacs from housing loan to be obtained from a housing finance company. For the purpose of obtaining the loan, he has approached the housing finance company which has in principle agreed to grant the loan, but has put a condition.

The condition put by the housing finance company is that the Company VRS Ltd. of which Mr. OK is a director should provide the guarantee for repayment of the loan and interest as per the terms of the proposed agreement for granting the loan to Mr. OK. You are required to advise Mr. OK on the matter with reference to the provisions of the Companies Act, 2013.

[CA (Final) May 2014; June 2009; May 2005]

OR

Mr. X is a director of M/s ABC Ltd. He has approached M/s Housing Finance Co. Ltd. for the purpose of obtaining a loan of Rs. 50 lacs to be used for construction of building his residential house. The loan was sanctioned subject to the condition that M/s ABC Ltd. should provide the guarantee for repayment of loan instalments by Mr. X. Advise Mr. X. [CA (Final) Nov. 2001]

Ans. As per section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, give any guarantee in connection with a loan taken by a director. Section 185(1) does not permit a company to give guarantee even with the approval of the Central Government. However, the prohibition under section 185(1) shall not apply to a company, which, in the ordinary course of its business, gives guarantees for the repayment of any loan.

In the given case, guarantee cannot be given by VRS Ltd. in respect of a loan advanced to Mr. OK by a housing finance company, unless VRS Ltd., in the ordinary course of its business, gives guarantees for the repayment of any loan.

❖❖❖

Loan to a director by a public company and private company, whether permissible?

P 2.24F. Mr. X is a director of several companies. He has approached the following companies in which he is a director for financial help to start his own personal business.

(i) Expandable Industries Ltd.

(ii) Expensive Gadgets Private Ltd.

(iii) Easy Finance Ltd.

The first named company has agreed to grant a loan of Rs. 50 lakhs. The second company also offered another loan of Rs. 50 lakhs. The third company has agreed to provide guarantee for the repayment of a loan sanctioned to Mr. X by a Private Bank to the tune of Rs. One crore. Advise Mr. X about the legal provisions that should be complied with under the Companies Act, 2013.

[CA (Final) Nov. 2008]

Ans. As per section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, advance any loan to a director or give any guarantee in connection with a loan taken by a director. Section 185(1) does not permit a company to advance any loan or give any guarantee even with the approval of the Central Government. However, the prohibition under section 185(1) shall not apply in the following cases:

Case I. Where loan is given to a managing director or whole-time director as a part of the conditions of service extended by the company to all its employees.

Case II. Where loan is given to a managing director or whole-time director pursuant to any scheme approved by the members by a special resolution.

Case III. Where a company, 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 1 year, 3 years, 5 years or 10 years Government security closest to the tenor of the loan.

Case IV. As per Notification No. G.S.R. 464(E) dated 5th June, 2015, the provisions of 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 Rs. 50 crore, whichever is lower;

(c) such a company has not defaulted in repayment of such borrowings subsisting at the time of making transactions under this section; and

(d) it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

Conclusions

1. Expandable Industries Ltd. may grant a loan of Rs. 50 lakhs to Mr. X in accordance with Case I or Case II, as explained above, if Mr. X is managing director or whole time director in such company. If Mr. X is not the managing director or whole time director of such company, loan of Rs. 50 lakhs may be granted to him in accordance with Case III above.
2. Expensive Gadgets Pvt. Ltd. may grant a loan of Rs. 50 lakhs to Mr. X in accordance with Case I or Case II, as explained above, if Mr. X is managing director or whole-time director in such company. If Mr. X is not the managing director or whole-time director of such company, loan of Rs. 50 lakhs may be granted to him in accordance with Case III above. If Expensive Gadgets Pvt. Ltd. satisfies all the 4 conditions specified in Notification No. G.S.R. 464(E) dated 5th June, 2015 as explained in Case IV above, the provisions of section 185 shall not apply to it, and so it may make loan of Rs. 50 lakhs to Mr. X.

3. Easy Finance Ltd. may provide guarantee for the repayment of loan sanctioned by a private bank in accordance with Case III above.

Loan to a director and his wife, whether permissible?

P 2.24G. Mr. DRT is a director of PCS Ltd. The said company is having sufficient liquid funds and Mr. DRT is in dire need of funds. In order to mitigate the hardship of Mr. DRT the Board of directors of PCS Ltd. wants to lend Rs. 5 lakhs to him and Rs. 2 lakhs to his wife. State whether such loans can be given and if so under what conditions. What would be your answer if the company PCS LTD would have been PCS Private Ltd. **[CA (Final) Nov. 2012]**

Ans. As per section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, advance any loan to a director or to relative of a director. Among others, the relative of a director is included in the term 'any other person in whom a director is interested'.

As per Clause (77) of section 2, wife is a relative.

Thus, the combined effect of section 185 and section 2(77) is that loan shall not be given by PCS Ltd. to its director, Mr. DRT or to the wife of Mr. DRT. Section 185 does not permit a company to give loan even with the approval of the Central Government. However, the prohibition under section 185 shall not apply in the following cases:

Case I. Where loan is given to a managing director or whole-time director as a part of the conditions of service extended by the company to all its employees.

Case II. Where loan is given to a managing director or whole-time director pursuant to any scheme approved by the members by a special resolution.

Case III. Where a company, 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 1 year, 3 years, 5 years or 10 years Government security closest to the tenor of the loan.

Case IV. As per Notification No. G.S.R. 464(E) dated 5th June, 2015, the provisions of 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 Rs. 50 crore, whichever is lower;

(c) such a company has no default in repayment of such borrowings subsisting at the time of making transactions under this section; and

(d) it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

Conclusions

1. PCS Ltd. may grant a loan of Rs. 5 lakh to Mr. DRT in accordance with Case I or Case II as explained above, if Mr. DRT is managing director or whole-time director in PCS Ltd. If Mr. DRT is not the managing director or whole-time director of PCS Ltd., loan of Rs. 5 lakh may be granted to him in accordance with Case III above.
2. PCS Ltd. may grant a loan of Rs. 2 lakh to wife of Mr. DRT in accordance with Case III above.
3. If PCS Ltd. were a private company, the provisions of section 185 shall not apply to it if it satisfies all the 4 conditions specified in Notification No. G.S.R. 464(E) dated 5th June, 2015 as explained in Case IV above, and so it may grant a loan of Rs. 5 lakh to Mr. DRT and a loan of Rs. 2 lakh to wife of Mr. DRT.

Loan by a holding company to its wholly owned subsidiary company – Whether permitted?

P 2.24H. Following transaction is made by a public company. You are required to examine whether this transaction is covered under section 185 of the Companies Act, 2013:

Loan to its 100% (One hundred per cent) subsidiary company. **[CA (Final) Nov. 2005]**

OR

Can a holding company advance any loan to its wholly owned subsidiary company? What are the relevant provisions of the Companies Act, 2013 with regard to granting of loans by holding company to its wholly owned subsidiary company? Mention the penalties for the contravention of the provisions of the Company Act, 2013. **[CA (Final) Nov. 2016]**

Ans. The given problem relates to section 185 of the Companies Act, 2013.

Section 185(1) imposes certain prohibitions and section 185(2) requires fulfilment of certain conditions with respect to loans to directors etc. and guarantees or securities in connection with loans to directors etc.

However, as per section 185(3), the provisions of section 185(1) and 185(2) shall not apply in case of the following transactions (*i.e.* following transactions are permitted):

(a) Where a holding company makes a loan to its wholly owned subsidiary company provided such loan is utilized by the wholly owned subsidiary company for its principal business activities.

(b) Where a holding company gives guarantee or provides security in connection with a loan made by any person to its wholly owned subsidiary company provided such loan is utilized by the wholly owned subsidiary company for its principal business activities.

Effects of contravention of section 185 [Section 185(4)]

(a) The company shall be punishable with fine which shall not be less than Rs. 5 lakh but which may extend to Rs. 25 lakh.

(b) The director or 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 shall be punishable with imprisonment upto 6 months or with fine which shall not be less than Rs. 5 lakh but which may extend to Rs. 25 lakh, or with both.

(c) Every officer of the company who is in default shall be punishable with imprisonment upto 6 months or with fine which shall not be less than Rs. 5 lakh but which may extend to Rs. 25 lakh.

Loan by a holding company to its wholly owned subsidiary company – Whether permitted?

P 2.241. Queen Construction Company Ltd. acquired 60% of the equity paid up share capital of ABC Ltd. Queen Construction Ltd. has planned to expand its operation for which additional fund is required. The Board of directors decided to avail additional exposure of Rs. 10 crore from the Bank.

The following data is furnished as on 30th June, 2017.

	Rs. in crores
Authorised Equity Share Capital	**25**
Issued and Subscribed Equity Share Capital	**22**
Paid up Equity Share Capital	**20**
Capital Reserve	**2**
Revaluation Reserve	**1**
General Reserve	**3**
Open cash credit Limit (for working capital requirement) with the Bank repayable in 3 months	**5**
Loan obtained under the Hire Purchase agreement for acquiring vehicles	**1**
Long term borrowing from Banks and other parties	**15**

ABC Ltd. approached Queen Construction Ltd. to grant a loan of Rs. 25 Lakhs and stand as guarantor for repayment of loan Rs. 10 Lakhs to be sanctioned by a Bank.

The two loans (25 lakhs plus 10 lakhs) will be utilized by ABC Ltd. for its principal business activities.

You being the financial advisor of the company, advise the Board of directors about the procedure to be followed to avail additional exposure of Rs. 10 crore from the bank. Also evaluate whether the loan/guarantee given by Queen Construction Ltd. to ABC Ltd. is valid according to section 185 of the Companies Act, 2013. [CA (Final) May, 2018]

Ans. The given problem relates to section 180(1)(c) and section 185 of the Companies Act, 2013.

The given questions are answered as under:

(1) Procedure to be followed for availing additional exposure of Rs. 10 crore from the Bank

As per section 180(1)(c), without the prior consent of the members in general meeting by way of a special resolution, the Board of directors of a company shall not borrow moneys where the borrowings (already made plus proposed) exceed the aggregate of the paid up share capital, free reserves and securities premium account. The total amount upto which moneys may be borrowed by the Board of directors must be specified in the special resolution passed by the company in the general meeting. However, temporary loans obtained from the company's bankers in the ordinary course of business shall not be considered as borrowings.

'Temporary loans' means loans repayable on demand or within 6 months from the date of the loan. But loans raised for the purpose of financial expenditure of a capital nature shall not be treated as temporary loans and will be included in borrowings.

The aggregate of paid up share capital, free reserves and securities premium account amounts to Rs. 23 crores. Capital reserve and revaluation reserve shall not be considered as free reserves since as they are not free for distribution of dividend.

The company has already borrowed Rs. 21 crores out of which Rs. 5 crores (Open cash credit Limit for working capital requirement) is not to be considered as borrowings since it amounts to temporary loan in terms of section 180(1)(c). Thus, the amount already borrowed for the purpose of section 180(1)(c) is Rs. 16 crores.

Thus, the Board can borrow upto Rs. 7 crores without the consent of the shareholders in general meeting by way of a special resolution.

Since the Board of directors of Queen Construction Company Ltd. proposes to borrow Rs. 10 crore from a bank, such borrowing requires the consent of the shareholders in general meeting by way of a special resolution.

(2) Whether the loan/guarantee given by Queen Construction Ltd. to ABC Ltd. is valid?

As per section 185(2), a company may, by passing a special resolution, –

(i) advance any loan, including any loan represented by a book debt, to any person in whom any of the director of the company is interested; or

(ii) give any guarantee in connection with any loan taken by any person in whom any of the director of the company is interested; or

(ii) provide any security in connection with any loan taken by any person in whom any of the director of the company is interested.

The expression 'any person in whom any of the director of the company is interested' means –

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

(b) a body corporate at a general meeting of which 25% or more total voting power may be exercised or controlled by any such director, or by two or more such directors together.

(c) a body corporate, the Board of directors or managing director or manager whereof is accustomed to act in accordance with the directions or instructions of the Board or any director of the lending company.

In the given case, Queen Construction Company Ltd. proposes to grant a loan of Rs. 25 lakhs to ABC Ltd. and also proposes to stand as guarantor for repayment of loan Rs. 10 lakhs to be sanctioned by a bank to ABC Ltd.

Since ABC Ltd. is not covered within the term 'any person in whom any of the director of the company is interested', the provisions of section 185 are not attracted at all.

However, Queen Construction Company Ltd. shall comply with the provisions of section 186 for granting a loan of Rs. 25 lakhs to ABC Ltd. and also for standing as guarantor for repayment of loan of Rs. 10 lakhs to be sanctioned by a bank to ABC Ltd.

Advanced Practical Problems

House building loan whether permitted?

P 2.24J. A Ltd. desires to grant a loan of Rs. 2 crore to one of its directors for the purpose of house building. Advise.

Ans. As per section 185(1) of the Companies Act, 2013, no company shall, directly or indirectly, give any loan to a director.

Section 185(1) does not make any special provision where loan is to be utilised by a director for house building. Accordingly, A Ltd. cannot give any loan to its director. However, the prohibition under section 185(1) shall not apply in the following cases:

(a) Where loan is given to a managing director or whole-time director as a part of the conditions of service extended by the company to all its employees.

(b) Where loan is given to a managing director or whole-time director pursuant to any scheme approved by the members by a special resolution.

(c) Where a company, 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 1 year, 3 years, 5 years or 10 years Government security closest to the tenor of the loan.

Tutorial Note w.r.t. house building loans

The Department of Company Affairs (Now Ministry of Corporate Affairs) had issued a Press Note permitting the companies to grant house building loans to its directors, subject to fulfilment of all the following conditions:

(a) The loan shall be made only to the managing director or whole-time director of the company.

(b) The loan shall be made on such terms and conditions as are applicable to other officers and employees of the company [F. No. 3/37/93-CL-V; Press Note No. 4/93, dated 20-08-1993].

The above Press Note had been issued for the purposes of section 295 of the Companies Act, 1956. The provisions contained in the above Press Note shall not apply after the commencement of section 185 of the Companies Act, 2013. Therefore, for the purpose of section 185 of the Companies Act, 2013, the above Press Note has become irrelevant.

2.25 Restrictions with respect to layers of investment companies [Section 186(1)]

1. Maximum 2 layers

Unless otherwise prescribed, a company shall not make investment through more than two layers of investment companies.

2. Exceptions

(i) A company may acquire any other company incorporated in a country outside India, even if such other company has investment subsidiaries beyond 2 layers as per the laws of such country.

(ii) A subsidiary company may have any investment subsidiary for the purposes of meeting the requirements under any law, rule or regulation.

2.26 Loans and investments by a company [Section 186 except Section 186(1) and 186(11), and Rules 11 and 13]

1. Scope of section 186

Section 186 regulates the following transactions:

(a) Where a company makes, directly or indirectly, any loan to any body corporate or to any other person.

(b) Where a company gives, directly or indirectly, any guarantee in connection with a loan made to any body corporate or to any other person.

(c) Where a company provides, directly or indirectly, any security in connection with a loan made to any body corporate or to any other person.

(d) Where a company gives, directly or indirectly, acquires by way of subscription, purchase or otherwise, the securities of any body corporate.

2. Limit for making loan, investment, guarantee or security, and approval of members by special resolution

(a) Limit for making loan, investment, guarantee or security [Section 186(2)]. The limit on making loan, investment, guarantee or security (either individually or more than one of these transactions together) is *higher of the following*:

(i) 60% of the aggregate of paid up share capital, free reserves and securities premium account.

Paid up share capital shall include paid up equity share capital as well as paid up preference share capital.

(ii) 100% of free reserves and securities premium account.

(b) Approval by special resolution [Section 186(3)]. Where the 'aggregate of loan, investment, guarantee or security already made' together with 'the aggregate of loan, investment, guarantee, or security proposed to be made' exceeds the limit specified u/s 186(2), prior approval by means of a special resolution shall be necessary.

(c) No requirement of special resolution in certain cases [First and Second Proviso to Section 186(3)]. No approval by way of a special resolution shall be required in the following cases:

(i) Where loan is given by a holding company to its wholly owned subsidiary company or a joint venture company.

(ii) Where guarantee is given by a holding company in connection with a loan made to its wholly owned subsidiary company or a joint venture company.

(iii) Where security is provided by a holding company in connection with a loan made to its wholly owned subsidiary company or a joint venture company.

(iv) Where acquisition of securities is made by a holding company (whether by way of subscription, purchase or otherwise) of the securities of its wholly owned subsidiary company.

Where a special resolution is not required as per points (i) to (iv) above, the company shall disclose the details of such loans or guarantee or security or acquisition in the financial statement as provided under section 186(4).

(d) Certain transactions to be ignored [Explanation to Section 186(2)]. For the purpose of calculating 'the aggregate of loan, guarantee, security or investment already made' and 'the aggregate of loan, guarantee, security or investment proposed to be made', following transactions shall be ignored:

(i) Loan given or proposed to be given by a company to any employee of the company.

(ii) Guarantee given or proposed to be given by a company to any person in connection with a loan given to any employee of the company.

(iii) Security provided or proposed to be provided by a company to any person in connection with a loan given to any employee of the company.

(e) Time of passing special resolution. If the limit u/s 186(2) is exceeded, the special resolution shall be required before making any loan, investment, guarantee or security.

(f) Manner of passing special resolution (Section 186 read with Section 110).

(i) If the proposed business relates to making of any loan, guarantee or security to any person, the special resolution can be passed only by means of postal ballot, and not in the general meeting.

(ii) If the proposed business relates to making of any investment in the securities of a body corporate, the special resolution may be passed in the general meeting or by postal ballot.

Non-applicability of postal ballot

One Person Companies and other companies having members upto 200 are not required to transact any business through postal ballot (Rule 22 of the Companies (Management and Administration) Rules, 2014).

(g) ***Contents of special resolution.*** The special resolution passed by the members shall specify the total amount up to which the Board is authorised to make loan, guarantee, security or investment (Rule 13 of the Companies (Meetings of Board and its Powers) Rules, 2014).

As per section 102, notice of the meeting in which the special resolution is to be passed shall contain an explanatory statement including all the particulars as required under section 102.

3. Approval of the Board

(a) ***Approval in all cases.*** The approval of the Board is required in all cases irrespective of the amount of loan, investment, guarantee, or security.

(b) ***Prior approval.*** The approval of the Board is to be obtained prior to making of loan, investment, guarantee or security.

(c) ***Resolution to be passed at a Board meeting.*** The approval of the Board shall be obtained by passing a resolution at a Board meeting only. Resolution by circulation as per the provisions of Section 175 or a resolution of committee of directors is not sufficient.

(d) ***Unanimous approval.*** The approval of the Board shall be obtained by means of a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting.

(e) ***No specific notice.*** Under section 186, there is no requirement of giving specific notice to the directors. As such, the business relating to making of loan, investment, guarantee or security may be taken at the Board meeting under *'any other business'* even if the agenda of Board meeting does not include it.

4. Approval of the Public Financial Institution

The company shall obtain the prior approval of the Public Financial Institution from which it has taken a term loan. The prior approval is required even if the loan agreement does not specify any such condition.

No approval of Public Financial Institution

Prior approval of the Public Financial Institution is not required, if the following two conditions are satisfied:

(i) The aggregate of loans, investments, guarantee, or security already made together with the loan, investment, guarantee, or security proposed to be made does not exceed the limit given u/s 186(2).

(ii) There is no default in repayment of loan instalments or interest to Public Financial Institution as per the terms and conditions of such term loan.

5. Minimum rate of interest

The rate of interest chargeable on any loan shall not be less than the prevailing yield of 1 year, 3 year, 5 year or 10 year Government Security closest to the period of the loan.

1. Situation where effective yield is greater than prevailing yield

Where the effective yield (effective rate of return) on tax free bonds is greater than the prevailing yield of 1 year, 3 year, 5 year or 10 year Government Security closest to the tenor of the loan, there is no violation (MCA General Circular No. 06/2015 dated 9th April, 2015).

2. Non-applicability to certain licenced companies

In case of a company licenced under section 8 in which 26% or more of the paid up share capital is held by the Central Government or one or more State Governments or both, and which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, this provision shall not apply, in respect of loans provided by such company for funding Industrial Research and Development projects in furtherance of its objects as stated in its memorandum of association [Notification No. G.S.R. 466(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 584(E) dated 13th June, 2017].

6. No subsisting default w.r.t. deposits

A company which has defaulted in repayment of any deposits accepted by it (whether before or after the commencement of this Act) or in payment of interest on deposits, shall not make any loan, investment, guarantee or security, till such default is subsisting. In other words, where a company fails to repay the deposits or interest thereon, on the due date, it may make loan, investment, guarantee or security only after the default has been made good.

7. Disclosure in financial statement

The company shall disclose to the members in the financial statement –

(a) full particulars of the loans given, investment made or guarantee given or security provided; and

(b) the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient.

8. Special provisions w.r.t. Companies registered u/s 12 of SEBI Act [Section 186(6) read with Rule 11]

(a) A company shall not take inter-corporate loan or deposits exceeding the limit specified under the regulations applicable to it, pursuant to which it has obtained certificate of registration from the Securities and Exchange Board of India if –

(i) it is registered under section 12 of the Securities and Exchange Board of India Act, 1992; and

(ii) it is covered under such class or classes of companies as may be prescribed by the Central Government in consultation with the Securities and Exchange Board of India.

(b) Such company shall furnish in its financial statement the details of such loan or deposits.

Some examples of companies which are registered under section 12 of the Securities and Exchange Board of India Act, 1992 are:

- Stock broker
- Sub-broker
- Merchant banker
- Registrar to issue
- Banker to issue
- Underwriter
- Share transfer agent
- Portfolio Manager

9. Punishment for contravention

If a company contravenes the provisions of this section, the punishment shall be as follows:

(i) The company shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh.

(ii) 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 Rs. 25,000 but which may extend to Rs. 1 lakh.

2.27 Non-applicability of section 186 [Section 186(11)]

Nothing contained in section 186 (except sub-section (1) of section 186) shall apply to –

1. any loan made, any guarantee given or any security provided or any investment made by –

   (a) a banking company in the ordinary course of its business; or

   (b) an insurance company in the ordinary course of its business; or

   (c) a housing finance company in the ordinary course of its business; or

   (d) a company established with the object of and engaged in the business of financing industrial enterprises, or of providing infrastructural facilities.

2. any investment –

   (a) made by an investment company;

   (b) made in shares allotted in pursuance of right issue made by a company in accordance with section 62(1)(a) of the Companies Act, 2013; or

   (c) made in shares allotted in pursuance of right issue made by a body corporate; or

   (d) made, in respect of investment or lending activities, by a non-banking financial company registered under Chapter III-B of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities.

1. As per Rule 11 of the Companies (Meetings of Board and its Powers) Rules, 2014, the expression 'business of financing industrial enterprises' shall include, with regard to a Non-Banking Financial Company registered with Reserve Bank of India, 'business of giving of any loan to a person or providing any guarantee or security for due repayment of any loan availed by any person in the ordinary course of its business'.

2. As per Notification No. G.S.R. 463(E) dated 5th June, 2015, the provisions of section 186 shall not apply to –

   (a) a Government company engaged in defence production;

   (b) a Government company, other than a listed company, in case such company obtains prior approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government,

   if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

3. For the purpose of section 186, the expression 'investment company' means a company whose principal business is the acquisition of shares, debentures or other securities and a company shall be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, debentures or other securities constitute not less than 50% of its total assets, or if its income derived from investment business constitutes not less than 50% as a proportion of its gross income.
4. For the purpose of section 186, the expression 'infrastructural facilities' means the facilities specified in Schedule VI.

Practical Problems from CA Examinations

Whether proposed loan and investments is permissible without passing special resolution?

P 2.27A. Following information is available from the audited Balance Sheet as at 31st December, 2014 of ASK Ltd.:

Capital and Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital:		*Fixed Assets:*	
Equity Share Capital (5,00,000 shares of Rs. 10 each fully paid up in cash)	50,00,000	Goodwill	10,00,000
		Land & buildings	75,00,000
		Plant & Machinery	1,50,00,000
Less: Calls in arrears	50,000	Furniture & Other Assets	2,50,000
	49,50,000		
Preference Share Capital	15,00,000	*Investments:*	
Share Application Money	10,00,000	Equity Shares in wholly owned Subsidiary Company – KMC Ltd.	12,50,000
Reserves and Surplus:			
Securities Premium A/c	15,00,000	Equity Shares representing 90% of Share capital of MTC Ltd.	4,50,000
Capital Redemption Reserve	12,00,000	Debentures in SKT Ltd.	12,00,000
Fixed Assets Revaluation Reserve	10,50,000	Preference Shares in HUT Ltd.	5,00,000
Sinking Fund Reserve	11,00,000	Capital Account Balance in Partnership Firm – BKP & Co.	8,00,000
General Reserve	40,00,000		
Profit & Loss A/c	22,00,000		
Dividend Equalisation Reserve	6,00,000	*Current Assets:*	
Secured Loans:		Stock and Book Debts	14,00,000
Cash Credit facility from Bank	1,00,00,000	Cash & Bank Balances	1,00,000
Unsecured Loans:		Loans & Advances:	
Fixed Deposits (from general public maturing after 31.12.2015)	20,00,000	Intercorporate Deposits	25,00,000
Current Liabilities & Provisions:		Business Advances	14,00,000
Current Liabilities	12,50,000		
Provision for Taxation	10,00,000		
	3,33,50,000		3,33,50,000

The directors of the company want to make further investments stated below by taking a decision in the meeting of Board of directors without seeking approval of the shareholders:

(a) Loan to KMC Ltd.	**25,00,000**
(b) Loan to MTC Ltd.	**15,00,000**
(c) Purchase of further debentures in SKT Ltd.	**8,00,000**
(d) Purchase of shares from the open market in Glaxo Ltd.	**15,00,000**

You are required to state, with to the relevant provisions of the Companies Act, 2013, whether the directors can do so and mention the relevant calculations. **[CA (Final) May 2007]**

Ans.

Requirements for making loans, investments etc.

(a) Unanimous approval of Board is required. The approval shall be obtained by passing a resolution at a Board meeting.

(b) Special resolution is required if the aggregate of loans etc. (already made plus proposed) exceeds the higher of –
- 60% of the aggregate of paid up share capital, free reserves and securities premium account; *or*
- 100% of its free reserves and securities premium account.

(c) Approval of Public Financial Institution shall be obtained unless –
- the limit under section 186(2) is not exceeded; *and*
- there is no default in repayment of loan instalments or interest.

(d) No default with respect to repayment of deposits or payment of interest on deposits is subsisting.

Following points are worth noting with respect to the given problem:

(i) Share application money shall not be considered while calculating the limits under section 186(2), since it is not 'paid up share capital' or 'free reserves' or 'securities premium account'.

(ii) Capital redemption reserve, Fixed Assets Revaluation Reserve and sinking fund are not available for distribution as dividend and hence are not included in free reserves.

(iii) Dividend Equalisation Reserve is available for distribution as dividend, and is therefore, included in the free reserves.

(iv) Provision for taxation is a liability and is therefore, not included in free reserves.

(v) Investment made in Partnership firm BKP & Co. is neither 'loan' nor 'investment in securities of a body corporate', and is therefore, not included in the 'loans, investments etc.' already made.

First determine whether a special resolution is required for making the proposed loans, investments etc. This can be determined as under:

	Amount (Rs.)
Step 1. Determine the paid up share capital	
Equity share capital	50,00,000
Less: Calls unpaid	50,000
Balance	49,50,000
Preference share capital	15,00,000
Paid up share capital	***64,50,000***
Step 2. Determine the 'free reserves'	
General reserve	40,00,000
Profit & loss A/c	22,00,000
Dividend equalisation reserve	6,00,000
Free reserves	***68,00,000***
Step 3. Determine the overall limit for loans, investments etc., i.e. higher of 60% of (paid up share capital, free reserves and securities premium account) or 100% of (free reserves and securities premium account)	
(i) 60% of (64,50,000 + 68,00,000 + 15,00,000)	88,50,000
(ii) 100% of (68,00,000 + 15,00,000)	83,00,000
Overall limit for loans, investments etc. [Higher of (i) and (ii)]	***88,50,000***
Step 4. Determine loans, investments etc. already made	
Equity Shares in wholly owned Subsidiary Company – KMC Ltd.	12,50,000
Equity Shares of MTC Ltd.	4,50,000
Debentures in SKT Ltd.	12,00,000
Preference Shares in HUT Ltd.	5,00,000
Intercorporate Deposits	25,00,000
Total loans, investments etc. already made	***59,00,000***

As per first proviso to section 186(3), where investment is proposed to be made by a holding company in its *wholly owned subsidiary*, the requirement of passing special resolution as per section 186(3) shall not be applicable. However, any investment in wholly owned subsidiary already made by the holding company shall be included in loans, investments etc. already made by the company. Therefore, investment of Rs. 12,50,000 made in equity shares of KMC Ltd. has been included while determining loans, investment etc. already made.

Step 5. Determine loans, investments etc. proposed to be made	
Loan to KMC Ltd.	N. A.
Loan to MTC Ltd.	15,00,000
Debentures in SKT Ltd.	8,00,000
Shares in Glaxo Ltd.	15,00,000
Proposed loans, investments etc.	***38,00,000***

As per first proviso to section 186(3), where loan is proposed to be given by a holding company to its wholly owned subsidiary, the requirement of passing special resolution as per section 186(3) shall not be applicable. Therefore, proposed loan of Rs. 25,00,000 to KMC Ltd. (a wholly owned subsidiary of ASK Ltd.) has been ignored.

Step 6. Determine whether special resolution is required

Loans, investments etc. already made *plus* loans, investments etc. proposed to be made 97,00,000
Overall limit for loans, investments etc. 88,50,000

Since loans, investments etc. already made together with loans, investments etc. proposed to be made (Rs. 97,00,000) exceed the overall limit for loans, investments etc., special resolution is required.

Therefore, ASK Ltd. may make the proposed loans, investments etc. as follows:

(a) A resolution shall be passed at a Board meeting with the consent of all the directors present.

(b) A special resolution shall be passed in the general meeting authorising the company to make loans, investments etc. upto or exceeding Rs. 97,00,000.

(c) The company shall, *within 7 days*, enter the prescribed particulars in the register maintained as per section 186(9).

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

(e) The company shall ensure that no default with respect to deposits is subsisting. Since deposits are maturing only after 31.12.2015, this condition is fulfilled.

Fresh investments in subsidiary exceeding the ceiling – Legal requirements

P 2.27B. Amar Textiles Ltd. is a company engaged in manufacture of fabrics. The company has investments in shares of other bodies corporate including shares in Amar Cotton Co. Ltd. and it has also advanced loans to other bodies corporate. The aggregate of all the investments made and loans granted by Amar Textiles Ltd. exceeds 60% of its paid up share capital, free reserves and securities premium account and also exceeds 100% of its free reserves and securities premium account. In course of its business requirements, Amar Textiles Ltd. has obtained a term loan from Industrial Development Bank of India and the same is still subsisting. Now the Company wants to increase its holding from 70% to 80% of the equity share capital in Amar Cotton Co. Ltd. by purchase of additional 10% shares from other existing shareholders.

State the legal requirements to be complied with by Amar Textiles Ltd. under the provisions of the Companies Act, 2013 to give effect to the above proposal.

Will your answer be different if Amar Textiles Ltd. would have defaulted in payment of matured fixed deposits accepted by it from the public?

[CA (Final) May 2012, May 2008, May 2005]

OR

Amar Textiles Ltd. is a Company engaged in manufacture of fabrics. The Company has investments in Shares of other Bodies Corporate including 70% Shares in Amar Cotton Co. Ltd. and it has also advanced loans to other bodies corporate. The aggregate of all the investments made and loans granted by Amar Textiles Ltd. exceeds 60% of its Paid up Share Capital, Free Reserves and securities premium account and also exceeds 100% of its Free Reserves and securities premium account. In course of its business requirements, Amar Textiles Ltd. has obtained a term loan from industrial Development Bank of India and the said loan is still subsisting. Now the Company wants to increase its holding from 70% to 80% of the Equity Share Capital in Amar Cotton Co. Ltd. by purchase of additional 10% Shares from other existing Shareholders. State the legal requirements to be compiled with by Amar Textiles Ltd under the provisions of the Companies Act, 2013 to give effect to the above proposal.

[CA (Final) June 2009]

Ans. In the given case, the aggregate of loans and investments already made by Amar Textiles Ltd. exceeds the two limits of 60% and 100% specified under section 186(2). Therefore, the company may make new intercorporate investments only by passing a special resolution. As per first proviso to section 186(3), where investment is made by a holding company in its wholly owned subsidiary, special resolution is not required. However, such benefit shall not be available in the given case since Amar Cotton Co. Ltd. is only a subsidiary of Amar Textiles Ltd., and is not a wholly owned subsidiary.

The proposed investment can be made as follows:

(a) A resolution shall be passed at a Board meeting with the consent of all the directors present.

(b) A special resolution shall be passed in the general meeting. Notice of the meeting in which the special resolution is to be passed shall contain an explanatory statement including all the particulars as required under section 102.
   The special resolution passed by the members shall specify the total amount up to which the Board is authorised to make loan, guarantee, security or investment (Rule 13 of the Companies (Meetings of Board and its Powers) Rules, 2014).

(c) IDBI is not a Public Financial Institution within the meaning of Clause (72) of Section 2 of the Companies Act, 2013. Therefore, prior approval of IDBI is not required.

(d) The company shall, within 7 days of making the investment, enter the prescribed particulars in the register maintained as per section 186(9).

(e) The company shall ensure that no default in repayment of deposits or payment of interest on deposits is subsisting. If the company has defaulted in repayment of deposits, the company cannot make any investments even if unanimous resolution is passed in the Board meeting and special resolution is passed in the general meeting. The investments can be made only after the default has been made good.

(f) The company shall disclose to the members in the financial statement the full particulars of the investment made.

Certain powers exercisable by the Board or not – A few cases

P 2.27C. Advise the Board of directors of a public company about their powers in respect of the following proposals explaining the relevant provisions of the Companies Act, 2013:

Delegating to the managing director of the company the power to invest surplus funds of the company in the shares of some companies. [CA (Final) May 2003, June 2009 (Modified)]

OR

Advise the Board of directors of Spectra Papers Ltd. regarding validity and extent of their powers, under the provisions of the Companies Act, 2013 in relation to delegation of power to the managing director of the company to invest surplus funds of the company in the shares of some companies. [CA (Final) May 2010 (Modified)]

Ans. As per section 179(1) of the Companies Act, 2013, the Board is entitled to exercise all such powers as the company is authorised to exercise. Similarly, the Board is authorised to do all such acts and things as the company is authorised to do. However, the provisions of section 179(1) of the Companies Act, 2013 are subject to the other provisions of the Companies Act, 2013 (*e.g.* Sections 179(3), 180, 181 and 182 of the Companies Act, 2013).

As per section 179(3) of the Companies Act, 2013, the powers relating to investment of funds of the company shall be exercised by the Board at a Board meeting only. However, such power may be delegated by the Board, subject to the following:

(a) The power to invest the funds of the company may be delegated to a committee of directors, managing director, manager, a principal officer of the company or a principal officer of the branch office.

(b) The delegation of power shall be made by passing a resolution at a Board meeting.

(c) The Board may delegate such power subject to such conditions as it may deem fit.

However, as per section 186 of the Companies Act, 2013, acquisition of securities of any body corporate shall be made by passing a unanimous resolution at a Board meeting only. Therefore, as per section 186, the power to invest the funds in the shares of other companies cannot be delegated.

In the present case, the power to invest surplus funds of the company in the shares of some companies is proposed to be delegated to the managing director of the company. Such delegation is not permissible in view of provisions of section 186 of the Companies Act, 2013.

Legal requirements for making an investment of Rs. 45 lakhs in another company

P 2.27D. Star Limited proposes to acquire 15% equity shares of Gain Investments (P) Limited for 45 lakhs which has a face value of Rs. 35 lakhs. Star Limited has an outstanding loan of Rs. 15 lakhs to a public financial institution and had not defaulted in the repayment of loan installments stipulated in the loan agreements. Based on the following financial data, advise Star Limited about the legal position regarding the allowability of the proposed investment under the provisions of the Companies Act, 2013.

	(Rs. in Crores)	
	Star Ltd.	**Gain Investments (P) Ltd.**
Authorized Capital	**1.00**	**3.00**
Paid up Share Capital	**0.50**	**2.00**
Free Reserves	**0.20**	**1.50**

As on the date of proposition, Star Ltd. does not hold any shares of any company. [CA (Final) Nov. 2017]

Ans.

Requirements for making loans, investments etc. (Section 186)

(a) Unanimous approval of Board is required. The approval shall be obtained by passing a resolution at a Board meeting.

(b) Special resolution is required if the aggregate of loans etc. (already made plus proposed) exceeds the *higher of* –

- 60% of the aggregate of paid up capital, free reserves and securities premium account; *or*
- 100% of its free reserves and securities premium account.

(c) Approval of Public Financial Institution shall be obtained unless –

- the limit under section 186(2) is not exceeded; *and*
- there is no default in repayment of loan instalments or interest.

(d) No default with respect to repayment of deposits or payment of interest on deposits is subsisting.

First determine whether a special resolution is required for making the proposed loans, investments etc. This can be determined as under:

Determine the overall limit for loans, investments etc., i.e. higher of 60% of (paid up share capital, free reserves and securities premium account) or 100% of (free reserves and securities premium account)

(i) 60% of (0.5 crore + 0.2 crore)	0.42 crore
(ii) 100% of Rs. 0.2 crore	0.2 crore
Overall limit for loans, investments etc. [Higher of (i) and (ii)]	***0.42 crore***
Loans, investments etc. already made by Star Limited	***Nil***

Determine loans, investments etc. proposed to be made

Investments in equity shares of Gain Investments (P) Limited	Rs. 0.45 crore

(for the purpose of section 186, the face value of shares is immaterial)

Determine whether special resolution is required

Since loans, investments etc. already made *plus* loans, investments etc. proposed to be made exceed the overall limit for loans, investments etc., special resolution is required.

Therefore, Star Ltd. may make the investments in equity shares of Gain Investments (P) Limited as follows:

(a) A resolution shall be passed at a Board meeting with the consent of all the directors present.

(b) A special resolution shall be passed in the general meeting authorising the company to make investments in equity shares of Gain Investments (P) Limited.

(c) The company shall, *within 7 days*, enter the prescribed particulars in the register maintained as per section 186(9).

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

(e) The company shall ensure that no default with respect to deposits is subsisting.

(f) Star Limited shall have to obtain the prior approval of the Public Financial Institution from which it has obtained the term loan, since the proposed investment exceeds the limit specified u/s 186(2), even though there is no default in repayment of loan installments.

Four out of five directors present in Board meeting approve making of a loan – Consequences

P 2.27E. Soft and Secure Lenders Limited, has convened a Board Meeting on 25th October, 2016. One of the items of the agenda is to approve the grant of loan of Rs. 20 crore to Easy Going Industries Limited, for expansion of its business activities. At the Board Meeting, out of the total of six directors of the lending company, five directors were present and except one director, the remaining four directors approved the grant of loan of Rs. 20 crores to Easy Going Industries Limited. The borrowing company has taken loans from a public financial institution and also deposits from public. Examine the loan proposal with reference to the provisions of the Companies Act, 2013. **[CA (Final) Nov. 2016]**

Ans. The given problem relates to section 186 of the Companies, as discussed below:

Section 186 imposes a number of conditions on the company making a loan to any other body corporate or person. Some of these conditions are as under:

1. Unanimous approval of the Board is required, *i.e.* a resolution is to be passed in the Board meeting with the consent of all the directors present in the Board meeting.
2. Approval of the members is also required, if the limit specified under section 186(2) is exceeded.
3. Prior approval of the Public Financial Institution (from which the lending company has taken a term loan) is required, subject to some exception.
4. The lending company shall make a loan only if there is no default in repayment of deposits or payment of interest on deposits accepted by it.
5. The rate of interest to be charged on loan by the lending company shall not be less than the yield of Government securities closest to the tenor of the loan.
6. The lending company shall make the required disclosures in its financial statements.
7. The company shall, *within 7 days*, enter the prescribed particulars in the register maintained as per section 186(9).

In the given case, Soft and Secure Lenders Limited is the lending company which intends to make a loan of Rs. 20 crore to Easy Going Industries Limited (*i.e.* the borrowing company). Since, Easy Going Industries Limited is the borrowing company, the facts that Easy Going Industries Limited has taken loans from a public financial institution and has accepted deposits from public are irrelevant for the purpose of section 186.

In the Board meeting of Soft and Secure Lenders Limited, the decision to make a loan of Rs. 20 crore was passed with the consent of 4 directors out of 5 directors present in the Board meeting. It is evident that the requirement of section 186 that the decision to make a loan has to be approved by a unanimous resolution in the Board meeting (*i.e.* with the consent of all the directors present in the Board meeting, *i.e.* 5, in the given case) has not been satisfied. Accordingly, Soft and Secure Lenders Limited cannot make a loan of Rs. 20 crore to Easy Going Industries Limited.

Whether section 186 is applicable where a company gives guarantee or provides security in connection with loans made to its employees?

P 2.27F. ASK Housing Finance Company Limited are prepared to give housing loans to the employees of M/s NEWS Pharmacy Limited subject to the condition that the loans are guaranteed by M/s NEWS Pharmacy Limited. M/s NEWS Pharmacy Limited is not a listed company and the company will be exceeding the limits prescribed under the Companies Act, 2013 by providing the guarantees. Advise the company about this legal requirement under the Companies Act, 2013 to give effect to the above proposal. What would be your advice if the company was required to provide security instead of guarantee?

[CA (Final) May 2018]

Ans. The given problem relates to section 186 of the Companies Act, 2013, as discussed below:

The legal position

1. Where a company gives any guarantee or provides any security in connection with a loan made to any body corporate or to any other person, it is required to comply with the provisions contained in sub-sections (2), (3), (4), (5), (7) and (8) of section 186.
2. However, as per Explanation to section 186(2), any guarantee given or any security provided by a company in connection with a loan made to any employee of the company shall not be considered while calculating 'the aggregate of loan, guarantee, security or investment already made' and 'the aggregate of loan, guarantee, security or investment proposed to be made'.

The given case and analysis of the case

3. M/s NEWS Pharmacy Limited intends to give guarantee in connection with loans made by ASK Housing Finance Company Limited to the employees of M/s NEWS Pharmacy Limited.
4. The guarantees proposed to be given by M/s NEWS Pharmacy Limited shall be covered in the Explanation to section 186(2), and so such guarantees shall not be considered while calculating 'the aggregate of loan, guarantee, security or investment already made' and 'the aggregate of loan, guarantee, security or investment proposed to be made'.

Conclusion

5. The provisions of section 186(2) and 186(3) shall not apply to the guarantees given by M/s NEWS Pharmacy Limited. Thus, NEWS Pharmacy Limited can give such guarantees without passing any special resolution. However, M/s NEWS Pharmacy Limited shall have to comply with other requirements contained in section 186, *i.e.* –
   (a) Unanimous approval of the Board shall be required, *i.e.* a resolution shall be passed in the Board meeting with the consent of all the directors present in the Board meeting.
   (b) If M/s NEWS Pharmacy Limited has taken any term loan from any Public Financial Institution, then, prior approval of such Public Financial Institution shall be required, subject to some exception.
   (c) It shall be ensured that there is no default in repayment of deposits or payment of interest on deposits accepted by it.
   (d) It shall make the required disclosures in its financial statements.
   (e) It shall, *within 7 days*, enter the prescribed particulars in the register maintained as per section 186(9).
6. Further, M/s NEWS Pharmacy Limited shall have to comply with the provisions of section 179(3), *i.e.* the guarantees shall be given pursuant to a resolution passed by the Board in a Board meeting only, or the Board may delegate the power to give such guarantees in accordance with the provisions contained in proviso to section 179(3).
7. The answer would remain same even if M/s NEWS Pharmacy Limited provides security in connection with the loans made to its employees, since the provisions contained in section 186 apply to a company in the same manner in case of a security in connection with the loan, as they apply in case of a guarantee in connection with a loan.

Whether a company can make an interest free loan of Rs. 60 lakhs to its wholly owned subsidiary?

P 2.27G. Vogue Limited has an authorised capital of Rs. 250 lakhs and paid up capital of Rs. 200 lakhs. The free reserves are there to the tune of Rs. 150 lakhs. The company has advanced a loan of Rs. 160 lakhs to other companies as on 30th November, 2018. Now the company propose to advance an interest free loan of Rs. 60 lakhs to its wholly owned subsidiary Fashion Limited.

Discuss the validity of the proposed transaction with reference to the restrictions imposed by the applicable provisions of the Companies Act, 2013 and relevant Rules made thereunder. **[CA (Final) May 2019]**

Ans.

Requirements for making loans, investments, etc.

(a) Unanimous approval of Board is required. The approval shall be obtained by passing a resolution at a Board meeting.

(b) Special resolution is required if the aggregate of loans etc. (already made plus proposed) exceeds the *higher of* –
- 60% of the aggregate of paid up capital, free reserves and securities premium account; *or*
- 100% of its free reserves and securities premium account.

(c) Approval of Public Financial Institution shall be obtained unless –
- the limit under section 186(2) is not exceeded; *and*
- there is no default in repayment of loan instalments or interest.

(d) No default with respect to repayment of deposits or payment of interest on deposits is subsisting.

(e) The rate of interest chargeable on any loan shall not be less than the prevailing yield of 1 year, 3 year, 5 year or 10 year Government Security closest to the period of the loan.

First determine whether a special resolution is required for making the proposed loan. This can be determined as under:

Determine the overall limit for loans, investments, etc., i.e. higher of 60% of (paid up share capital, free reserves and securities premium account) or 100% of (free reserves and securities premium account)

(i) 60% of (200 lakhs + 150 lakhs)	Rs. 210 lakhs
(ii) 100% of Rs. 150 lakhs	Rs. 150 lakhs
Overall limit for loans, investments, etc. [Higher of (i) and (ii)]	***Rs. 210 lakhs***
Loans, investments, etc. already made by Vogue Limited	***Rs. 160 lakhs***
Loans, investments, etc. that can be made without requiring a special resolution	***Rs. 50 lakhs***
Loan proposed to be made to Fashion Ltd. (a wholly owned subsidiary of Vogue Ltd.)	***Rs. 60 lakhs***

As per first proviso to section 186(3), where loan is given by a holding company to its wholly owned subsidiary company or a joint venture company, the requirement of passing special resolution as per section 186(3) shall not be applicable. Therefore, Vogue Limited may make a loan of Rs. 60 lakhs to Fashion Limited without requiring a special resolution.

Vogue Limited intends to make the loan of Rs. 60 lakhs to Fashion Limited as an interest free loan. However, section 186 requires that the rate of interest chargeable on any loan shall not be less than the prevailing yield of 1 year, 3 year, 5 year or 10 year Government Security closest to the period of the loan. Accordingly, it is not possible for Vogue Limited to grant a loan of Rs. 60 lakhs to Fashion Limited as an interest free loan.

2.28 Register of loans etc. [Section 186(9) and (10) and Rule 12]

1. Provisions contained in section 186(9) and (10) of the Act

(a) Every company which makes a loan, investment, guarantee or security, shall maintain a register.

(b) The register shall contain such particulars as may be prescribed.

(c) The register shall be maintained in such manner as may be prescribed.

(d) The register shall be kept at the registered office of the company.

(e) The register shall be open to inspection at the registered office of the company.

(f) The copies of the register may be obtained by any member on payment of the prescribed fees.

(g) Extracts may be taken from the register by any member on payment of the prescribed fees.

2. Provisions contained in Rule 12 of the Companies (Meetings of Board and its Powers) Rules, 2014

(a) The register shall be maintained in Form MBP-2.

(b) The company shall enter in the register separately, the particulars of loans and guarantees given, securities provided and acquisitions made.

(c) The register shall be maintained with effect from the date of its incorporation.

(d) The entries in the register shall be made chronologically in respect of each such transaction within 7 days of making such loan or giving guarantee or providing security or making acquisition.

(e) The register shall be kept at the registered office of the company.

(f) The register shall be preserved permanently.

(g) The register shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for this purpose.

(h) The register may be maintained either manually or in electronic mode.

(i) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

(j) The extracts from the register may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed Rs. 10 per page.

2.29 Investments of company to be held in its own name (Section 187 and Rule 14)

1. Investments to be held in own name

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.

2. Exceptions

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

(b) A company may deposit with a bank, being the bankers of the company, any shares or securities for the collection of any dividend or interest payable thereon.

(c) A company may deposit with, or transfer to, or hold in the name of, the State Bank of India or a scheduled bank, being the bankers of the company, shares or securities, in order to facilitate the transfer thereof.

However, the company shall ensure that if within a period of 6 months from the date on which the shares or securities are transferred by the company to, or are first held by the company in the name of, the State Bank of India or a scheduled bank, no transfer of such shares or securities takes place, the company shall, as soon as practicable after the expiry of that period, have the shares or securities re-transferred to it from the State Bank of India or the scheduled bank or, as the case may be, again hold the shares or securities in its own name.

(d) A company may deposit with, or transfer to, any person any shares or securities, by way of security for the repayment of any loan advanced to the company or the performance of any obligation undertaken by it.

(e) A company may hold investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

In such a case, the company shall maintain a register which shall contain such particulars as may be prescribed and such register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

3. Provisions contained in Rule 14 of the Companies (Meetings of Board and its Powers) Rules, 2014

(a) Every company shall maintain a register in Form MBP-3 and enter therein, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name and the company shall also record the reasons for not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.

(b) The register shall be kept with effect from the date of its registration.

(c) The company shall also record whether such investments are held in a third party's name for the time being or otherwise.

(d) The register shall be maintained at the registered office of the company.

(e) The register shall be preserved permanently.

(f) The register shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for this purpose.

(g) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorised by the Board for this purpose.

4. Punishment for contravention

If a company contravenes the provisions of this section, the punishment shall be as follows:

(i) The company shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 25 lakh.

(ii) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh, or with both.

2.30 Disclosure of interest by a director (Section 184 and Rule 9)

A director occupies a fiduciary position towards the company. Therefore, he should not make a profit from his position except with the consent of the company to which he owes the duty of disclosure. The provisions of section 184 are explained as follows:

1. Duty of director to disclose his interest in the first Board meeting [Section 184(1)]

The purpose of section 184(1) is to ensure that the interest or concern of a director in other entities is brought to the notice of the other directors of the company. Section 184(1) is explained as follows

(a) Every director shall disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals.

(b) The disclosure shall be made at the first Board meeting –

(i) in which he participates as a director;

(ii) in every financial year; and

(iii) after any change takes place in the disclosures already made by the director.

(c) The disclosure shall include the shareholding, in such manner as may be prescribed.

Provisions contained Rule 9 of the Companies (Meetings of Board and its Powers) Rules, 2014.

(1) The disclosure of interest under section 184(1) shall be given by the director in Form MBP-1.

(2) It shall be the duty of the director giving notice of interest to cause it to be disclosed at the meeting held immediately after the date of the notice.

(3) All notices of disclosure of interest received by the company shall be –

(i) kept by the company at the registered office;

(ii) preserved for a period of 8 years from the end of the financial year to which the notices relate; and

(iii) kept in the custody of the company secretary of the company or any other person authorized by the Board for the purpose.

2. Duty of director to disclose his interest and not to participate [Section 184(2)]

It is the duty of every director to protect and promote the interests of the company. Section 184(2) seeks to ensure that a director whose personal interest conflicts with the interest of the company makes a disclosure of his interest and does not discuss and vote in relation to such contract or arrangement. The provisions of section 184(2) are discussed as follows:

(a) Applicability of section 184(2). Section 184(2) applies where a director is in anyway, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into–

(i) with a body corporate in which –

- such director in association with any other director, holds more than 2% shareholding of that body corporate; or
- such director is a promoter, manager or Chief Executive Officer; or

(ii) with a firm or other entity in which, such director is a partner, owner or member, as the case may be.

(b) Legal requirements under section 184(2).

(i) The interested director shall make a disclosure of his interest.

(ii) The disclosure of interest shall be made at the Board meeting in which the contract or arrangement is first discussed.

(iii) However, if at the time when the contract or arrangement was entered into, the director was not an interested director, but afterwards he became an interested director, he shall disclose his interest forthwith or at the first Board meeting held after he became an interested director.

(iv) The disclosure shall include the nature of his concern or interest.

(v) The interested director shall not participate in such meeting.

1. In case of a private company which has not committed any default in filing its financial statements under section 137 or annual return under section 92, the interested director may participate in the Board meeting after disclosure of his interest [Notification No. G.S.R. 464(E) dated 5th June, 2015].
2. The provisions of section 184(2) shall apply to a company licenced u/s 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds Rs. 1 lakh [Notification No. G.S.R. 466(E) dated 5th June, 2015].

3. Validity of contract in case of non-disclosure or participation [Section 184(3)]

A contract or arrangement entered into by a company shall be voidable at the option of the company, if a director who is concerned or interested in such contract or arrangement –

(a) does not disclose his interest in such contract or arrangement; or

(b) participates in such meeting.

4. Punishment for director for contravention [Section 184(4)]

If a director of a company contravenes the provisions of this section, he shall be punishable with –

(a) imprisonment upto 1 year; or

(b) fine upto Rs. 1 lakh; or

(c) both.

5. Non-applicability of section 184 [Section 184(5)]

Nothing in section 184 shall apply to any contract or arrangement entered into or to be entered into between two companies or between one or more companies and one or more bodies corporate where any of the directors of the one company or body corporate 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.

Thus, if the aggregate shareholding of two or more directors in the other company or body corporate exceeds 2% of the paid up share capital of the other company or body corporate, all such directors shall make a disclosure of interest and shall not participate in the Board meeting, even if the individual shareholding of each of the directors is not more than 2% of the paid up share capital in the other company or body corporate.

1. Applicability of section 184

Section 184 applies to all companies, whether public or private.

2. Interested director shall not be counted in quorum

As per section 184(2), an interested director shall not participate in such meeting. It means that a director shall not participate in the discussion and voting on the contract or arrangement in which he is concerned or interested. Accordingly, the presence of the interested director shall not be counted for determining quorum with respect to such contract or arrangement.

3. Vacation of office by reason of contravention of section 184

As per section 167, the office of a director shall become vacant, in case –

(a) he fails to disclose his concern or interest in the contract or arrangement in which he is interested; or

(b) he participates in such meeting, *i.e.* he participate in the discussion or voting on the contract or arrangement in which he is concerned or interested.

4. Validity of vote cast by an interested director

Section 184(2) restrains a director from voting on the contract or arrangement in which he is interested. However, section 184(2) is silent with respect to the validity of vote cast by the interested director. In the opinion of the Author, the vote cast by the interested director shall not be considered, *i.e.* his vote shall be void.

5. Validity of contract in case of voting by an interested director

(a) If an interested director votes on a contract or arrangement in which he is interested (although he is prohibited from voting), his vote shall be void. However, the contract does not become void or unenforceable. The transaction is voidable at the option of the Board but not at the option of the other party **[*Movitex Ltd.* v *Bulfield* 1988 BCLC 104 (Ch D)]**.

(b) However, voting by an interested director will make a contract void in the following 2 cases **[*Victors Ltd.* v *Lingard* (1927) 1 Ch 323]**:

(i) If his exclusion from quorum would have resulted in a situation of 'no quorum'.

(ii) If exclusion of his vote would have resulted in failure of such resolution.

6. Application of other provisions not barred

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.

Theoretical Questions from CA Examinations

Q 2.30A. Outline the provisions of section 184 with regard to disclosure of interest by directors. What are the consequences of non-disclosure? [CS (Final) June 1997, June 1999, Dec. 1999]

Q 2.30B. State the consequences if a director fails to disclose his interest in a contract approved by the Board meeting. [CS (Final) Dec. 1996, June 96, June 95, June 94]

Q 2.30C. State the circumstances in which a director of a company is required under the Companies Act, 2013 to disclose his interest in a contract or arrangement to be entered into by the company. Examine whether the validity of the contract is affected by non-disclosure of interest by the director. [CA (Final) May 2016]

Q 2.30D. When is a director required to disclose his/her interest to the company as per section 184 of the Companies Act, 2013? What are the consequences of non-disclosure? [CA (Final) May 2018]

Practical Problems from CA Examinations

Contracts between two public companies – Applicability and requirements

P 2.30A. Directors of ABC Limited are not holding any shares in MDJ Company Limited. Similarly directors of MDJ Company Limited are not holding any shares in ABC Limited. But, wife of director 'A' of ABC Limited holds 40% of the paid up share capital of MDJ Company Limited. Board of directors of ABC Limited entered into a contract with MDJ Company Limited for purchase of goods and director 'A' did not disclose his indirect interest in MDJ Company Limited. Examine whether 'A' has violated any of the provisions of the Companies Act, 2013 and also the validity of the contract. [CA (Final) Nov. 1996]

Ans. Section 184(2) applies where a director is in anyway, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into with a body corporate in which such director in association with any other director, holds more than 2% shareholding of that body corporate.

Section 184(2) requires the interested director to disclose his interest including the nature of his concern or interest. Further, the interested director is prohibited from participating in the Board meeting. The disclosure of interest shall be made at the Board meeting in which the contract or arrangement is first discussed.

In the given case, 'A' is required to disclose his interest since he is indirectly interested in the contract, as his wife is holding 40% of the paid up share capital of MDJ Company Limited. Failure to disclose the interest by 'A' amounts to non-compliance of section 184, and the following consequences shall follow:

- 'A' shall vacate the office of director held by him (Section 167).
- As per Section 184(4), Mr. A shall be punishable with –
  - (a) imprisonment upto 1 year; or
  - (b) fine upto Rs. 1 lakh; or
  - (c) both.
- The contract or arrangement entered into by ABC Limited shall be voidable at the option of ABC Limited [Section 184(3)].

Individual holding of two directors less than 2% each – Consequences of non-disclosure

P 2.30B. X Ltd. entered into a contract with M and Co. Ltd. for purchase of raw materials of Rs. 2,50,000 at the prevailing market rate. The director of X Ltd., Mr. B, was holding shares of the value of 1% of the paid up capital of M and Co. Ltd. Another director of X Ltd. Mr. C was holding shares of the value of 1.5% of the paid up capital of M and Co. Ltd. Mr. B at the beginning of the year, gave a general notice to X Ltd. that he was interested in M and Co. Ltd.

Mr. B claims that he had given notice to X Ltd. as required under the Companies Act, 2013 and that his holding being only 1% is within the limit under the Companies Act, 2013. [CA (Final) Nov. 2000]

Ans. As per section 184(2), every director who is any way, directly or indirectly, interested in a contract or arrangement shall disclose the nature of his interest, if such contract or arrangement is with a body corporate in which such director, in association with any other director, holds more than 2% of paid up capital of such body corporate.

If the aggregate shareholding of two or more directors in a body corporate exceeds 2% of the paid up share capital of such body corporate, all such directors shall make a disclosure as required under section 184(2), irrespective of the fact that individual shareholding of each of the directors is not more than 2% of the paid up share capital of the other company.

Section 184(1) requires every director to disclose the nature of his concern or interest (along with the shareholding, if applicable) in any company, body corporate, association of individuals or firm. Such disclosure is to be made by the director in the first Board meeting in which he participates as a director, the first Board in every financial year and the first Board meeting held after any change in the interest or concern takes place.

In the present case, the aggregate shareholding of Mr. B and Mr. C is more than 2% of the paid up share capital of M and Co., and so section 184(2) has become applicable. Accordingly, Mr. B and Mr. C, both, are required to disclose the nature of their interest (*i.e.* their shareholding in M and Co. Ltd.) in the Board meeting of X Ltd. in which the contract or arrangement between X Ltd. and M and Co. Ltd. is first discussed.

The requirement specified under section 184(2) is independent of the requirement of section 184(1). *In other words*, even where a director has disclosed his concern or interest as per section 184(1), he is still required to disclose his concern or interest in each and every contract or arrangement covered under section 184(2), although such contract or arrangement is with a body corporate in respect of which disclosure of interest was already given by him in terms of section 184(1).

The general notice given by Mr. B in terms of section 184(1) is not a sufficient compliance of the requirements of section 184(2), and so Mr. B has contravened the provisions of section 184(2). Also, Mr. C has not disclosed his concern or interest in the Board meeting in which the contract or arrangement is first discussed, and so, Mr. C has also contravened the provisions of section 184(2).

Consequences of contravention of section 184(2) shall be as follows:

- Mr. B and Mr. C shall vacate the office of director held by them (Section 167).
- As per Section 184(4), Mr. B and Mr. C shall be punishable with –
  (a) imprisonment upto 1 year; or
  (b) fine upto Rs. 1 lakh; or
  (c) both.
- The contract or arrangement entered into by X Limited shall be voidable at the option of X Limited [Section 184(3)].

Director interested in a contract – Can he vote in general meeting?

P 2.30C. The articles of association of a company states that a director shall not vote in respect of a contract in which he is interested. In a resolution put up for approval of the shareholders, can a director exercise his voting right in favour of a contract in which he is interested? [CA (Final) Nov. 2001]

OR

Examine the validity of the following with reference to the relevant provisions of the Companies Act, 2013 and/or decided case laws:

Mr. G, a director of Sam Limited was interested in a contract to be entered into by the company. The articles of association of Sam Limited contained a clause, which prohibited the directors from voting on the resolution in respect of any contract in which he is interested. The matter in respect of the said contract was put up for approval of the shareholders in a general meeting. The general meeting was attended by Mr. G and he also voted on the resolution. Mr. G. claims that he has a right to vote on the resolution in the general meeting. [CA (Final) Nov. 2005]

Ans. The given problem relates to section 184 read with sections 6, 102, 106 and 188 of the Companies Act, 2013, as discussed below:

The directors stand in a fiduciary relationship with the company and they must exercise their voting powers in a manner that will be in the best interest of the company. Keeping this objective, section 184 has been enacted. As per section 184, a director shall disclose his interest where he is in anyway, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into with a body corporate in which such director in association with any other director, holds more than 2% shareholding of that body corporate. Also, the interested director shall not participate in discussion and voting.

It must be carefully noted that restrictions imposed under section 184 is attracted only in case of a resolution put for the *approval of the Board*. Where the same matter comes before a general meeting, the right of an interested director to vote on it is not affected by section 184 **[*Seth Mohanlal v Grain Chambers Ltd.* AIR 1959 All 276]**.

The shareholders do not owe any fiduciary duty to the company and they are free to exercise their voting rights in their own interests, even if his interest is opposed to the interest of the company. The shareholders are not the trustees for the company or for one another. Accordingly, where a director exercises his voting rights as a shareholder, he is free to vote in his own best interests like any other shareholder. In case of a public company, the only restriction on the voting rights of a shareholder can be on the ground of non-payment of calls on shares or other sums due from the shareholder to the company, or where the company has exercised lien on shares of a shareholder (Section 106). As per section 6, any other restriction or prohibition shall be *ultra vires* the provisions of section 106 and consequently void. Therefore, a provision in the articles shall be invalid if it restrains a director from voting in the *general meeting*, on a contract in which he is interested. However, one exception to this rule may be found under section 188. As per section 188, if a contract or arrangement requires the approval of the members by way of an ordinary resolution, no member shall vote on such ordinary resolution to approve such contract or arrangement if he is a related party.

But, where the directors usurp the corporate opportunity (*i.e.* where the directors convert to their own benefit, opportunities belonging to the company), they cannot use their voting power as shareholders to prevent the company from recovering damages from the directors. *For example*, three directors holding 75% of the share capital of the company used their positions as directors and obtained a contract in their own names. As it amounted to breach of duty towards the company, they called a general meeting in which a resolution was passed to the effect that the company had no interest in the contract. It was held that the company could claim the profits realised by the directors **[*Cook v Deeks* (1916) 1 AC 554]**.

Conclusion: Mr. G, the director of Sam Limited, can vote in the general meeting even though he is interested in such contract. Therefore, the contention of Mr. G is correct.

1. The scope of section 184 is limited to Board meetings only; section 184 does not apply when a resolution is put before the general meeting.
2. A director may exercise his voting right at a general meeting on a contact in which he is interested, provided –
   (a) it does not result in misappropriation of a corporate opportunity by the director; and
   (b) the interest of the director has been sufficiently disclosed in the explanatory statement annexed to the notice of the general meeting (Section 102).

Advanced Practical Problems

Whether disclosure of interest is required?

P 2.30D. Company Y with a paid up capital of Rs. 50 lakhs entered into a contract with Company Z in which a director of Company Y is holding equity shares of the nominal value of Rs. 50,000. The director did not disclose his interest at the Board meeting under section 184 of the Companies Act, 2013. Is the director liable for his act?

[ICAI, Practice Manual, Nov. 2016 Exams (Modified)]

Ans. Section 184(2) applies where a director is in anyway, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into with a body corporate in which such director in association with any other director, holds more than 2% shareholding of that body corporate.

In the given case, a director of Company Y holds equity shares of Rs. 50,000 in Company Z. However, the shareholding of such director in Company Z cannot be said to be 1% since in the given question, Rs. 50 lakh is the paid up share capital of Company Y, and not of Company Z. So, the percentage shareholding held by a director of Company Y in Company Z cannot be determined.

If the paid up share capital of Company Z is less than Rs. 25 lakh, then, the shareholding of director of Company Y in Company Z shall be more than 2% of the paid up share capital of Company Z, and so the director of Company Y is required to disclose his interest and he shall not participate in discussion and voting. However, the director of Company Y did not disclose his interest, and so he shall be liable for contravention of section 184(2).

However, if the paid up share capital of Company Z is Rs. 25 lakh or more, then, the director of Company Y is not required to disclose his interest and he can participate in discussion and voting also, and so the director of Company Y shall not be liable for contravention of section 184(2).

It should be noted that the director of Company Y shall be liable to disclose his concern or interest in Company Z in Form MBP-1 as per the provisions of section 184(1). Disclosure of concern or interest under section 184(1) is required irrespective of the percentage of shareholding in the other body corporate.

Difference in answer as compared to the answer given by ICAI

The Author's answer to this question differs from the Answer given in the Practice Manual for November, 2016 Exams issued by the Board of Studies, ICAI. The relevant portion of the answer given in the Practice Manual is reproduced hereunder:

"As per section 184 (2) of the Companies Act, 2013 the disclosure of interest by directors do not apply to any contract or arrangement within two companies where any of the directors of 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. In the present case, the holding of the director of Y company in company Z is less than 2%[(50,000/50,00,000) x 100% = 1%], so the director of company Y is not liable."

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Whether disclosure of interest is required?

P 2.30E. Y Ltd. entered into a contract with Z Ltd. which has a paid-up capital of Rs. 50 lakhs. One of the directors of Y Ltd. is holding equity shares of the nominal value of Rs. 50,000 in Z Ltd. but he did not disclose his interest at the appropriate Board meeting. Is the concerned director liable for punishment for such non-disclosure? [ICAI, Study Material, August, 2019]

Ans. Section 184(2) applies where a director is in anyway, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into with a body corporate in which such director in association with any other director, holds more than 2% shareholding of that body corporate.

In the given case, a director of Y Ltd. holds equity shares of Rs. 50,000 in Z Ltd. The percentage shareholding held by director of Y Ltd. in Z Ltd. is 1%. Since the shareholding held by the director of Y Ltd. in Z Ltd. is not more than 2%, the director of Y Ltd. is not required to disclose his interest and he can participate in discussion and voting also, and so there is no contravention of section 184(2) by the director of Y Ltd. Therefore, the concerned director is not liable for any punishment.

2.31 Related party transactions (Section 188 and Rule 15)

1. Meaning of 'related party' [Section 2(76) of the Companies Act, 2013]

'Related party', with reference to a company, means –

(i) a director or his relative;

(ii) a key managerial personnel or his relative;

(iii) a firm, in which a director, manager or his relative is a partner;

(iv) a private company in which a director or manager or his relative is a member or director;

(v) a public company in which a director or manager is a director and holds along with his relatives, more than 2% of its paid up share capital;

(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

(viii) any body corporate which is –

(A) a holding, subsidiary or an associate company of such company;

(B) a subsidiary of a holding company to which it is also a subsidiary; or

(C) an investing company or the venturer of the company;

Explanation. For the purpose of this clause, 'the investing company or the venturer of a company' means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate;

In case of a private company which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, sub-clause (viii) of clause (76) of section 2 shall not apply with respect to section 188 [Notification No. G.S.R. 464(E) dated 5th June, 2015].

(ix) such other person as may be prescribed.

As per Rule 3 of the Companies (Specification of definitions details) Rules, 2014, a director other than an independent director or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.

2. Applicability of section 188 [Section 188(1)]

Section 188 applies to every contract or arrangement between a company and a related party with respect to –

(a) sale, purchase or supply of any goods or materials [Clause (a) of sub-section (1) of section 188];

(b) selling or otherwise disposing of, or buying, property of any kind [Clause (b) of sub-section (1) of section 188];

(c) leasing of property of any kind [Clause (c) of sub-section (1) of section 188];

(d) availing or rendering of any services [Clause (d) of sub-section (1) of section 188];

(e) appointment of any agent for purchase or sale of goods, materials, services or property [Clause (e) of sub-section (1) of section 188];

(f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company [Clause (f) of sub-section (1) of section 188]; and

(g) underwriting the subscription of any securities or derivatives thereof, of the company [Clause (g) of sub-section (1) of section 188].

3. Legal Requirements under section 188

(i) ***Consent of the Board.*** Every contract or arrangement covered under section 188 requires the consent of the Board by passing a resolution at a Board meeting only. Thus, passing of resolution by circulation is prohibited.

(ii) ***Disclosures required in agenda of Board meeting.*** The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the following particulars:

(a) Name of the related party and nature of relationship

(b) Nature, duration of the contract and particulars of the contract or arrangement

(c) Material terms of the contract or arrangement including the value, if any

(d) Any advance paid or received for the contract or arrangement, if any

(e) Manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract

(f) Whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors

(g) Any other information relevant or important for the Board to take a decision on the proposed transaction.

(iii) ***Interested director not to be present.*** If any director is interested in such contract or arrangement, he shall not be present at the Board meeting during discussions on such contract or arrangement.

(iv) ***Requirement of ordinary resolution.*** The contract or arrangement shall require the prior approval of the members by an ordinary resolution, where –

(a) any individual transaction or all the transactions during a financial year to be entered into as contracts or arrangements relates to sale, purchase or supply of any goods or materials, directly or through appointment of agent, amounting to 10% or more of the turnover of the company, as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188;

(b) any individual transaction or all the transactions during a financial year to be entered into as contracts or arrangements relates to selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent, amounting to 10% or more of net worth of the company, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188;

(c) any individual transaction or all the transactions during a financial year to be entered into as contracts or arrangements relates to leasing of property of any kind amounting to 10% or more of the turnover of the company, as mentioned in clause (c) of sub-section (1) of section 188;

(d) any individual transaction or all the transactions during a financial year to be entered into as contracts or arrangements relates to availing or rendering of any services, directly or through appointment of agent, amounting to 10% or more of the turnover of the company, as mentioned in clause (d) and clause (e) respectively of sub-section (1) of section 188;

(e) the contract or arrangement relates to appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rs. 2.5 lakh as mentioned in clause (f) of subsection (1) of section 188;

(f) the contract or arrangement relates to underwriting the subscription of any securities or derivatives thereof, of the company exceeding 1% of the net worth as mentioned in clause (g) of sub-section (1) of section 188.

Relevant date for reckoning 'turnover' or 'net worth'. The 'turnover' or 'net worth' shall be as per the audited financial statement of the preceding financial year.

1. Relaxation in case of transactions between a holding company and its wholly owned subsidiary company

The requirement of passing the ordinary resolution shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

2. Relaxation in case of certain Government companies

As per Notification No. G.S.R. 463(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 151(E) dated 2nd March, 2020, the requirement of passing the ordinary resolution shall not apply in case of –

(a) a Government company in respect of contracts or arrangements entered into by it with any other Government company, or with Central Government or any State Government or any combination thereof;

(b) a Government company, other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before entering into such contract or arrangement,

if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

(v) ***Disclosures required in explanatory statement.*** The explanatory statement annexed to the notice of the general meeting in which the ordinary resolution is to be passed, shall contain the following disclosures:

(a) Name of the related party

(b) Name of the director or key managerial personnel who is related, if any

(c) Nature of relationship

(d) Nature, material terms, monetary value and particulars of the contract or arrangement

(e) Any other information relevant or important for the members to take a decision on the proposed resolution.

(vi) ***Restrictions w.r.t. voting on ordinary resolution.*** If a member is a related party, he shall not vote on such ordinary resolution to approve any contract or arrangement.

1. Relaxation in case of a private company, which has not committed any default in filing financial statement under section 137 or annual return under section 92

Every member shall have a right to vote on the ordinary resolution (whether to approve or disapprove such contract or arrangement, as he may deem fit) even though he is a related party [Notification No. G.S.R. 464(E) dated 5th June, 2015].

2. Relaxation in case of a company in which 90% or more members, in number, are relatives of promoters or are related parties

Every member shall have a right to vote on the ordinary resolution (whether to approve or disapprove such contract or arrangement, as he may deem fit) even though he is a related party.

3. Relaxation in case of certain Government companies

As per Notification No. G.S.R. 463(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 151(E) dated 2nd March, 2020, the restriction that a member shall not vote on the ordinary resolution to approve such contract or arrangement, if he is a related party, shall not apply in case of –

(a) a Government company in respect of contracts or arrangements entered into by it with any other Government company, or with Central Government or any State Government or any combination thereof;

(b) a Government company, other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before entering into such contract or arrangement,

if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

4. Meaning of office or place of profit

(a) An office or place held by a director is an office or place of profit 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.

(b) An office or place held by a person other than a director is an office or place of profit if such person receives from the company anything by way of remuneration.

5. Non-Applicability of section 188

Section 188 shall not apply to the transactions entered into by the company –

(a) in the ordinary course of business;

(b) other than transactions which are not on an arm's length basis.

Meaning of 'arm's length transaction'

A transaction between two related parties shall be termed as an 'arm's length transaction' if it is conducted as if they were unrelated, so that there is no conflict of interest.

6. Disclosures

Every contract or arrangement to which section 188 applies, shall be referred to in the Board's report to the shareholders along with the justification for entering into such contract or arrangement.

As per Rule 8(2) of the Companies (Accounts) Rules, 2014, the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 shall be in the Form AOC-2.

7. Option to avoid the contract and recover damages

If any contract or arrangement is entered into by a director or any other employee, –

(a) without obtaining the consent of the Board or approval by an ordinary resolution in the general meeting; and

(b) it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within 3 months from the date on which such contract or arrangement was entered into,

then, the consequences shall be as follows:

(i) If such contract or arrangement was entered into without obtaining the consent of the Board, it shall be voidable at the option of the Board, and if such contract or arrangement was entered into without obtaining approval by an ordinary resolution in the general meeting, it shall be voidable at the option of the shareholders.

(ii) In case the contract or arrangement is with a related party to any director, or is authorised by any director, the directors concerned shall indemnify the company against any loss incurred by it.

(iii) The company may proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.

8. Punishment for contravention

The director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section, shall be punishable as follows:

(a) In case of a listed company, he shall be punishable with imprisonment upto 1 year or fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh, or with both.

(b) In case of any other company, he shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh.

Theoretical Questions from CA Examinations

Q 2.31A. Discuss "Related Party Transactions" under the Companies Act, 2013, with specific reference to the nature of transactions which fall under the purview of the Companies Act, 2013. [CA (Final) Nov. 2016]

Practical Problems from CA Examinations

Appointments as a managing director and a chief executive officer – Legal requirements

P 2.31A. M/s Kith and Kin Consultants Private Limited seeks your legal advice regarding the following appointments relating to directors and their relatives:

(i) Miss Niece, a relative of a director, is to be appointed as Chief Public Relations Officer on a salary of Rs. 65,000 per month.

(ii) Mr. Wellconnected, a relative of a director, is to be appointed as Chief Executive Officer on a consolidated salary of Rs. 2,55,000 per month.

(iii) Mr. Nephew, who is a relative of one of the directors, is to be appointed as the managing director on a monthly salary of Rs. 2,80,000 plus other perquisites as applicable to other executives of the company.

Advise explaining the relevant provisions of the Companies Act, 2013. [CA (Final) May 2002 (Modified)]

Ans. Appointment of any related party to an office or place of profit in the company, its subsidiary company or associate company attracts section 188 of the Companies Act, 2013.

Legal requirements under section 188

Section 188 requires compliance with the following legal requirements:

1. Consent of the Board is to be obtained by passing a resolution at a Board Meeting.
2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars prescribed under sub-rule (1) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.
3. If any director is interested in such appointment, he shall not be present at the Board meeting during discussions on such appointment.

4. The appointment shall require the prior approval of the members by an ordinary resolution if the monthly remuneration exceeds Rs. 2,50,000.
5. The explanatory statement annexed to the notice of the general meeting in which the ordinary resolution is to be passed, shall contain the prescribed particulars.
6. If a member is a related party, he shall not vote on such ordinary resolution.
7. The term 'office or place of profit' is defined under Explanation to sub-section (1) of section 188, as follows:
   (a) An office or place *held by a director* is an office or place of profit 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.*
   (b) An office or place *held by a person other than a director* is an office or place of profit if such person receives from the company *anything by way of remuneration.*

The given problem

The answer to the given problem is given as under:

(i) Miss Niece is a relative of a director. As per Clause (76) of section (2), a relative of a director is a related party. Thus, appointment of Miss Niece as Chief Public Relations Officer at a monthly remuneration of Rs. 65,000 amounts to appointment of a related party to an office or place of profit in the company, attracting the provisions of section 188.

   However, such appointment does not require the prior approval of the members by passing an ordinary resolution since the monthly remuneration does not exceed Rs. 2,50,000.

   Thus, the appointment of Miss Niece as Chief Public Relations Officer at a monthly remuneration of Rs. 65,000 requires compliance with legal requirements as stated earlier in Points 1 to 3.

(ii) Mr. Wellconnected is a relative of a director. As per Clause (76) of section (2), a relative of a director is a related party. Thus, appointment of Mr. Wellconnected as Chief Executive Officer at a monthly remuneration of Rs. 2,55,000 amounts to appointment of a related party to an office or place of profit in the company, attracting the provisions of section 188.

   Such appointment also requires the prior approval of the members by passing an ordinary resolution since the monthly remuneration exceeds Rs. 2,50,000.

   Thus, the appointment of Mr. Wellconnected as Chief Executive Officer at a monthly remuneration of Rs. 2,55,000 requires compliance with legal requirements as stated earlier in Points 1 to 6.

(iii) Mr. Nephew is a relative of a director. As per Clause (76) of section (2), a relative of a director is a related party. He is proposed to be appointed as a managing director of the company at a monthly remuneration of Rs. 2,80,000. Since, a managing director does not draw anything more than the remuneration to which he is entitled as a director, the office of managing director cannot be said to be an office or place of profit. Thus, the appointment of Mr. Nephew as a managing director does not attract the provisions of section 188, and so compliance with any of the legal requirements specified under section 188 is not required.

Case studies on appointment at an office or place of profit

P 2.31B. Reliable Castings Limited is a subsidiary of Unique Machineries Limited. The Board of Directors of the respective companies have made the following appointments on a consolidated monthly salary of Rs. 2,52,000 with effect from 1.6.2014:

(i) Shri Ram Singh, a director of Unique Machineries Limited, as factory manager of Reliable Castings Limited.

(ii) Shri Rajesh Patel, a director of Reliable Castings Limited, as purchase manager of Unique Machineries Limited.

(iii) Shri Sundar, relative of a director of Unique Machineries Limited, as sales manager of Unique Machineries Limited.

(iv) Shri Rakesh, not related to any director of both the companies, as chief accountant of Unique Machineries Limited. But his relative has been appointed as additional director of Unique Machineries Limited with effect from 1.11.2014. Explain the legal requirements to be complied with under the Companies Act, 2013 to give effect to or continuation of the above appointments of employees.

[CA (Final) May 1997 (Modified)]

Ans. Appointment of any related party to an office or place of profit in the company, its subsidiary company or associate company attracts section 188 of the Companies Act, 2013.

Legal requirements under section 188

Section 188 requires compliance with the following legal requirements:

1. Consent of the Board is to be obtained by passing a resolution at a Board Meeting.
2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars prescribed under sub-rule (1) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.
3. If any director is interested in such appointment, he shall not be present at the Board meeting during discussions on such appointment.
4. The appointment shall require the prior approval of the members by an ordinary resolution if the monthly remuneration exceeds Rs. 2,50,000.

5. The explanatory statement annexed to the notice of the general meeting in which the ordinary resolution is to be passed, shall contain the prescribed particulars.
6. If a member is a related party, he shall not vote on such ordinary resolution.
7. The term 'office or place of profit' is defined under Explanation to sub-section (1) of section 188, as follows:
   (a) An office or place *held by a director* is an office or place of profit 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.*
   (b) An office or place *held by a person other than a director* is an office or place of profit if such person receives from the company *anything by way of remuneration.*

The given problem

The answer to the given problem is given as under:

(i) Reliable Castings Limited is the subsidiary company of Unique Machineries Limited. Shri Ram Singh is the director of Unique Machineries Limited. As per Clause (76) of section (2), a director of a company is a related party. Therefore, appointment of Shri Ram Singh as a factory manager of Reliable Castings Limited amounts to appointment of a related party to an office or place of profit in the subsidiary company, thus attracting the provisions of section 188. Such appointment also requires the prior approval of the members by passing an ordinary resolution since the monthly remuneration exceeds Rs. 2,50,000.

Thus, the appointment of Shri Ram Singh as a factory manager of Reliable Castings Limited at a monthly remuneration of Rs. 2,52,000 requires compliance with legal requirements as stated earlier in Points 1 to 6.

(ii) Shri Rajesh Patel is the director of Reliable Castings Limited. As per Clause (76) of section (2), a director of a company is a related party, and so Mr. Rajesh Patel is a related party. He is to be appointed as purchase manager in Unique Machineries Limited. The appointment of Shri Rajesh Patel as purchase manager in Unique Machineries Limited amounts to appointment of a related party to an office or place of profit in the holding company, which is not covered under section 188. Therefore, the appointment of Shri Rajesh Patel does not attract the provisions of section 188. Such appointment can be made without requiring any compliance with any of the legal requirements specified under section 188.

(iii) Shri Sundar is a relative of a director of Unique Machineries Limited. As per Clause (76) of section (2), a relative of a director is a related party. He is to be appointed as sales manager in Unique Machineries Limited. The appointment of Shri Sundar as sales manager in Unique Machineries Limited amounts to appointment of a related party to an office or place of profit in the company, thus attracting the provisions of section 188. Such appointment also requires the prior approval of the members by passing an ordinary resolution since the monthly remuneration exceeds Rs. 2,50,000.

Thus, the appointment of Shri Sundar as sales manager of Unique Machineries Limited at a monthly remuneration of Rs. 2,52,000 requires compliance with legal requirements as stated earlier in Points 1 to 6.

(iv) Shri Rakesh is not related to any director at the time of appointment, and so he is not a related party in terms of Clause (76) of section 2. Therefore, his appointment does not attract the provisions of section 188, and so he can be appointed as Chief Accountant in Unique Machineries Limited at a monthly remuneration of Rs. 2,52,000 without requiring any compliance with any of the legal requirements specified under section 188.

Subsequent appointment of a relative of Shri Rakesh as a director in Unique Machineries Limited shall not affect the appointment of Shri Rakesh as Chief Accountant, since the appointment of Shri Rakesh as Chief Accountant was made prior to appointment of his relative as a director. Thus, no compliance with the provisions of section 188 is required even after appointment as a director of relative of Shri Rakesh.

Legal requirements for sale of goods to related parties

P 2.31C. Sweet Tea Limited wants to sell its tea by entering into contract with the following parties:

(1) Tea Bros, a partnership firm in which a director of Sweet Tea limited is a partner.

(2) R & T Private Limited in which one of the director of Sweet Tea Limited is a member.

(3) Strong Tea Limited in which one of the directors of Sweet Tea Limited is a director holding 3% of the paid up capital of strong Tea Limited.

Advice the steps that should be taken by Sweet Tea Limited taking into account the relevant provision of the Companies Act, 2013 for entering into contracts in which the directors are interested. **[CA (Final) May 2014]**

Ans. As per section 188 of the Companies Act, 2013, any contract or arrangement between a company and any related party for sale, purchase or supply of any goods or materials shall require compliance with the requirements specified under section 188 read with Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.

As per section 2(76), among others, following are the related parties:

(i) A firm, in which a director, manager or his relative is a partner.

(ii) A private company in which a director or manager or his relative is a member or director.

(iii) A public company in which a director or manager is a director and holds along with his relatives, more than 2% of its paid up share capital.

In the given case, all the three parties are related parties. Therefore, following legal requirements are required to be complied with for sale of tea to any of these parties:

1. Consent of the Board is to be obtained by passing a resolution at a Board Meeting.
2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars prescribed under sub-rule (1) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.
3. If any director is interested in such contract or arrangement, he shall not be present at the Board meeting during discussions on such contract or arrangement.
4. The contract or arrangement shall require the prior approval of the members by an ordinary resolution if the value of the contract or arrangement for sale, purchase or supply of any goods or materials exceeds 10% of the turnover of the company.
5. The explanatory statement annexed to the notice of the general meeting in which the ordinary resolution is to be passed, shall contain the prescribed particulars.
6. If a member is a related party, he shall not vote on such ordinary resolution.

Appointment of a related party as purchase manager in the holding company, and appointment of relative of sales manager as director – Implications

P 2.31D. The Board of directors of M/s ABC Motors Ltd. made the following appointments at its meeting held on 1st January, 2018:

(i) Mr. X, a director of its subsidiary company, namely, M/s ABC Forgings Ltd., was appointed as purchase manager on a consolidated salary of Rs. 1,00,000 per month with effect from 1st January, 2018.

(ii) Mr. Y was appointed as the sales manager on a consolidated salary of Rs. 1,50,000 per month with effect from 1st January, 2018. Answer the following, explaining the relevant provisions of the Companies Act, 2013:

(1) Does the appointment of Mr. X require the approval of the members in a general meeting of the company?

(2) Mr. P, a relative of Mr. Y was appointed as a director of M/s ABC Motors Ltd. on 1st August, 2018. Does it affect the continuation of Mr. Y as the sales manager? [CA (Final) Nov. 2018]

Ans. Appointment of any related party to an office or place of profit in the company, its subsidiary company or associate company attracts section 188 of the Companies Act, 2013.

The given problems are answered as under:

(1) Mr. X is the director of ABC Forgings Ltd. As per Clause (76) of section (2), a director of a company is a related party, and so Mr. X is a related party. He is appointed as purchase manager in ABC Motors Ltd. at a monthly remuneration of Rs. 1,00,000. The appointment of Mr. X as purchase manager in ABC Motors Limited amounts to appointment of a related party to an office or place of profit in the holding company, which is not covered under section 188. Therefore, the appointment of Mr. X does not attract the provisions of section 188. Such appointment can be made without requiring any compliance with any of the legal requirements specified under section 188.

(2) Mr. Y is not related to any director at the time of appointment (*i.e.* 1st January, 2018), and so he is not a related party in terms of clause (76) of section 2. Therefore, his appointment does not attract the provisions of section 188, and so he can be appointed as sales manager in ABC Motors Limited at a monthly remuneration of Rs. 1,50,000 without requiring any compliance with any of the legal requirements specified under section 188.

Subsequent appointment of a relative of Mr. Y as a director in ABC Motors Limited shall not affect the appointment of Mr. Y as sales manager, since the appointment of Mr. Y as sales manager was made prior to appointment of his relative as a director. Thus, no compliance with the provisions of section 188 is required even after appointment as a director of relative of Mr. Y.

Difference in answer as compared to the answer given by ICAI

The Author's answer to this question differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. The answer given in the Suggested Answers is reproduced hereunder:

"Section 188 of the Companies Act, 2013 relates with the related party transactions (RPT) with related party. Here, as per section 2(76) of the Companies Act, 2013, related party with reference to a company, includes, any company which is holding, subsidiary or an associate company of such company. According to this section 188, except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as prescribed under rule 15(1) of the Companies (Meetings of Board and its Powers) Rules, 2014, no company shall enter into any contract or arrangement with a related party with respect to the such transaction where there is a related party's appointment to any office or place of profit in the company, its subsidiary company or associate company.

(1) In the given case, Mr. X, a director of M/s ABC Forgings which is a subsidiary of M/s ABC Motors Ltd. was appointed as purchase manager on salary of 1,00,000 per month.

Accordingly, related party's appointment (*i.e.* of Mr. X) to an office or place of profit in M/s ABC Motors Ltd. will not require the approval of the members in a general meeting of the company as the monthly remuneration is not exceeding Rs. 2.5 lakh. Such transactions as to a related party's appointment to any office or place of profit in the company, its subsidiary company or associate company shall require consent of the Board of Directors given by a resolution at a meeting of the Board.

(2) As per section 2(76) of the Companies Act, 2013, related party with reference to a company, includes, a director or his relative. So, Mr. P, appointed as a director of M/s ABC Motors Ltd. on 1st of August, 2018, was a relative of Mr. Y who was appointed as sales manager in the M/s ABC Motors Ltd. This falls within the purview of Section 188 of the Companies Act, 2013 which relates with the related party transactions (RPT) with related party. Yes, the continuation of Mr. Y as a sales manager will lead to interest of conflict and will affect the continuation unless ratified by the board [Section 188 (3)]."

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

A director of company entered into a contract with a private company in which he is a member – Consequences

P 2.31E.

Case I. M/s. Tristar Ltd. (an unlisted public limited company) with the annual turnover of Rs. 700 crores entered into a contract of purchasing of raw material from M/s. PTC Pvt. Ltd. during the year 2018. M/s. Tristar Ltd. appointed Mr. Sudhir, a director of the company, to act in this deal of transaction on behalf of the company. Mr. Sudhir is also one of the member of M/s. PTC Pvt. Ltd. Mr. Sudhir settled the said transaction of purchase for Rs. 85 crores and entered into the contract. After a few transactions executed under the contract, the Board of M/s. Tristar Ltd. finds degradation in the quality of the raw material supplied. Further, in a Board meeting this contract was challenged considering it as a related party transaction and in contravention to section 188(1) of the Companies Act, 2013 read with rules framed thereunder. During the period Mr. Sudhir was appointed as director in a newly incorporated company M/s. Raaga Limited.

In the light of the given facts, examine the following situations as per the Companies Act, 2013:

(i) What is the legal position of the contract entered between M/s. Tristar Ltd. through its director Mr. Sudhir, and M/s. PTC Pvt. Ltd.?

(ii) Is there any contravention of section 188(1)? If yes, then state the liability of the wrongdoer.

(iii) Comment upon the appointment of Mr. Sudhir as a Director in M/s. Raaga Limited. [CA (Final) May 2019]

Case II. XYZ Ltd. with the turnover of Rs. 500 crore entered into a contract of purchasing of raw material from a private company. XYZ Ltd. appointed Mr. Khurana, a director of the company, to act in this deal of transaction. Mr. Khurana is also a member of that private company. He settled the said transaction into Rs. 60 crore and entered into the contract. After few transactions made under the contract, XYZ Ltd. finds degradation in the quality of the product supplied. In the Board Meeting, this contract was challenged considering it as a related party transaction and in contravention to section 188(1). During this period, Mr. Khurana was appointed as a director in newly setup, PQR Ltd. In the light of the given facts, examine the following situations as per the Companies Act, 2013.

(i) What is the legal position of the contract entered between XYZ Ltd. through Mr. Khurana, and the private company?

(ii) Is there any contravention of section 188(1)? If yes, then the liability of the wrong doer.

(iii) Comment upon the appointment of Mr. Khurana as a director in PQR Ltd. [ICAI, Mock Test Paper, October 2018]

Ans. The given problem relates to section 188 of the Companies Act, 2013 read with Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014, discussed as under:

As per section 188, any contract or arrangement between a company and any related party for sale, purchase or supply of any goods or materials shall require compliance with the requirements specified under section 188 read with Rule 15.

As per section 2(76), among others, 'a private company in which a director or manager or his relative is a member or director' is a related party.

Case I. A contract has been entered into between M/s Tristar Ltd. and M/s PTC Pvt. Ltd. Mr. Sudhir is a director in M/s Tristar Ltd., and a member in M/s PTC Pvt. Ltd. Since Mr. Sudhir is a member in M/s PTC Pvt. Ltd., it amounts to entering into a contract by M/s Tristar Ltd. with a related party, thus attracting the provisions of section 188 and Rule 15. For entering into such a contract, following compliances are required:

1. Consent of the Board of directors of M/s Tristar Ltd. is to be obtained by passing a resolution at a Board Meeting.
2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars prescribed under sub-rule (1) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.
3. Mr. Sudhir, who is interested in such contract or arrangement, shall not be present at the Board meeting during discussions on such contract or arrangement.
4. The value of the contract between M/s Tristar Ltd. and M/s PTC Pvt. Ltd. for purchase of raw materials is Rs. 85 crore. 10% of the turnover of the company amounts to Rs. 70 crore. Since the value of the contract (Rs. 85 crore) exceeds Rs. 70 crore, the contract or arrangement between M/s Tristar Ltd. and M/s PTC Pvt. Ltd. shall require the prior approval of the members by an ordinary resolution.
5. The explanatory statement annexed to the notice of the general meeting in which the ordinary resolution is to be passed, shall contain the prescribed particulars.
6. Since Mr. Sudhir is a related party, he shall not vote on such ordinary resolution.

The questions asked in the given problem are answered as under:

(i) By entering into a contract with M/s PTC Pvt. Ltd. (*i.e.* a private company in which a director of the company is a member), M/s Tristar Ltd. has contravened the provisions of section 188, since the legal requirements stated in points (1) to (6) above have not been complied with. Therefore, the consequences shall be as follows:

  (a) The contract is voidable at the option of the Board as well as at the option of the shareholders of M/s Tristar Ltd., if such contract is not ratified by the Board and the shareholders at a meeting within 3 months from the date on which such contract or arrangement was entered into.

  (b) Mr. Sudhir shall be liable to indemnify Tristar Ltd. against any loss incurred by it.

  (c) Tristar Ltd. may proceed against Mr. Sudhir for recovery of any loss sustained by it as a result of such contract or arrangement.

(ii) Section 188 has been contravened. The wrongdoer in this case is Mr. Sudhir. Since Tristar Ltd. is not a listed company, Mr. Sudhir shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh.

(iii) As per section 164, a person shall be disqualified for appointment as a director, if he has been convicted of an offence dealing with related party transactions under section 188 at any time during the preceding 5 years.

In the given case, Mr. Sudhir is liable for punishment for contravention under section 188. The word 'convicted' used under section 164 makes it evident that disqualification under section 164 is not attracted where a person is liable to be punished for contravention of section 188, but is attracted when a person is held liable for punishment by the Court on a complaint made to the Court.

Since Mr. Sudhir has not yet been convicted for contravention under section 188, he is not disqualified for appointment as a director. Accordingly, his appointment as a director in Raaga Limited is valid.

Case II. A contract has been entered into between XYZ Ltd. and a private company. Mr. Khurana is a director in XYZ Ltd., and a member in such private company. Since Mr. Khurana is a member in the private company with which XYZ Ltd. has entered into a contract or arrangement, it amounts to entering into a contract by XYZ Ltd. with a related party, thus attracting the provisions of section 188 and Rule 15. For entering into such a contract, following compliances are required:

1. Consent of the Board of directors of XYZ Ltd. is to be obtained by passing a resolution at a Board Meeting.
2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars prescribed under sub-rule (1) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.
3. Mr. Khurana, who is interested in such contract or arrangement, shall not be present at the Board meeting during discussions on such contract or arrangement.
4. The value of the contract between XYZ Ltd. and the private company for purchase of raw materials is Rs. 60 crore. 10% of the turnover of the company amounts to Rs. 50 crore. Since the value of the contract (Rs. 60 crore) exceeds Rs. 50 crore, the contract or arrangement between M/s XYZ Ltd. and the private company shall require the prior approval of the members by an ordinary resolution.
5. The explanatory statement annexed to the notice of the general meeting in which the ordinary resolution is to be passed, shall contain the prescribed particulars.
6. Since Mr. Khurana is a related party, he shall not vote on such ordinary resolution.

The questions asked in the given problem are answered as under:

(i) By entering into a contract with a private company in which Mr. Khurana is a member, XYZ Ltd. has contravened the provisions of section 188, since the legal requirements stated in points (1) to (6) above have not been complied with. Therefore, the consequences shall be as follows:

  (a) The contract is voidable at the option of the Board as well as at the option of the shareholders of XYZ Ltd. if such contract is not ratified by the Board and the shareholders at a meeting within 3 months from the date on which such contract or arrangement was entered into.

  (b) Mr. Khurana shall be liable to indemnify XYZ Ltd. against any loss incurred by it.

  (c) XYZ Ltd. may proceed against Mr. Khurana for recovery of any loss sustained by it as a result of such contract or arrangement.

(ii) Section 188 has been contravened. The wrongdoer in this case is Mr. Khurana. Accordingly, Mr. Khurana shall be punishable as follows:

  (a) If XYZ Ltd. is a listed company, he shall be punishable with imprisonment upto 1 year or fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh, or with both.

  (b) If XYZ Ltd. is not a listed company, he shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh.

(iii) As per section 164, a person shall be disqualified for appointment as a director, if he has been convicted of an offence dealing with related party transactions under section 188 at any time during the preceding 5 years.

In the given case, Mr. Khurana is liable for punishment for contravention under section 188. The word 'convicted' used under section 164 makes it evident that disqualification under section 164 is not attracted where a person is liable to be punished for contravention of section 188, but is attracted when a person is held liable for punishment by the Court on a complaint made to the Court.

Since Mr. Khurana has not yet been convicted for contravention under section 188, he is not disqualified for appointment as a director. Accordingly, his appointment as a director in PQR Ltd. is valid.

2.32 Registers of contracts or arrangements in which directors are interested (Section 189 and Rule 16)

1. Scope of the registers

Every company shall keep one or more registers of contracts or arrangements in which directors are interested. The registers shall contain –

(a) the particulars of all contracts or arrangements to which section 188 applies;

(b) the particulars of all contracts or arrangements with respect to which the director concerned (*i.e.* the interested director) had given a disclosure of his concern or interest as per the provisions of section 184(2).

2. Manner and particulars of maintenance of registers

(a) The registers shall be maintained in such manner as may be prescribed.

(b) The registers shall contain such particulars as may be prescribed.

3. Registers to be placed in the next Board meeting

(a) After entering the prescribed particulars in the registers, such registers shall be placed before the next Board meeting.

(b) The registers shall be signed by all the directors present at the Board meeting.

4. Disclosure of particulars by directors and key managerial personnel

(a) Every director or key managerial personnel shall disclose to the company the particulars required to be disclosed by him in accordance with the provisions of section 184(1), *i.e.* his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals along with the shareholding and such other information as may be prescribed.

(b) Such disclosure shall be made within 30 days of his appointment, or relinquishment of his office, as the case may be.

5. Place of keeping the registers

(a) The registers shall be kept at the registered office of the company.

(b) The registers shall be open to inspection at the registered office during business hours.

(c) The copies of, and extracts from, the registers may be taken by any member of the company to such extent, in such manner, and on payment of such fees as may be prescribed.

6. Placing the registers at every AGM

(a) The registers shall be produced at the commencement of every annual general meeting of the company.

(b) During the continuance of the annual general meeting, the registers shall remain open and accessible to any person having the right to attend the annual general meeting.

7. Non-applicability

Any contract or arrangement shall not be required to be included in the registers if –

(a) it relates to the sale, purchase or supply of any goods, materials or services, if the value of such goods and materials or the cost of such services does not exceed Rs. 5 lakh in the aggregate in any year; or

(b) it is entered into by a banking company for the collection of bills in the ordinary course of its business.

8. Punishment

Every director who fails to comply with the provisions of this section and the rules made thereunder shall be liable to a penalty of Rs. 25,000.

9. Provisions contained in Rule 16 of the Companies (Meetings of Board and its Powers) Rules, 2014

(a) The register shall be maintained in Form MBP-4.

(b) The particulars of the company or companies or bodies corporate in which a director himself together with any other director holds 2% or less of the paid up share capital shall not be required to be entered in the register.

(c) The entries in the register shall be made at once, whenever there is a cause to make entry, in chronological order.

(d) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorised by the Board for this purpose.

(e) The register shall be kept at the registered office of the company.

(f) The register shall be preserved permanently.

(g) The register shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for this purpose.

(h) The company shall provide extracts from such register to a member of the company on his request, within 7 days from the date on which such request is made upon the payment of such fee as may be specified in the articles of the company but not exceeding Rs. 10 per page.

The provisions of section 189 shall apply to a company licenced u/s 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, only if the transaction with reference to Sec. 188 on the basis of terms and conditions of the contract or arrangement exceeds Rs. 1 lakh [Notification No. G.S.R. 466(E) dated 5th June, 2015].

Practical Problems from CA Examinations

Whether the register of contracts or arrangements is to be made available at the AGM where AGM is held at a place other than the registered office?

P 2.32A. The register of contracts or arrangement under section 189 of the Companies Act, 2013 is maintained at the registered office of Fortune Ltd., under the custody of the Company Secretary. The AGM was held in different place but in the same town where the registered office is situated. Mr. Semar, a shareholder of the company and Mr. Raj, proxy of a shareholder insisted for producing the said register at the commencement of the AGM for inspection. The Company Secretary refused to produce the register stating that being the statutory register it has to be maintained at the registered office only. Examine whether Mr. Semar and Mr. Raj will succeed in their attempt under the provisions of the Companies Act, 2013? [CA (Final) May 2018]

Ans. The given problem relates to section 189 of the Companies Act, 2013.

Section 189 requires that the register of contracts and arrangements shall be kept at the registered office of the company, and shall be open to inspection at the registered office during business hours.

Section 189 further requires that the register of contracts and arrangements shall be produced at the commencement of every annual general meeting, and during the continuance of the annual general meeting, it shall remain open and accessible to any person having the right to attend the annual general meeting.

In the given case, the annual general meeting of Fortune Ltd. is held at a place other than them registered office of the company. The company secretary of Fortune Ltd. contends that the register of contracts and arrangements is not to be produced at the annual general meeting as it is a statutory register and is to be kept at the registered office of the company.

With respect to place of keeping the register of contracts and arrangements, section 189 has prescribed two different requirements; first is to keep the register of contracts and arrangements at the registered office, and second is to produce the register of contracts and arrangements at every annual general meeting. Every company needs to comply with both these requirements.

Thus, where any annual general meeting of a company is held at a place other than the registered office of the company, it is the duty of the company to move the register of contracts and arrangements from the registered office to the venue of the annual general meeting. Also, section 189 entitles every person having right to attend the annual general meeting to access (*i.e.* inspect) the register of contracts and arrangements. As per section 105, a proxy is entitled to attend an annual general meeting. Thus, a member personally present as well as a proxy are entitled to inspect the register of contracts and arrangements.

In the given case, the refusal of the company secretary to produce the register of contracts and arrangements at the annual general meeting is not valid. Accordingly, Mr. Semar (a member personally present) as well as Mr. Raj (a proxy) are entitled to inspect the register of contracts and arrangements.

2.33 Contract of employment with managing or whole-time directors (Section 190)

1. **Duty of company to keep copy of contract or memorandum**

   Every company shall keep at its registered office, –

   (a) a copy of the contract of service entered into by it with its managing director and whole-time director;

   (b) a written memorandum setting out the terms of the contract of service entered into by it with its managing director and whole-time director, where such a contract is not in writing.

2. **Inspection of contract or memorandum**

   The copies of such contract or memorandum shall be open to inspection by any member of the company without payment of any fees.

3. Punishment for contravention

If default is made in complying with the provisions of this section, the company shall be liable to a penalty of Rs. 25,000 and every officer of the company who is in default shall be liable to a penalty of Rs. 5,000 for each default.

Non-applicability

Section 190 does not apply to a private company.

2.34 Payment to directors for loss of office, etc. in connection with transfer of undertaking, property or shares (Section 191 and Rule 17)

1. Applicability of section 191

Section 191 is attracted, where –

(a) the whole or any part of any undertaking or property of the company is transferred; or

(b) all or any of the shares in a company are transferred to any person, being a transfer of shares resulting from –

- (i) an offer made to the general body of shareholders;
- (ii) an offer made by or on behalf of some other body corporate with a view to a company becoming a subsidiary company of such body corporate or a subsidiary company of its holding company;
- (iii) an offer made by or on behalf of an individual with a view to his obtaining the right to exercise, or control the exercise of, not less than 1/3rd of the total voting power; or
- (iv) any other offer which is conditional on acceptance to a given extent; and

(c) any director of the transferor company is to receive compensation for loss of office or as consideration for retirement from office, from –

- (i) such company; or
- (ii) the transferee of such undertaking or property; or
- (iii) the transferees of shares; or
- (iv) any other person.

2. Restrictions on payment of compensation

Where section 191 is attracted, no director shall receive such compensation, unless –

(a) the prescribed particulars with respect to the payment of compensation are disclosed to the members; and

As per Rule 17 of the Companies (Meetings of Board and its Powers) Rules, 2014, following particulars shall be disclosed to the members of the company.

- (a) Name of the director
- (b) Amount proposed to be paid
- (c) Event due to which compensation become payable
- (d) Date of Board meeting recommending such payment
- (e) Basis for the amount determined
- (f) Reason or justification for the payment
- (g) Manner of payment - whether payable in cash or otherwise and how
- (h) Sources of payment
- (i) Any other relevant particulars as the Board may think fit.

(b) the payment of compensation is approved by the company in general meeting.

3. Prohibitions on payment of compensation

As per Rule 17 of the Companies (Meetings of Board and its Powers) Rules, 2014, no payment of compensation shall be made in the following cases:

(a) Where the company is in default in repayment of public deposits or payment of interest thereon

(b) Where the company is in default in redemption of debentures or payment of interest thereon

(c) Where the company is in default in repayment of any liability, secured or unsecured, payable to any bank, public financial institution or any other financial institution

(d) Where the company is in default in payment of any dues towards income tax, VAT, excise duty, service tax or any other tax or duty, by whatever name called, payable to the Central Government or any State Government, statutory authority or local authority (other than in cases where the company has disputed the liability to pay such dues)

(e) Where there are outstanding statutory dues to the employees or workmen of the company which have not been paid by the company (other than in cases where the company has disputed the liability to pay such dues)

(f) Where the company has not paid dividend on preference shares or not redeemed preference shares on due date.

4. **Compensation permitted subject to limits prescribed**

Any payment made by a company to its managing director or whole-time director or manager by way of compensation for loss of office or as consideration for retirement from office shall be valid, if it is within such limits and subject to such priorities, as may be prescribed.

As per Rule 17 of the Companies (Meetings of Board and its Powers) Rules, 2014, the amount of compensation shall not exceed the limit on compensation as specified under section 202 of the Companies Act, 2013.

5. **Situation of 'no quorum' does not result in automatic approval**

If any payment of compensation is not approved for want of quorum either in a meeting or an adjourned meeting, the proposal shall not be deemed to have been approved.

6. **Legal effect where compensation is received in contravention of section 191**

Where a director of a company receives the compensation –

(a) in contravention of the provisions of this section; or

(b) before such payment of compensation is approved by the company in general meeting,

then, the director shall be deemed to have received such amount in trust for the company.

7. **Punishment for default**

If a director of the company makes any default in complying with the provisions of this section, he shall be liable to a penalty of Rs. 1 lakh.

8. **Provisions requiring disclosures not affected**

Nothing in section 191 shall prejudice the operation of any law requiring disclosure of any compensation received by any director of the company.

Theoretical Questions from CA Examinations

Q 2.34A. Identify the particulars to be disclosed to the members of a company to pass a resolution approving any payment by way of compensation for loss of office of a director as per the provisions of Section 191 of the Companies Act, 2013 read with Rule 17 of the Companies (Meetings of Board and its Powers) Rules, 2014. [CA (Final) May 2018]

2.35 Restriction on non-cash transactions involving directors (Section 192)

1. **Scope of section 192 [Section 192(1)]**

Section 192 applies where an arrangement is entered into by which –

(a) assets are acquired or to be acquired for consideration other than cash, from the company, by –

(i) a director of the company; or

(ii) a director of its holding, subsidiary or associate company; or

(iii) a person connected with such director; or

(b) assets are acquired or to be acquired for consideration other than cash, by the company, from –

(i) a director of the company; or

(ii) a director of its holding, subsidiary or associate company; or

(iii) a person connected with such director.

2. **Legal requirements under section 192 [Section 192(1)]**

A company may enter into an arrangement of such nature as is specified under section 192(1), if –

(a) prior approval for such arrangement is accorded by a resolution of the company in general meeting;

(b) prior approval for such arrangement is also accorded by a resolution of the holding company in general meeting, if the director or connected person is a director of its holding company.

3. **Legal requirements w.r.t. notice of general meeting [Section 192(2)]**

   The notice of the general meeting sent by the company or holding company for obtaining the approval of the members, shall include –

   (a) the particulars of the arrangement; and

   (b) the value of the assets involved in such arrangement duly calculated by a registered valuer.

4. **Effects of contravention [Section 192(3)]**

   Any arrangement entered into by a company or its holding company in contravention of the provisions of this section shall be voidable at the instance of the company unless –

   (a) the restitution of any money or other consideration which is the subject matter of the arrangement is no longer possible and the company has been indemnified by any other person for any loss or damage caused to it; or

   (b) any rights are acquired *bonafide* for value and without notice of the contravention of the provisions of this section by any other person.

Definition of 'associate company' [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.

Explanation. For the purposes of this clause, 'significant influence' means control of at least 20% of total share capital, or of business decisions under an agreement.

Theoretical Questions from CA Examinations

Q 2.35A. In what way does the Companies Act, 2013 restrict the non-cash transactions involving directors of a public limited company? Explain. [CA (Final) Nov. 2014]

Practical Problems from CA Examinations

Acquisition of stock in trade in consideration of furniture by director of holding company – Legal requirements

P 2.35A. Mr. K is making an arrangement to acquire some stock-in-trade from BL Limited for consideration of some furniture lying with him. He is a Director of JS Limited, which is the holding company of BL Limited. Advise him on the basis of provisions of Companies Act, 2013. What will be the position of the arrangement if there is a contravention of the applicable provisions of the Companies Act, 2013? [CA (Final) Nov. 2016]

Ans. The given problem relates to section 192 of the Companies Act, 2013, as discussed below.

1. **Applicability of section 192**

   Section 192 applies where an arrangement is entered into by which assets are acquired or to be acquired for consideration other than cash, from the company, by –

   (i) a director of the company; or

   (ii) a director of its holding, subsidiary or associate company; or

   (iii) a person connected with such director

2. **Legal requirements under section 192**

   A company may enter into an arrangement of such nature as is specified under section 192(1), if –

   (a) prior approval for such arrangement is accorded by a resolution of the company in general meeting;

   (b) prior approval for such arrangement is also accorded by a resolution of the holding company in general meeting, if the director or connected person is a director of its holding company; and

   (c) the notice of the general meeting sent by the company or holding company for obtaining the approval of the members, shall include –

      (i) the particulars of the arrangement; and

      (ii) the value of the assets involved in such arrangement duly calculated by a registered valuer.

In the given case, an arrangement is proposed to be entered into by which assets (i.e. stock in trade) of BL Limited are to be acquired by Mr. K (i.e. a director of holding company, i.e. JS Limited) for consideration other than cash (i.e. furniture lying with Mr. K). This arrangement clearly falls under section 192.

Thus, Mr. K can acquire the stock in trade of BL Limited, if –

(a) prior approval for such arrangement is accorded by a resolution passed in the general meeting of BL Limited;

(b) prior approval for such arrangement is also accorded by a resolution passed in the general meeting of JS Limited; and

(c) the notices of the general meetings sent by BL Limited and JS Limited for obtaining the approval of the members, shall include –
   (i) the particulars of the arrangement; and
   (ii) the value of the assets involved in such arrangement duly calculated by a registered valuer.

Effects of contravention

If any arrangement is entered into by BL Limited or JS Limited in contravention of the provisions of section 192, such arrangement shall be voidable at the instance of the company unless –

(a) the restitution of any money or other consideration which is the subject matter of the arrangement is no longer possible and the company has been indemnified by any other person for any loss or damage caused to it; or

(b) any rights are acquired *bonafide* for value and without notice of the contravention of the provisions of this section by any other person.

2.36 Contracts by One Person Company (Section 193)

1. Applicability of section 193

Section 193 applies where –

(a) the company is a One Person Company;

(b) it enters into a contract with its sole member; and

(c) the sole member is also the director of the company.

2. Legal requirements

(a) The contract entered into between the company and the sole member shall be in writing.

(b) If the contract is not in writing, the company shall ensure that the terms of the contract are contained in a memorandum or are recorded in the minutes of the first Board meeting held next after entering into such contract.

3. Non-applicability of section 193

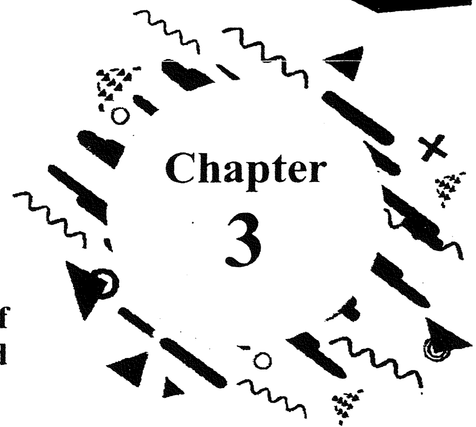
Section 193 shall not apply where a contract is entered into by the company in the ordinary course of its business.

4. Duty of the company to inform the Registrar

(a) Where a contract is entered into by One Person Company and recorded in the minutes of the Board meeting in accordance with the provisions of this section, the company shall inform the Registrar about such contract.

(b) Such information shall be given to the registrar within 15 days of the date of approval by the Board of Directors.

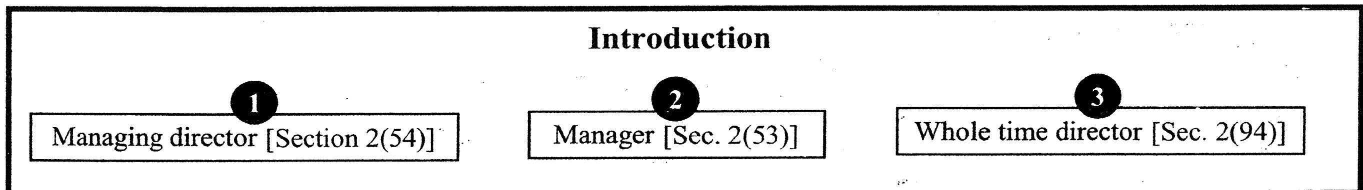
Section 193 shall apply to One Person Company, irrespective of the fact as to whether it is limited by shares or by guarantee.

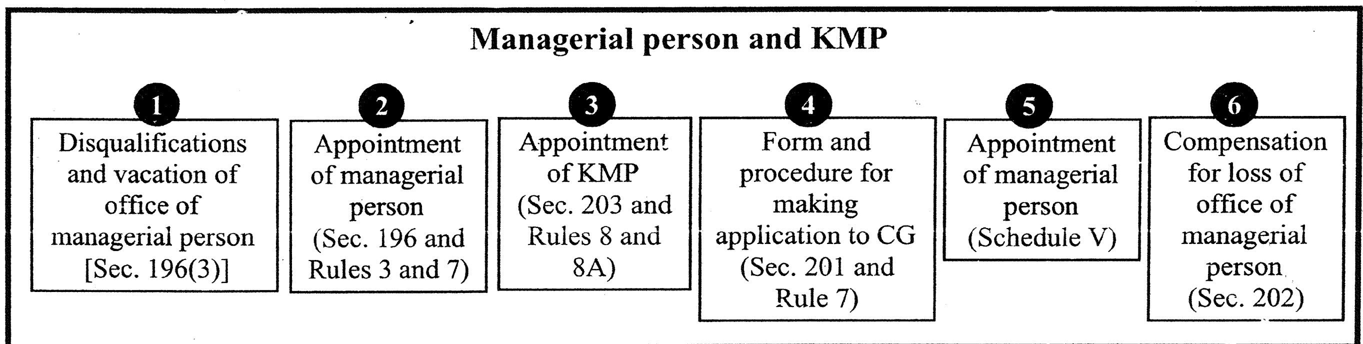


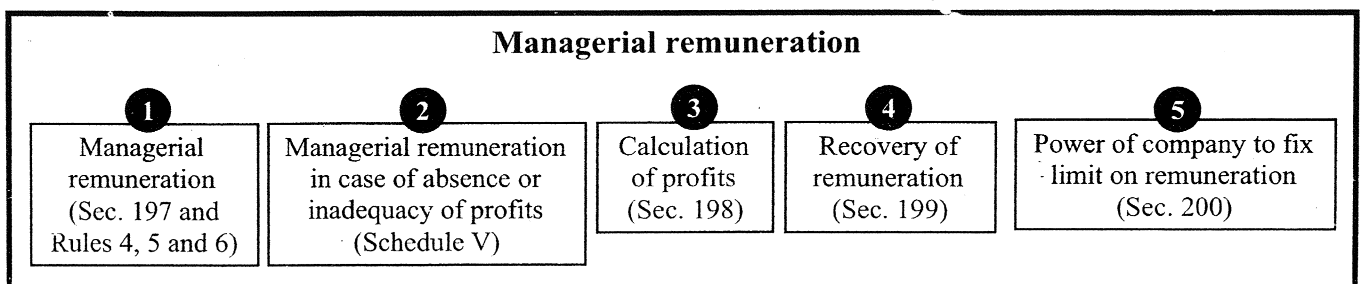
Appointment and Remuneration of Managerial Personnel

(Chapter XIII of the Companies Act, 2013 consisting of Sections 196 to 205 and the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014)

Bird's eye-view of the Chapter







Secretarial audit and Company Secretary

1. Secretarial audit (Sec. 204 and Rule 9)
2. Functions of Company Secretary (Sec. 205 and Rule 10)

Bird's eye-view of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014

Rule No.	Marginal Heading
1	Short title and commencement
2	Definitions
3	Filing of return of appointment
4	Sitting fees
5	Disclosure in Board's report
6	Parameters for consideration of remuneration
7	Fees
8	Appointment of Key Managerial Personnel
9	Secretarial Audit Report
10	Duties of Company Secretary

Bird's eye-view of the Forms used in this Chapter

Form No.	Description of E-Form (Purpose of E-Form)	Relevant Section	Relevant Rule
MR-1	Return of appointment of key managerial personnel	196 and 197, Schedule V	3
MR-2	Form of application to the Central Government for approval of appointment or reappointment and remuneration or increase in remuneration or waiver for excess or over payment to managing director or whole time director or manager and commission or remuneration to directors	196, 197, 200, 201(1) and 203(1), Schedule V	7
MR-3	Secretarial Audit Report	204(1)	9

Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, –
   (a) any reference to any section means reference to the sections of the Companies Act, 2013; and
   (b) any reference to any rule means reference to the Rules contained in the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

3.1 Definition of 'managing director' [Section 2(54)]

1. **Definition of managing director**

Section 2(54) of the Companies Act, 2013 reads as follows:

'Managing director' means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

Explanation. For the purposes of this clause, the power to do administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, shall not be deemed to be included within the substantial powers of management.

2. **Analysis of the definition of managing director**

From an analysis of definition of 'managing director', following inferences may be drawn:

(a) A person may be appointed as a managing director only if he is already a director of the company. Therefore, –
  (i) all the provisions applicable to a director also apply to a managing director; *and*
  (ii) if a managing director ceases to be a director, he automatically ceases to be a managing director.

(b) A person shall be a managing director only if he is entrusted with substantial powers of management which are not otherwise exercisable by a director.

(c) A person who is not designated as a managing director, but occupies the position of a managing director shall also be deemed to be a managing director.

(d) The powers to do administrative acts are not deemed to be substantial powers of management.

(e) Managing director exercises his powers subject to the superintendence, control, and direction of Board. As such, a managing director is subordinate to the Board of directors. His authority can be revoked by the Board of directors.

(f) The powers of management may be entrusted to a managing director by –
  - the articles of association of the company; *or*
  - an agreement; *or*
  - a resolution passed in a general meeting; *or*
  - a resolution passed by the Board of directors.

(g) Two or more than two directors of a company may be entrusted with substantial powers of management. Thus, a company may have two or more than two managing directors.

(h) A company cannot, at the same time, employ a managing director and a manager [Section 196(1)]. However, a company may, at the same time, employ managing director(s) and whole time director(s).

1. **Managing director – Whether rotational or non-rotational?**

Any director (whether rotational or non-rotational) may be appointed as a managing director. In other words, a managing director may be a rotational director or a non-rotational director. In case a rotational director is appointed as managing director, he shall retire as per the provisions of section 152(6), notwithstanding the fact that his term of office (maximum 5 years) has not yet expired.

2. **Additional director as managing director**

An additional director may be appointed as a managing director. If on the expiry of his term in the next annual general meeting, he is not appointed as a director by the shareholders, he shall vacate the office of additional director and consequently the office of managing director shall also be vacated. If in the next annual general meeting, he is appointed as a director by the shareholders, he shall also continue as a managing director.

Practical Problems from CS Examinations

Whether appointment of a person as an additional director first and then managing director in the same meeting is valid?

P 3.1A. Prince was appointed as additional director by the Board of directors of John Ltd. on 1st March, 2015. He was simultaneously appointed as the company's managing director by majority voting at the same Board meeting. Referring to the provisions of the Companies Act, 2013, examine the validity of the appointment of Prince as additional director and as the managing director at the same time. What shall be your answer in case Prince failed to get appointed at the company's annual general meeting?

[CA (Final) Dec. 2015]

Ans. The given problem relates to section 2(54) read with section 161(1) of the Companies Act, 2013, as discussed below:

The legal position:

1. As per section 2(54), 'managing director' means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.
2. By referring to the definition of 'managing director' it is evident that a person may be appointed as a managing director only if he is already a director of the company.
3. Thus, if a company intends to appoint a person, who is not already a director, as a managing director, then, such person shall first be appointed as a director, and only then he may be appointed as a managing director.
4. As per section 161(1), a person may be appointed as an additional director only if the articles of the company authorise the Board of directors to appoint the additional directors.
5. As per section 161(1), an additional director shall hold office upto the next annual general meeting or the last date on which the annual general meeting should have been held (in case AGM is not held upto the last due date), whichever is earlier.
6. As per Explanation to section 152(7), a retiring director means a director retiring by rotation. Since an additional director does not retire by rotation, he is not a retiring director. Therefore, a person appointed as an additional director can continue in office after the next annual general meeting only if he is appointed as a director in the annual general meeting by complying with the provisions of section 160.

The given case and analysis of the case:

7. Prince was appointed as the additional director and then, in the same Board meeting, he was appointed as a managing director.
8. There is no requirement that the appointment of a person as an additional director and as a managing director has to be made in separate Board meetings. Thus, the company has not contravened any provision of the Act by appointing Prince as an additional director and also as a managing director in the same Board meeting.

Conclusion:

9. Assuming that the articles of John Ltd. authorise the Board to appoint the additional directors, the appointments of Prince as additional director as well as managing director are valid.
10. If Prince fails to get appointed as a director in the annual general meeting, he shall cease to be the additional director. Also, he shall simultaneously cease to be the managing director since a person cannot be a managing director unless he is a director.

3.2 Definition of 'manager' [Section 2(53)]

1. Definition of 'manager'

Section 2(53) of the Companies Act, 2013 defines 'manager' as follows:

'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, and whether under a contract of service or not.

2. Analysis of the definition of manager

(a) 'Manager' need not be a director of the company. However, there is no restriction on appointment of a director as manager.

(b) 'Manager' is a person who has the management of whole or substantially the whole of the affairs of the company. The whole of the affairs of the company cannot anyway be in the hands of two or more persons. Therefore, a company cannot have two or more than two managers.

(c) A company cannot, at the same time, employ a managing director and manager [Section 196(1)]. However, a company may, at the same time, employ manager and whole time director(s).

3.3 Definition of 'whole time director' [Section 2(94)]

1. Definition of a whole time director

The term 'whole time director' has been defined under Clause (94) of section 2 of the Companies Act, 2013, as follows:

'Whole-time director' includes a director in the whole-time employment of the company.

2. Analysis of the definition of whole time director

(a) A whole time employee when appointed as a director of the company, is in the position of a 'whole time director'. Accordingly, appointment of a whole time employee as an alternate director also amounts to appointment of a whole time director. Similarly, appointment of a branch manager as a director amounts to appointment of a whole time director.

(b) A whole time director means a director who is entrusted with day-to-day management of the company.

(c) Where a person, not being an employee of the company, is appointed as a director, he occupies the position of an ordinary director; he does not become a whole time director.

(d) A company may, at the same time, employ –

- two or more than two whole time directors;
- managing director(s) and whole time director(s);
- the manager and whole time director(s).

(e) A person cannot act as a whole time director in more than one company.

1. **Whole time director – Whether rotational or non-rotational?**

Any director (whether rotational or non-rotational) may be appointed as a whole time director. In other words, a whole time director may be a rotational director or a non-rotational director. In case a rotational director is appointed as whole time director, he shall retire as per the provisions of section 152(6), notwithstanding the fact that his term of office has not yet expired.

2. **Additional director as whole time director**

An additional director may be appointed as a whole time director. If on the expiry of his term in the next annual general meeting, he is not appointed as a director by the shareholders, he shall vacate the office of additional director and consequently the office of whole time director shall also be vacated. If in the next annual general meeting, he is appointed as a director by the shareholders, he shall also continue as a whole time director.

3.4 Appointment of managing director, whole-time director or manager (Section 196 and Rules 3 and 7)

1. Prohibition on simultaneous appointment of MD and manager [Section 196(1)]

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

2. Maximum term of MD, WTD and manager [Section 196(2)]

No company shall appoint or re-appoint any person as its managing director, whole-time director or manager for a term exceeding 5 years at a time.

3. Reappointment possible only in last 1 year [Proviso to Section 196(2)]

No re-appointment of managing director, whole-time director or manager shall be made earlier than 1 year before the expiry of his term.

4. Disqualifications for appointment as, and vacation of office of, MD, WTD or manager [Section 196(3)]

No company shall appoint or continue the employment of any of the following persons as its managing director, whole-time director or manager:

(a) A person who is below the age of 21 years or has attained the age of 70 years.

Appointment of a person aged 70 years or more as MD, WTD or manager

A person who has attained the age of 70 years may be appointed as managing director, whole-time director or manager, if –

(i) such appointment is made by passing a special resolution; and

(ii) the explanatory statement annexed to the notice shall indicate the justification for appointing such person.

However, even if no such special resolution is passed, the appointment of a person who has attained the age of 70 years may be made, if –

(i) the votes cast in favour of the motion exceed the votes, if any, cast against the motion; and

(ii) the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company.

(b) A person who is an undischarged insolvent or has at any time been adjudged as an insolvent.

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

(d) A person who has at any time been convicted by a court of any offence and sentenced for a period of more than 6 months.

The term 'Court' shall include 'Indian Courts' as well as 'any Court outside India'.

5. Approvals required for the appointment of MD, WTD or manger [Section 196(4)]

Subject to the provisions of section 197 and Schedule V, the terms and conditions of the appointment of a managing director, whole-time director or manager and the remuneration payable to him shall be –

(a) approved by the Board of directors at a meeting;

(b) approved at a general meeting held immediately after the approval by the Board; and

(c) approved by the Central Government, in case such appointment is at variance to the conditions specified in Part I of Schedule V.

As per Rule 7 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the application for obtaining approval of the Central Government shall be made by the company in Form No. MR-2. The application shall be made within 90 days of such appointment.

6. Notice of meetings to contain disclosures [First Proviso to Section 196(4)]

The notice of the Board meeting and of the general meeting called for the purpose of approving the appointment of the managing director, whole time director or manager shall include –

(a) the terms and conditions of such appointment;

(b) remuneration payable to him; and

(c) such other matters (including interest, of a director or directors in such appointments, if any).

7. Filing of return with the Registrar [Second Proviso to Section 196(4)]

Within 60 days of appointment of the managing director, whole time director or manager, the company shall file with the Registrar a return of appointment in the prescribed form.

As per Rule 3 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the return of appointment shall be filed in Form No. MR-1. It is to be noted that Form MR-1 is not to be filed in case of appointment of Chief Executive Officer (CEO), Company Secretary or Chief Financial Officer (CFO).

8. Validity of acts where appointment is not approved at a general meeting [Section 196(5)]

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, no prior act done by him shall be deemed to be invalid.

Non-applicability of section 196

(a) The provisions of section 196(2), 196(4) and 196(5) shall not apply to a Government company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

(b) The provisions of section 196(4) and 196(5) shall not apply to a private company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 464(E) dated 5th June, 2015].

Practical Problems from CA Examinations

Appointment of a managing director made without seeking the approval of the Central Government – Consequences

P 3.4A. A complaint was received by the Central Government from some shareholders of a public company that a person had been appointed as the Managing Director of the company without seeking the approval of the Central Government when such approval was required. State as to what action can be taken by the Central Government under the Companies Act, 2013. Also examine the validity of the acts of the Managing Director, if the complaint is found true. [CA (Final) Nov. 2011]

Ans. The given problem relates to section 196 of the Companies Act, 2013, as discussed below:

The legal position

1. As per section 196(4), the terms and conditions of the appointment of a managing director, whole-time director or manager and the remuneration payable to him shall be –
   (a) approved by the Board of directors at a meeting;
   (b) approved at a general meeting held immediately after the approval by the Board; and
   (c) approved by the Central Government, in case such appointment is at variance to the conditions specified in Part I of Schedule V.

The given case and analysis of the case

2. A public company has appointed a person as the managing director without seeking the approval of the Central Government, though the approval of the Central Government was required for such appointment.
3. It is evident that the company has contravened the provisions of section 196(4).

4. Neither section 196 nor any other section of the Companies Act, 2013 contains any provision with respect to the consequences in such a case.
5. As per section 439, the Central Government may authorise any person to make a complaint in writing to a Court, and on such a complaint being made the Court shall take cognisance of the offence committed by the company.

Conclusion

6. If the Court makes an order that the appointment of the managing director was made without seeking the approval of the Central Government, though the approval of the Central Government was required for such appointment, the consequences shall be as follows:
   (a) Since no specific penalty or punishment is provided under the Companies Act, 2013 for contravention of section 196(4), the provisions of section 450 shall get attracted, according to which the company shall be punishable with fine upto Rs. 10,000 plus a fine upto Rs. 1,000 per day where the offence is of continuing nature.
   (b) The appointment of the managing director shall not be valid.
   (c) As per section 196(5), where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, no prior act done by him shall be deemed to be invalid. By applying the provisions contained in section 196(5) to the given situation, an inference may be drawn that the acts done by the managing director shall remain valid even though his appointment was made without seeking the approval of the Central Government.

When is a person considered as managing director?

P 3.4B. There are four directors in Two Squares Ltd. Mr. Rao, being the director in station, has been authorized to draw and endorse cheque or other negotiable instruments on account of the company and also to direct registration of transfer of shares and signing the share certificates etc. Whether as per provisions of Companies Act, 2013, he will be treated as managing director of the company?

Also narrate the procedure of appointment of a managing director in a company. [CA (Final) May, 2017]

Ans. The given problem relates to section 2(54) of the Companies Act, 2013, as discussed below:

1. As per section 2(54), 'managing director' means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

   As per the Explanation to section 2(54), the power to do administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, shall not be deemed to be included within the substantial powers of management.
2. Neither section 2(54) nor any other section of the Companies Act, 2013 explains as to what amounts to 'substantial powers of management'. So, what amounts to substantial powers of management depends on the facts and circumstances of the case.
3. Mr. Rao has been authorised to do certain acts on behalf of the company, which are essentially of administrative nature. Because of the mere fact that Mr. Rao has been exercising certain administrative powers, he cannot be considered as the managing director of the company.
4. Mr. Rao shall be regarded as managing director only if he is entrusted with substantial powers of management. However, no fact given in the question so suggests. Therefore, Mr. Rao cannot be considered as the managing director of the company.

Procedure for appointment of managing director

1. **Approval for appointment of managing director**

   The terms and conditions of the appointment of a managing director and his remuneration shall be –
   (a) approved by the Board of directors at a meeting;
   (b) approved at a general meeting held immediately after the approval by the Board; and
   (c) approved by the Central Government, in case such appointment is at variance to the conditions specified in Part I of Schedule V.

   As per Rule 7 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the application for obtaining approval of the Central Government shall be made by the company in Form No. MR-2. The application shall be made within 90 days of such appointment.
2. **Notice of meetings to contain disclosures**

   The notice of the Board meeting and of the general meeting called for the purpose of approving the appointment of the managing director shall include –

(a) the terms and conditions of such appointment;

(b) remuneration payable to him; and

(c) such other matters (including interest, of a director or directors in such appointments, if any).

3. **Filing of return with the Registrar**

Within 60 days of appointment of the managing director, the company shall file with the Registrar a return of appointment in Form No. MR-1.

Advanced Practical Problems

Can a person be appointed as a managing director for life?

P 3.4C.

Case I. 'X' was appointed as Managing Director for life by the Articles of Association of a private company incorporated on 1st June, 2016. Examine in this connection, Can 'X' be appointed for life as Managing Director? **[ICAI, Practice Manual]**

OR

Mr. Pawan is proposed to be appointed as manager for life by the articles of association of Sri Ram private company incorporated on 1st June, 2015. Examine in the light of the Companies Act, 2013, whether such an appointment is valid.

[ICAI, RTP]

Case II.

'X' was appointed as Managing Director for life by the Articles of Association of a private company incorporated on 1st June, 2005. The articles also empowered 'X' to appoint a successor. 'X' appointed by will 'G' to succeed him after his death. Examine in this connection

(a) Can 'G' succeed 'X' as Managing Director after the death of' X'?

(b) Is it possible for the company in general meeting to remove 'X' from his office of directorship during his life time?

[ICAI, Practice Manual]

Ans. The given problem relates to section 196 of the Companies Act, 2013, as discussed below:

The legal position

1. As per section 196(2), no company shall appoint or re-appoint any person as its managing director, whole-time director or manager for a term exceeding 5 years at a time.

   This condition applies to all companies, whether public or private.

2. As per section 196(4), the terms and conditions of the appointment of a managing director, whole-time director or manager and the remuneration payable to him shall be –

   (a) approved by the Board of directors at a meeting;

   (b) approved at a general meeting held immediately after the approval by the Board; and

   (c) approved by the Central Government, in case such appointment is at variance to the conditions specified in Part I of Schedule V.

   However, the provisions of section 196(4) shall not apply to a private company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 464(E) dated 5th June, 2015].

Ans. to Case I.

The given case and analysis of the case

1. Mr. X was appointed as the managing director for life in accordance with the articles of a private company.
2. Such appointment is in contravention of section 196(2).
3. Further, if the private company which has appointed Mr. X as the managing director has committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, there would be contravention of section 196(2) as well as section 196(4).

Conclusion

4. The appointment of Mr. X as the managing director for life is not valid.

Ans. to Case II.

The given case and analysis of the case

1. Mr. X was appointed as the managing director for life in accordance with the articles of a private company.
2. Such appointment is in contravention of section 196(2).
3. Further, if the private company which has appointed Mr. X as the managing director has committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, there would be contravention of section 196(2) as well as section 196(4).
4. The appointment of Mr. X as the managing director for life is not valid.

5. Since the appointment of Mr. X as the managing director is not valid, he is not entitled to name Mr. G as his successor for the position of managing director.

Conclusion

(i) Mr. G cannot succeed Mr. X as the managing director, after the death of Mr. X.

(ii) Had Mr. X been validly appointed as the managing director, it would have been possible for the company to remove him before the expiry of his term, in accordance with the provisions of section 169.

Section 169 empowers a company (whether public or private) to remove any director (including a managing director) by passing an ordinary resolution and after giving a reasonable opportunity of being heard to the director concerned. A special notice (in accordance with the provisions of section 115) has to be given to the company for such removal.

3.5 Eligibility for appointment as a managerial person as per Schedule V (Part I of Schedule V)

As per Part I of Schedule V, a person shall be eligible to be appointed as a managing director, whole time director or manager (hereinafter referred to as 'managerial person'), without obtaining the approval of the Central Government, only if he satisfies all the following conditions:

1. Neither imprisoned nor fined exceeding Rs. 1,000 for specified defaults

(a) He has not been sentenced to imprisonment for any period, or to a fine exceeding Rs. 1,000, for the conviction of an offence under any of the following Acts:

(i) the Indian Stamp Act, 1899
(ii) the Central Excise and Salt Act, 1944
(iii) the Industries (Development and Regulation) Act, 1951
(iv) the Prevention of Food Adulteration Act, 1954
(v) the Essential Commodities Act, 1955
(vi) the Companies Act, 2013 or any previous company law
(vii) the Securities Contracts (Regulation) Act, 1956
(viii) the Wealth-tax Act, 1957
(ix) the Income-tax Act, 1961
(x) the Customs Act, 1962
(xi) the Competition Act, 2002
(xii) the Foreign Exchange Management Act, 1999
(xiii) the Sick Industrial Companies (Special Provisions) Act, 1985
(xiv) the Securities and Exchange Board of India Act, 1992
(xv) the Foreign Trade (Development and Regulation) Act, 1992
(xvi) the Prevention of Money Laundering Act, 2002
(xvii) the Insolvency and Bankruptcy Code, 2016
(xviii) the Goods and Services Tax Act, 2017
(xix) the Fugitive Economic Offenders Act, 2018

Where an offence is compounded, it does not amount to 'fine', and therefore, a person who has availed of the benefit of compounding under any of the above 19 Acts, shall not be disqualified.

(b) However, if a person, who is convicted of an offence under any of the above Acts, is appointed as a managerial person with the approval of the Central Government, then, he shall not be disqualified for appointment in accordance with Part I of Schedule V, if he is not so convicted subsequently.

2. No detention under COFEPOSA

(a) He has not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

(b) However, if a person, who is, detained under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 is appointed as a managerial person with the approval of the Central Government, then, he shall not be disqualified for appointment in accordance with Part I of Schedule V, if he is not so detained subsequently.

3. **Aged 21 to 70 years**
   (a) He has completed the age of 21 years and has not attained the age of 70 years.
   (b) However, a person who has attained the age of 70 years, may be appointed as a managerial person if his appointment is approved by a special resolution.
4. **Resident in India**
   (a) He must be resident in India.
   (b) For this purpose, resident in India includes a person who has been staying in India for a continuous period of not less than 12 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 vocation in India.

Theoretical Questions from CA Examinations

Q 3.5A. **When does an appointment of managing or whole time director require the approval of the Central Government?**

[CA (Final) May 1990]

Advanced Practical Problems

Eligibility for appointment as a managing director – Various cases

P 3.5A. ABC Ltd. wants to appoint a Managing Director for the company. Out of the following persons, who can be appointed as a Managing Director in the company as per the provisions of the Companies Act, 2013?

(i) Mr. Mohan, a director of the company having the age of 71 years.

(ii) Mr. Samuel who been sentenced for a period of 2 months for the conviction of an offence under the Income-tax Act, 1961.

(iii) Mr. Manoj who is an undischarged insolvent. **[ICAI, Mock Test Paper]**

Ans. The given problem relates to section 196 and Schedule V, as discussed below:

The legal position

1. As per section 196(3), no company shall appoint or continue the employment of any of the following persons as its managing director, whole-time director or manager:
   (a) A person who is below the age of 21 years or has attained the age of 70 years.
   However, a person who has attained the age of 70 years may be appointed as managing director, whole-time director or manager, if –
      (i) such appointment is made by passing a special resolution; and
      (ii) the explanatory statement annexed to the notice shall indicate the justification for appointing such person.
   Further, even if no such special resolution is passed, the appointment of a person who has attained the age of 70 years may be made, if –
      (i) the votes cast in favour of the motion exceed the votes, if any, cast against the motion; and
      (ii) the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company.
   (b) A person who is an undischarged insolvent or has at any time been adjudged as an insolvent.
   (c) A person who has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them.
   (d) A person who has at any time been convicted by a court (whether in India or outside India) of any offence and sentenced for a period of more than 6 months.
2. As per Part I of Schedule V, the appointment of a person who has attained the age of 70 years, as a managerial person requires approval by a special resolution.
3. As per Part I of Schedule V, a person shall not be eligible to be appointed as a managing director, whole time director or manager, without obtaining the approval of the Central Government if he has been sentenced to imprisonment for any period, or to a fine exceeding Rs. 1,000, for the conviction of an offence under any of the 19 Acts specified in Part I of Schedule V.
4. As per section 196(4), the terms and conditions of the appointment of a managing director, whole-time director or manager and the remuneration payable to him shall be –
   (a) approved by the Board of directors at a meeting;
   (b) approved at a general meeting held immediately after the approval by the Board; and
   (c) approved by the Central Government, in case such appointment is at variance to the conditions specified in Part I of Schedule V.

The given cases, analysis of the cases and conclusions

(i) Mr. Mohan has attained the age of 71 years. Therefore, he can be appointed as a managing director only if –
  (a) his appointment is made by passing a special resolution; and
  (b) the explanatory statement annexed to the notice indicates the justification for appointing him.
  However, even if no such special resolution is passed, Mr. Mohan may be appointed as a managing director, if –
  (a) the votes cast in favour of the motion exceed the votes, if any, cast against the motion; and
  (b) the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company
  Further, if Mr. Mohan does not fulfil one or more conditions contained in Part I of Schedule V, his appointment as the managing director shall require the approval of the Central Government.
  However, if Mr. Mohan fulfils all the conditions contained in Part I of Schedule V, no approval of the Central Government shall be required.
  Whether or not Mr. Mohan fulfils the conditions contained in Part I of Schedule V, his appointment as the managing director shall require –
  (a) approval of the Board of directors at a meeting of the Board; and
  (b) approval of the members at a general meeting held immediately after obtaining the approval of the Board.

(ii) Mr. Samuel has been sentenced for a period of 2 months for the conviction of an offence under the Income-tax Act, 1961.
  Income-tax Act, 1961 is one of the 19 Acts specified in Part I of Schedule V, and so Mr. Samuel cannot be appointed as a managing director in accordance with Part I of Schedule V.
  However, Mr. Samuel shall not be disqualified for appointment as a managing director as per section 196(3), since he has been sentenced to imprisonment for 2 months only, and not for more than 6 months.
  Since Mr. Samuel does not fulfil the conditions specified in Part I of Schedule V, he may be appointed as the managing director with the approval of the Central Government. Before making an application to the Central Government, his appointment shall have to be –
  (a) approved by the Board of directors at a meeting of the Board; and
  (b) approved by the members at a general meeting held immediately after obtaining the approval of the Board.

(iii) Mr. Manoj is an undischarged insolvent. So, he is disqualified for appointment as a managing as per section 196(3). Accordingly, he cannot be appointed as a managing director.

3.6 Remuneration of a managerial person as per Schedule V (Part II of Schedule V)

1. **Remuneration payable by companies having profits (Section I of Part II of Schedule V)**
   A company having profits in a financial year may pay remuneration to a managerial person(s) not exceeding the limits specified in section 197.
2. **Remuneration payable by companies having no profit or inadequate profit (Section II of Part II of Schedule V)**
   Where in any financial year, a company has no profits or its profits are inadequate, it may pay remuneration to its managerial person(s) as per Item (A) or Item (B) given below:
   (A) Remuneration based on the effective capital. The remuneration shall be calculated as per the following scale:

Where the Effective Capital of company is –	*Yearly remuneration payable to each managerial person shall not exceed (in Rs.)*
(i) negative or less than Rs. 5 crore	60 lakhs
(ii) Rs. 5 crore or more but less than Rs. 100 crores	84 lakhs
(iii) Rs. 100 crores or more but less than Rs. 250 crores	120 lakhs
(iv) Rs. 250 crores or more	120 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores

Note 1. The remuneration in excess of above limits may be paid, if the resolution passed by the shareholders is a special resolution.

Note 2. If a managerial person has been employed for a period less than 1 year, the above limits shall be pro-rated.

(B) Remuneration to professional director.

Remuneration as per item (A) may be paid to a managerial person who –

(i) is functioning in a professional capacity;

(ii) does not hold, directly or indirectly or through any other statutory structures, any shares in the company or its holding company or any of its subsidiaries at any time during the last 2 years before or on or after the date of appointment (if an employee of a company holds shares in the company not exceeding 0.5% of its paid up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock Option Plan, it shall be deemed that he does not hold any shares for this purpose);

"Statutory Structure" means any entity which is formed under any statute and is entitled to hold shares in any company.

(iii) is not related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last 2 years before or on or after the date of appointment; and

(iv) possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates.

3. Conditions for payment of remuneration as per Section II of Part II of Schedule V

(a) Payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee.

(b) The company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor. However, in case the company has made such a default, this condition shall be deemed to be complied with if the company obtains the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting.

(c) An ordinary resolution or a special resolution, as the case may be, has been passed at the general meeting of the company authorising the payment of remuneration as per Item (A) above, or a special resolution has been passed at the general meeting of the company authorising the payment of remuneration as per Item (B) above. Such ordinary resolution or special resolution, as the case may be, shall remain valid for a period not exceeding 3 years.

(d) A statement shall be given to the shareholders alongwith the notice calling the general meeting. The statement shall contain the following information:

(i) General Information

(ii) Information about the appointee

(iii) Other information

(iv) Disclosures.

4. Remuneration payable by companies having no profit or inadequate profit in certain special circumstances (Section III of Part II of Schedule V)

In the following circumstances a company may pay remuneration to a managerial person in excess of the amounts provided in Section II:

(a) Where all the following conditions are satisfied:

(i) The remuneration in excess of the limits specified in Section I or II is paid by any company, other than the company of which the person is employed as a managerial person.

(ii) That other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment.

(iii) That other company treats such amount as managerial remuneration for the purpose of section 197.

(iv) The total managerial remuneration payable by such other company to its managerial persons including such amount is within the permissible limits under section 197.

(b) Where all the following conditions are satisfied:

(i) The company is a newly incorporated company.

(ii) The remuneration is paid for a period of 7 years from the date of incorporation of the company.

(c) Where all the following conditions are satisfied:

(i) The company is a sick company.

(ii) A scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction.

(iii) The remuneration is paid for a period of 5 years from the date of sanction of scheme of revival or rehabilitation.

(d) Where the remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal.

(e) Where all the following conditions are satisfied:

(i) A resolution plan has been approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016 in relation to such company.

(ii) The remuneration is paid for a period of 5 years from the date of such approval.

Compliance of conditions for payment of excess remuneration. For payment of excess remuneration in the special circumstances specified above in points (a), (b), (c), (d) and (e) above, the company shall comply with all the conditions specified under Section II and the following additional conditions:

(i) Except where the remuneration is paid by any other company (as per point (a) above), the managerial person is not receiving remuneration from any other company.

(ii) The auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under section 196.

(iii) The auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

5. Perquisites not included in managerial remuneration (Section IV of Part II of Schedule V)

(a) A managerial person shall be eligible for the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II and Section III:

(i) Contribution to provident fund, superannuation fund or annuity fund

(ii) Gratuity

(iii) Encashment of leave at the end of the tenure.

(b) An expatriate managerial person (including a non-resident Indian) shall be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II or Section III:

(i) Children's education allowance

(ii) Holiday passage for children studying outside India or family staying abroad

(iii) Leave travel concession.

6. Meaning of certain terms (Section IV of Part II of Schedule V)

(a) 'Effective capital' means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after 1 year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

(b) Where the appointment of the managerial person is made in the year in which company has been incorporated, the effective capital shall be calculated as on the date of such appointment. In any other case the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

(c) The Nomination and Remuneration Committee while approving the remuneration under Section II or Section III, shall –

(i) take into account, financial position of the company, trend in the industry, appointee's qualification, experience, past performance, past remuneration, etc.;

(ii) be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

(d) 'Negative effective capital means the effective capital which is calculated in accordance with the provisions contained in Schedule V, and is less than zero.

(e) 'Remuneration' means remuneration as defined in clause (78) of section 2 and includes reimbursement of any direct taxes to the managerial person.

7. **Remuneration payable to a managerial person in two companies (Section V of Part II of Schedule V)**

A managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person. The provisions of Section V of Part II of Schedule V are subject to the provisions of Sections I to IV of Part II of Schedule V.

3.7 Procedural requirements for appointment or payment of remuneration as per Schedule V (Part III of Schedule V)

1. The appointment and remuneration referred to in Part I and Part II of Schedule V shall be subject to approval by a resolution of the shareholders in general meeting.
2. The auditor or the Secretary of the company or where the company is not required to appointed a Secretary, a Secretary in whole-time practice shall certify that the requirement of Schedule V have been complied with and such certificate shall be incorporated in the return filed with the Registrar under section 196 (*i.e.* Form No. MR-2).

3.8 Managerial remuneration (Section 197 and Rules 4, 5 and 6)

1. **Total managerial remuneration not to exceed 11% [Section 197(1)]**

(a) ***Remuneration not to exceed 11%.*** The total managerial remuneration payable to the directors and manager in respect of any financial year shall not exceed 11% of 'net profits' of the company for that financial year.

(b) ***Computation of 'net profits'.*** Net profits of the company shall be computed in the manner laid down under section 198 except that remuneration paid to the directors shall not be deducted.

2. **Total managerial remuneration exceeding 11% [First Proviso to Section 197(1)]**

The total managerial remuneration payable to the directors and manger in respect of any financial year may exceed 11% of 'net profits' of the company, if –

(a) such higher remuneration is authorised by the members in the general meeting, *i.e.* by passing an ordinary resolution in the general meeting; and

(b) the provisions contained in Schedule V are complied with.

3. **Remuneration of whole time director(s), managing director(s) and manager [Second Proviso to Section 197(1)]**

The remuneration payable to a whole time director or a managing director or the manager shall not exceed –

(a) 5% of net profits, if there is only one of them; *or*

(b) 10% of net profits, if there is more than one whole time director, managing director or manager, taken together.

However, remuneration exceeding the aforesaid limits may be paid if –

(i) the approval of the company in general meeting is obtained by passing a special resolution; and

(ii) where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting by passing a special resolution.

4. **Remuneration of other directors [Second Proviso to Section 197(1)]**

The remuneration payable to a director who is neither a managing director nor a whole-time director shall not exceed –

(a) 1% of net profits, if the company has employed a managing director or whole time director or manager; *or*

(b) 3% of net profits, if the company has not employed any managing director, whole time director and manager.

However, remuneration exceeding the aforesaid limits may be paid if –

(i) the approval of the company in general meeting is obtained by passing a special resolution; and

(ii) where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting by passing a special resolution.

5. **Remuneration to be exclusive of sitting fees [Section 197(2)]**

Any remuneration paid to the directors under the provisions of sub-section (1) or First Proviso to sub-section (1) or Second Proviso to sub-section (1) shall be exclusive of sitting fees.

6. **Remuneration, in case of no profits or inadequate profits [Section 197(3)]**

If, in any financial year, a company has no profits or its profits are inadequate, the company may pay the remuneration to its directors and manager as follows:

(a) Sitting fees, in accordance with section 197(5); and

(b) Remuneration, in accordance with Schedule V.

The above provision shall apply –

(a) notwithstanding anything contained in section 197(1) or 197(2);

(b) subject to the provisions of Schedule V.

7. **Modes of determination of remuneration [Section 197(4)]**

The remuneration payable to the directors and manager of a company shall be determined –

(a) by the articles of the company; *or*

(b) by an ordinary resolution; *or*

(c) by a special resolution, where the articles so require.

Thus, the Board has no power to fix or determine the remuneration of directors.

Parameters for consideration of remuneration (Rule 6 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014):

The company shall have regard to the following matters:

(a) The Financial and operating performance of the company during preceding 3 financial years.

(b) The relationship between remuneration and performance.

(c) 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 who receives remuneration and employees or executives of the company.

(d) Whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference.

(e) The securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.

8. **Remuneration for other services to be included in remuneration of directors [Section 197(4)]**

The remuneration payable to a director shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

9. **Remuneration for other services not to be included in remuneration of directors [Proviso to Section 197(4)]**

The remuneration paid to a director for services rendered by him in any other capacity shall not be so included, if –

(a) the services rendered are of professional nature; *and*

(b) the director possesses the requisite qualification for the practice of the profession, as opined by –

(i) the Nomination and Remuneration Committee, if the company is covered under section 178(1); or

(ii) the Board of Directors, if the company is not covered under section 178(1).

10. Amount of sitting fees [Section 197(5)]

(a) A director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof (termed as 'sitting fees').

(b) The amount of sitting fees shall not exceed such amount as may be prescribed. The Central Government may prescribe different fees for different classes of companies, and different amount of sitting fees may be prescribed for independent directors.

Provisions contained in Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014:

(a) A company may pay sitting fees to a director for attending meetings of the Board or committees thereof.

(b) The amount of sitting fees shall be such as may be decided by the Board of directors of the company.

(c) The amount of sitting fees shall not exceed Rs. 1 lakh per meeting of the Board or any committee of the Board.

(d) The amount of sitting fees payable to Independent Directors and Women Directors shall not be less than the sitting fees payable to other directors.

11. Mode of payment of remuneration [Section 197(6)]

Remuneration may be paid to any director (whether whole time director or managing director or non-executive director) or manager by way of –

(a) monthly payment; *or*

(b) specified percentage of net profits; *or*

(c) partly by monthly payment and partly by specified percentage of net profits.

12. Consequence of payment of excess remuneration [Section 197(9)]

If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without the approval required under this section, he shall refund such sums to the company, within 2 years or such lesser period as may be allowed by the company. Until such sum is refunded, he shall hold it in trust for the company.

13. No waiver of excess remuneration by the company [Section 197(10)]

The company shall not waive the recovery of any excess remuneration drawn or received by a director, unless approved by the company by passing a special resolution within 2 years from the date the sum becomes refundable. However, if the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining approval of such waiver by passing a special resolution.

14. Increase in remuneration to be in accordance with Schedule V or approval of CG [Section 197(11)]

(a) In case of no profits or inadequate profits, if Schedule V is applicable, then, no provision which has the effect of increasing the remuneration of any director shall have any effect unless such increase is in accordance with the conditions specified in Schedule V.

(b) It is immaterial as to whether the provision which has the effect of increasing the remuneration of any director, is contained in –

(i) the company's memorandum or articles; or

(ii) any agreement entered into by the company; or

(iii) any resolution passed by the company in general meeting or by the Board.

15. Disclosures by listed companies [Section 197(12)]

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.

As per Rule 5(2) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the Board's report shall include a statement showing the names of the top 10 employees in terms of remuneration drawn and the name of every employee, who –

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than Rs. 1,02,00,000;

(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 Rs. 8,50,000 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 MD or WTD or manager and holds by himself or along with his spouse and dependent children, not less than 2% of the equity shares of the company.

16. Insurance premium not to be a part of remuneration [Section 197(13) and its Proviso]

(a) Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel.

(b) However, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.

17. No prohibition on receipt of remuneration from the holding or subsidiary company [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.

18. Punishment for default [Section 197(15)]

If any person makes any default in complying with the provisions of this section, he shall be liable to a penalty of Rs. 1 lakh and where any default has been made by a company, the company shall be liable to a penalty of Rs. 5 lakh.

19. Duty of the auditor to make disclosures in his report with respect to remuneration of directors [Section 197(16)]

The auditor of the company shall, in his report under section 143, make the following disclosures:

(a) A statement as to whether the remuneration paid by the company to its directors is in accordance with the provisions of section 197.

(b) A statement as to whether remuneration paid to any director is in excess of the limit laid down under section 197.

(c) Such other details as may be prescribed.

20. Abatement of applications made to the Central Government [Section 197(17)]

Any application made to the Central Government shall abate, if –

(a) such application was made to the Central Government under the provisions of section 197 (as it stood before commencement of the Companies (Amendment) Act, 2017); and

(b) such application was pending with the Central Government as on the commencement of the Companies (Amendment) Act, 2017;

In all such cases, the company shall, within 1 year of commencement of the Companies (Amendment) Act, 2017, obtain the approval in accordance with the provisions of section 197, as amended.

Non-applicability of section 197

(a) The provisions of section 197 do not apply to a private company.

(b) The provisions of section 197 shall not apply to a Government company if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

Theoretical Questions from CA Examinations

Q 3.8A. What is the maximum amount of remuneration that can be paid to a managing or whole time director in the event of loss in any financial year? [CA (Final) May 1996 (Modified)]

Practical Problems from CA Examinations

Validity of payment of remuneration to managing director, ordinary directors and additional remuneration paid for rendering services of professional nature

P 3.8A. International Technologies Limited, a listed company, being managed by a Managing Director proposes to pay the following managerial remuneration:

(i) Commission at the rate of five percent of the net profits to its Managing Director, Mr. Kamal.

(ii) The directors other than the Managing Director are proposed to be paid monthly remuneration of Rs. 50,000 and also commission at the rate of one percent of net profits of the company subject to the condition that overall remuneration payable to ordinary directors including monthly remuneration payable to each of them shall not exceed two percent of the net profits of the company. The commission is to be distributed equally among all the directors.

(iii) The company also proposes to pay suitable additional remuneration to Mr. Bhatt, a director, for professional services rendered as software engineer, whenever such services are utilized.

You are required to examine with reference to the provisions of the Companies Act, 2013 the validity of the above proposals.
[CA (Final) May 2016]

Ans.

(i) The given problem relates to Second Proviso to Sub-Section (1) of Section 197 and sub-section (6) of section 197 of the Companies Act, 2013.

As per Second Proviso to Sub-Section (1) of Section 197, where a company has appointed only one managing director or one whole time director or manager, it can pay a maximum of 5% of the net profits to him.

However, payment of remuneration exceeding 5% of net profits may be made if –

(a) the approval of the company in general meeting is obtained by passing a special resolution; and

(b) where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting by passing a special resolution.

As per sub-section (6) of section 197, remuneration may be paid to any director (whether whole time director or managing director or non-executive director) or manager by way of –

(a) monthly payment; or

(b) specified percentage of net profits; or

(c) partly by monthly payment and partly by specified percentage of net profits.

In the given case, International Technologies Limited intends to pay 5% of the net profits as remuneration to its managing director, Mr. Kamal. Such payment does not exceed the limit specified under section 197, and is therefore, permissible, without requiring any approval by way of a special resolution in the general meeting and without requiring approval of any bank or public financial institution or non-convertible debenture holders or any other secured creditor.

(ii) As per Second Proviso to Sub-Section (1) of Section 197, where a company has employed a managing director or whole time director or manager, it can pay a maximum of 1% of the net profits as remuneration to its ordinary directors.

However, remuneration exceeding 1% of the net profits may be paid to the ordinary directors if –

(a) the approval of the company in general meeting is obtained by passing a special resolution; and

(b) where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting by passing a special resolution.

In the given case, International Technologies Limited intends to pay to its ordinary directors –

(a) 1% of the net profits as commission; and

(b) Rs. 50,000 per month in addition to commission,

subject to the condition that total remuneration paid to ordinary directors shall not exceed 2% of the net profits.

Since the total remuneration for all the ordinary directors would exceed 1% of the net profits, such payment of remuneration is permissible if the approval of the members is obtained in the general meeting by passing a special resolution. Further, if International Technologies Limited has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by International Technologies Limited before obtaining the approval of the members in the general meeting by passing a special resolution.

(iii) The given problem relates to section 197(4) of the Companies Act, 2013.

As per section 197(4), remuneration payable to a director for rendering services in any other capacity shall also be covered in 'managerial remuneration'. However, the remuneration paid for rendering services in any other capacity shall not be so included, if –

(a) the services rendered are of professional nature; and

(b) the director possesses the requisite qualification for the practice of the profession, as opined by –

(i) the Nomination and Remuneration Committee, if the company is covered under section 178(1); or

(ii) the Board of Directors, if the company is not covered under section 178(1).

In the given case, Mr. Bhatt, an ordinary director has rendered professional services as a software engineer to International Technologies Limited, and International Technologies Limited intends to pay additional remuneration for such professional services. Such payment of additional remuneration shall be permissible since the services rendered by Mr. Bhatt are of professional nature. However, the Nomination and Remuneration Committee constituted by International Technologies Limited (or in its absence, the Board of directors) shall have to express an opinion that Mr. Bhatt possesses requisite professional qualifications.

Appointment of a person aged 71 years as managing director, meaning of effective capital and maximum permissible remuneration payable to managing director

P 3.8B. Mr. Smart, a technocrat aged 71 years and reputed to be a specialist in reviewing sick companies is being considered to be appointed as Managing Director of Downhill Industries Limited. The company has been incurring losses for the past several years and its "effective capital" is Rs. 500 crores. Referring to the provisions of the Companies Act, 2013, discuss:

(i) Can Mr. Smart be appointed as Managing Director of the company despite being over 70 years of age? If so, what is the process to be followed to enable this?

(ii) What is "effective capital" as per Schedule V of the Act?

(iii) What is the maximum permissible remuneration under the Companies Act, 2013? **[CA (Final) Nov. 2016]**

OR

Advise M/s Super Specialities Ltd. in respect of appointment of managing director who is more than 70 years of age.

[CA (Final) May 2005]

Ans. The given problem relates to section 196(3) read with Schedule V of the Companies Act, 2013.

The given problems are answered as under:

(i) Appointment of Mr. Smart as the managing director

As per section 196(3), a person who has attained the age of 70 years may be appointed as a managing director, whole-time director or manager, if –

(i) such appointment is made by passing a special resolution; and

(ii) the explanatory statement annexed to the notice shall indicate the justification for appointing such person.

Part I of Schedule V also provides that the appointment of a person who has attained the age of 70 years, as a managerial person requires approval by a special resolution.

In the given case, Mr. Smart has completed the age of 70 years. Thus, the conditions required to be fulfilled for appointment of Mr. Smart as the managing director are as under:

- If Mr. Smart fulfils all the conditions contained in Part I of Schedule V, no approval of the Central Government is required and therefore Mr. Smart may be appointed as a managing director for 5 years.

  The company shall file a return with the registrar in Form No. MR-1 within 60 days of such appointment.
- If Mr. Smart does not fulfil one or more of the conditions contained in Part I of Schedule V, he may be appointed as a managing director only with the approval of the Central Government.
- Whether or not Mr. Smart fulfils the conditions contained in Part I of Schedule V, he may be appointed as a managing director (since his age is more than 70 years), if –

  (i) his appointment is made by passing a special resolution; and

  (ii) the explanatory statement annexed to the notice indicates the justification for appointing him.

  However, even if no such special resolution is passed, the appointment of Mr. Smart may be made, if –

  (i) the votes cast in favour of the motion exceed the votes, if any, cast against the motion; and

  (ii) the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company.

(ii) Meaning of effective capital

Section IV of Part II of Schedule V defines the term 'effective capital' as follows:

'Effective capital' means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after 1 year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

(iii) Maximum permissible remuneration of Mr. Smart under the Companies Act, 2013

(a) Maximum permissible remuneration as per section 197

If Downhill Industries Limited has made adequate profits, and it has not employed any whole-time director and manager, then, it can pay a maximum of 5% of net profits of that financial year as the remuneration to Mr. Smart.

However, payment of remuneration exceeding 5% of net profits may be made if –

(i) the approval of the company in general meeting is obtained by passing a special resolution; and

(ii) where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting by passing a special resolution.

(b) **Maximum permissible remuneration as per Section II of Part II of Schedule V**

If Downhill Industries Limited has made no profits or its profits are inadequate, it can pay to Mr. Smart a maximum of Rs. 120 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores.

Thus, the maximum remuneration payable to Mr. Smart can be –

(i) Rs. 120 lakhs; plus

(ii) 0.01% of Rs. 250 crores, *i.e.* Rs. 2.5 lakh.

Total: Rs. 122.5 lakh.

However, the remuneration in excess of Rs. 122.5 lakh may be paid if the resolution passed by the shareholders approving the remuneration of Mr. Smart, is a special resolution.

Difference in answer as compared to the answer given by ICAI

As per the Author, the remuneration of Mr. Smart can be a maximum of Rs. 122.5 lakh (if no special resolution is passed by the shareholders). However, the Author's answer differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. The answer given in the Suggested Answers is as under:

"According to Section II of Part II of Schedule V, where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to the managerial person not exceeding 60 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores in case where the effective capital is 250 crores and above. Hence, the maximum permissible remuneration shall be 60 lakhs plus 0.01% of 250 crore [500 crore - 250 crore]: Rs. 60 lakhs + 2.5 lakhs is Rs. 62.5 lakhs.

In the opinion of the Author, since the effective capital of the company is Rs. 500 crore, the maximum yearly remuneration payable to Mr. Smart can be 'Rs. 120 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores' and not '60 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores' as stated in the Suggested Answers.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

(c) **Maximum permissible remuneration as per Section III of Part II of Schedule V**

It is given that Downhill Industries Limited has been making losses continuously during past several years. So, if it is a sick company, the remuneration payable to Mr. Smart can exceed the limits specified in Section II of Part II of Schedule V, if –

(i) a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction; and

(ii) the remuneration is paid for a period of 5 years from the date of sanction of scheme of revival or rehabilitation.

3.9 Calculation of profits (Section 198)

1. Credit to be given in computing net profits [Section 198(2)]

In computing the net profits of a company in any financial year for the purpose of section 197, credit shall be given for the 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.

2. Credit not to be given in computing net profits [Section 198(3)]

In computing the net profits of a company in any financial year for the purpose of section 197, credit shall not be given for the following sums:

(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 as referred to in clause (a) of the Explanation to section 186

(b) Profits on sales by the company of forfeited shares

(c) Profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof

(d) Profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets

Where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written down value.

(e) Any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value

(f) Any amount representing unrealised gains, notional gains or revaluation of assets.

3. **Sums to be deducted in computing net profits [Section 198(4)]**

In computing the net profits of a company in any financial year for the purpose of section 197, the following sums 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, 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)

(o) Debts considered bad and written off or adjusted during the year of account.

4. **Sums not to be deducted in computing net profits [Section 198(5)]**

In computing the net profits of a company in any financial year for the purpose of section 197, the following sums 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 sub-section (4)

(b) Any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (m) of sub-section (4)

(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.

3.10 Recovery of remuneration in certain cases (Section 199)

1. **When is section 199 attracted?**

Section 199 is attracted where a company is required to re-state its financial statements due to –

(a) fraud; or

(b) non-compliance with any requirement under this Act and the rules made thereunder.

2. Legal requirement

(a) ***Recovery from whom?*** The company shall recover from any past or present managing director or whole-time director or manager or Chief Executive Officer (by whatever name called) who, during the period for which the financial statements are required to be re-stated, received any remuneration.

(b) ***Amount of recovery.*** Any amount paid to such person as remuneration in excess of such remuneration (including stock option) as would have been payable to him as per re-statement of financial statements, shall be recovered.

The liability to refund the remuneration under section 199 shall be in addition to any liability incurred under the provisions of this Act or any other law for the time being in force.

3.11 Company to fix limit with regard to remuneration (Section 200)

A company may, while according its approval to any appointment under section 196, or to any remuneration under section 197, fix the remuneration within the limits specified in this Act, at such amount or percentage of profits of the company, as it may deem fit and while fixing the remuneration, the company shall have regard to the following:

(a) The financial position of the company

(b) The remuneration or commission drawn by the individual concerned in any other capacity

(c) The remuneration or commission drawn by him from any other company

(d) Professional qualifications and experience of the individual concerned

(e) Such other matters as may be prescribed.

3.12 Forms of, and procedure in relation to, certain applications (Section 201 and Rule 7)

The procedure for making application to the Central Government is as under:

1. Every application made to the Central Government under section 196 shall be in such form as may be prescribed.
2. Before any application is made by a company to the Central Government under section 196, there shall be issued by or on behalf of the company a general notice to the members thereof, indicating the nature of the application proposed to be made.
3. Such notice shall be published at least once in a newspaper in the principal 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 in an English newspaper circulating in that district.
4. The copies of the notices, together with a certificate by the company as to the due publication thereof, shall be attached to the application.

Practical Problems from CA Examinations

Can a person aged 71 years be appointed as a managing director and paid assured remuneration?

P 3.12A. The managing director of M/s. Speculative Builders Ltd. has resigned, as the company was not doing well and also incurring losses. The Board of directors have decided to appoint Mr. Reliable aged 71 years as the new managing director, because of his proven track record of nearly 50 years, turning sick companies into profitable ones. The only condition put forth by Mr. Reliable is that he should be paid the maximum permissible salary and perquisites as provided in the Companies Act, 2013 without requiring the approval of Central Government. The effective capital of the company is Rs. 20 crores. Advise the company about:

(i) The procedure to be followed for the appointment of Mr. Reliable; and

(ii) The quantum of remuneration payable to him. **[CA (Final) May 1999]**

OR

Advise M/s Super Specialities Ltd. in respect of appointment of managing director who is more than 70 years of age.
[CA (Final) May 2005]

Ans.

(i) As per section 196, the terms and conditions of the appointment of a managing director, whole-time director or manager and the remuneration payable to him shall be –

(a) approved by the Board of directors at a meeting;

(b) approved at a general meeting held immediately after the approval by the Board; and

(c) approved by the Central Government, in case such appointment is at variance to the conditions specified in Part I of Schedule V.

Also, section 196 provides that a person who has attained the age of 70 years may be appointed as managing director, whole-time director or manager, if –

(i) such appointment is made by passing a special resolution; and

(ii) the explanatory statement annexed to the notice shall indicate the justification for appointing such person.

Part I of Schedule V also provides that the appointment of a person who has attained the age of 70 years, as a managerial person requires approval by a special resolution.

In the given case, Mr. Reliable has completed the age of 70 years. Thus, the conditions required to be fulfilled by Mr. Reliable are described as under:

- If Mr. Reliable fulfils all the conditions contained in Part I of Schedule V, no approval of the Central Government is required and therefore Mr. Reliable may be appointed as a managing director for 5 years.

  The company shall file a return with the registrar in Form No. MR-1 within 60 days of such appointment.
- If Mr. Reliable does not fulfil one or more of the conditions contained in Part I of Schedule V, he may be appointed as a managing director only with the approval of Central Government.
- Whether or not Mr. Reliable fulfils the conditions contained in Part I of Schedule V, he may be appointed as a managing director (since his age is more than 70 years), if –

  (i) his appointment is made by passing a special resolution; and

  (ii) the explanatory statement annexed to the notice indicates the justification for appointing him.

  However, if no such special resolution is passed, the appointment of Mr. Smart may be made, if –

  (i) votes cast in favour of the motion exceed the votes, if any, cast against the motion; and

  (ii) the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company.

(ii) Where a company does not make any profits or its profits are inadequate, it may pay remuneration to its managing director in accordance with Section II of Part II of Schedule V.

In the present case, the effective capital of the company is Rs. 20 crores. As per Section II of Part II of Schedule V, a company having effective capital between Rs. 5 crores and Rs. 100 crores may pay to its managerial person maximum remuneration of Rs. 84 lakh per year. Thus, a maximum of Rs. 84 lakh per year can be paid to Mr. Reliable as assured remuneration. However, remuneration in excess of Rs. 84 lakh per year (i.e. without any limit) may be paid, if the resolution passed by the shareholders is a special resolution.

Mr. Reliable is also eligible to the following perquisites which shall not be included in the computation of ceiling on remuneration:

(a) Contribution to provident fund, superannuation fund, or annuity fund to the extent not taxable under Income-tax Act.

(b) Gratuity payable at a rate not exceeding half month's salary for each completed year of service.

(c) Encashment of leave at the end of the tenure.

Whether payment of Rs. 40,000 p.m. to a whole time director is permissible if the company has incurred a loss?

P 3.12B. Advise M/s Super Specialities Ltd. in respect of payment of remuneration of Rs. 40,000 per month to the whole time director of the company running in loss and having an effective capital of Rs. 95.00 lacs. [CA (Final) May 2005]

Ans. Remuneration to a whole time director or managing director may be paid by way of monthly payment or/and specified percentage of net profits. Such remuneration shall not exceed –

(a) 5% of net profits, if the company has one whole time director or managing director or manager; or

(b) 10% of net profits, if the company has more than one whole time director or managing director or manager, taken together.

However, remuneration exceeding the aforesaid limits may be paid if –

(i) the approval of the company in general meeting is obtained by passing a special resolution; and

(ii) where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting by passing a special resolution.

Section II of Part II of Schedule V empowers a company to pay remuneration to its whole time director, managing director or manager, even in case of inadequacy of profits or in case of a loss. As per Section II of Part II of Schedule V, the remuneration to a whole time director depends upon the effective capital of the company. In case of a company having an effective capital of less than Rs. 5 crore, the remuneration payable to whole time director shall not exceed Rs. 60 lakh per year.

In the given case, M/s Super Specialities Ltd. has suffered a loss and so it may pay remuneration to its whole time director in accordance with Section II of Part II of Schedule V. Since the effective capital of the M/s Super Specialities Ltd. is less than Rs. 5 crore, it may pay a maximum of Rs. 60 lakh per year to its whole time director. Therefore, the payment of Rs. 40,000 per month (equivalent to Rs. 4.8 lakh for the entire financial year) to the whole time director is within the limit specified under Section II of Part II of Schedule V, and is, therefore, valid. However, the payment of such remuneration shall be possible only if the following conditions are satisfied:

(a) The payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee.

(b) The payment of remuneration as per Section II of Part II of Schedule V is possible if the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor. However, in case the company has made such a default, this condition shall be deemed to be complied with if the company obtains the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting.

(c) An ordinary resolution has been passed at the general meeting of the company authorising the payment of remuneration. Such ordinary resolution shall remain valid for a period not exceeding 3 years.

(d) A statement shall be given to the shareholders alongwith the notice calling the general meeting.

Can remuneration be paid to ordinary directors in case of a loss?

P 3.12C. PQR Limited is paying remuneration to its non-executive directors at the rate of one percent of the net profits of the company distributed equally among all the non-executive directors. Is it possible for the company to pay minimum remuneration to non-executive directors besides sitting fees in the event of loss in a financial year?

[CA (Final) May 2002 (Modified)]

Ans. The remuneration of non-executive directors shall not exceed –

(a) 1% of net profits, if the company has employed a managing director or whole time director or manager; or

(b) 3% of net profits, if the company has not employed any managing director, whole time director and manager.

Remuneration to a non-executive director may be paid only if the company has made profits. Schedule V does not empower a company to pay remuneration to its non-executive directors where the company has suffered a loss.

There is no prohibition on payment of sitting fees even where the company has not earned any profits or its profits are inadequate. However, the sitting fees shall not exceed Rs. 1 lakh for every meeting of the Board or any committee of the Board [First proviso to section 197(5) read with Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014].

Whether payment of 4% of net profits to ordinary directors is permissible?

P 3.12D. Advise M/s Super Specialities Ltd. in respect of payment of commission of 4% of the net profits per annum to the ordinary directors of the company. **[CA (Final) May 2005]**

Ans.

The legal position

An ordinary director means a director who is not a whole time director or a managing director.

The provisions contained in section 197 regulate the remuneration of ordinary directors. These provisions are explained as follows:

1. The remuneration payable to a director who is neither a managing director nor a whole-time director shall not exceed –
   (a) 1% of net profits, if the company has employed a managing director or whole time director or manager; or
   (b) 3% of net profits, if the company has not employed any managing director, whole time director and manager.
2. However, remuneration exceeding the aforesaid limits may be paid if –
   (i) the approval of the company in general meeting is obtained by passing a special resolution; and
   (ii) where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting by passing a special resolution.

The given case and analysis of the case

3. M/s Super Specialities Ltd. intends to pay 4% of net profits per annum to its ordinary directors. Such payment shall exceed the limit specified under section 197, whether or not the company has employed any managing director, whole time director or manager.

Conclusion

4. The payment of commission of 4% of net profits may be made to the ordinary directors only if the approval of the members is obtained in the general meeting by passing a special resolution. Further, if Super Specialities Ltd. has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by M/s Super Specialities Ltd. before obtaining the approval of the members in the general meeting by passing a special resolution.

Appointment of 2 whole time directors in accordance with Schedule V – Legal requirements

P 3.12E. EF Chemicals Limited proposes to appoint one whole-time technical director on a consolidated monthly remuneration of Rs. 30,000 and one whole-time marketing director on a consolidated salary of Rs. 25,000 per month for a period of three years, with effect from 1st September, 2014. The company has got a managing director and he is getting Rs. 40,000 per month. Explain the requirements under the Companies Act, 2013 to be complied with by the company in connection with the proposed appointment of whole-time directors taking into account the following data collected from the balance sheet of the company as on 31st March, 2014.

1.	**Paid-up Share Capital**	**80,00,000**
2.	**Debentures redeemable after three years**	**90,00,000**
3.	**Investments**	**20,00,000**
4.	**Accumulated Loss**	**70,00,000**
5.	**Preliminary expenses not written off**	**15,00,000**

[CA (Final) May 2006 (Modified)]

Ans. The given problem may be discussed as follows:

(A) Computation of effective capital of the company

The 'effective capital' shall be computed as follows:

Items to be added:

- Paid-up share capital (excluding share application money or advances against shares)
- Securities premium account
- Reserves and surplus (excluding revaluation reserve)
- Long-term loans
- Deposits repayable after 1 year (excluding working capital loans, overdrafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements)

Items to be deducted:

- Investments (except in the case of an investment company)
- Accumulated losses
- Preliminary expenses not written off.

The effective capital shall be calculated as on the last day of the financial year preceding the financial year in which the appointment of the managerial person is made.

The effective capital of EF Chemicals Limited shall be calculated as on 31.03.2014. Accordingly, the effective capital of EF Chemicals Limited is Rs. 80,00,000 + 90,00,000 – 20,00,000 – 70,00,000 – 15,00,000 = Rs. 65,00,000.

(B) Check if the conditions prescribed under Part I of Schedule V are complied with

1. ***Eligibility for appointment.*** The proposed whole time directors must satisfy all the conditions prescribed under Part I of Schedule V. These conditions are briefly summed up as under:
   (a) He has not been sentenced to imprisonment for any period, or to a fine exceeding Rs. 1,000 for the conviction of an offence under any of the 19 Acts specified in Part I of Schedule V.
   (b) He has not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.
   (c) He has completed the age of 21 years and has not attained the age of 70 years, subject to certain exceptions.
   (d) He must be resident in India.

   It may be assumed that the proposed whole-time technical director and whole-time marketing director fulfil all these conditions.
2. ***Remuneration of whole time directors.*** Section II of Part II of Schedule V prescribes various slabs of monthly remuneration depending on the effective capital of the company. Accordingly, a company having an effective capital of less than Rs. 5 crore may pay maximum remuneration of Rs. 60 lakh to each of its managerial person.

   Therefore, it is permissible to pay monthly remuneration of Rs. 30,000 to the whole-time technical director and monthly remuneration of Rs. 25,000 to whole-time marketing director, as well as monthly remuneration of Rs. 40,000 to the already appointed managing director.

The payment of remuneration as per Section II of Part II of Schedule V is possible if the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor. However, in case the company has made such a default, this condition shall be deemed to be complied with if the company obtains the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting.

Legal requirements and steps for appointment of 2 whole time directors in accordance with Schedule V

P 3.12F. M/s Supreme Technologies Limited proposes to appoint Mr. E and Mr. F as whole-time directors for a period of three years with effect from 1st June, 2018. The company proposes to pay a consolidated salary of Rs. 80,000 per month to each of them.

Mr. D, the managing director of the company, has been appointed for a period of five years with effect from 1st January, 2016 on a remuneration payable in the form of commission at the rate of five per cent of net profits subject to a minimum remuneration of Rs. 80,000 per month.

The effective capital of the company at the end of the financial year ending 31st March, 2018 is Rs. 4.5 crores and it has been increased to Rs. 5.5 crores on 1st April, 2018 by way of right issue of equity shares. The company failed to pay the dues of a bank on 1st January, 2018 and the default is still continuing.

The company seeks your advice on the steps to be taken to comply with the requirements of section 196 read with Schedule V of the Companies Act, 2013 with regard to the proposed appointment of Mr. E and Mr. F as whole time directors. Advise explaining the relevant provisions. **[CA (Final) May 2003 (Modified)]**

OR

Neemuch Pharma Limited having an "Effective Capital" of Rs. 4 crore as on 31st March, 2018 raised Rs. 2 crore by way of issue of right shares in May, 2018 during the current Financial Year 2018-2019. The company is managed by Mr. chandrasekhar, the Managing Director, and he is getting a minimum remuneration of Rs. 80,000 per month. The company proposes to appoint two whole time Directors in July, 2018 on a consolidated minimum salary of Rs. 60,000 per month to each of them.

What is the "Effective Capital" for the purpose of determining the minimum remuneration payable to the proposed whole time directors? State the requirements to be complied with under Schedule V to the Companies Act, 2013 to give effect to the proposed appointments. **[CA (Final) Nov. 2012 (Modified)]**

Ans. The given problem may be discussed as follows:

(A) Effective capital of the company

The effective capital shall be calculated as on the last day of the financial year preceding the financial year in which the appointment of the managerial person is made.

Therefore, the effective capital of M/s Supreme Technologies Limited shall be calculated on 31.03.2018 and so the right shares issued on 1st April, 2018 shall be ignored. As on 31.03.2018, the effective capital of M/s Supreme Technologies Limited was Rs. 4.5 crores.

(B) Check if the conditions prescribed under Schedule V are complied with

1. **Eligibility for appointment**

   The proposed whole time director must satisfy all the conditions prescribed under Part I of Schedule V. These conditions are briefly summed up as under:

   (a) The managerial person has not been sentenced to imprisonment for any period, or to a fine exceeding Rs. 1,000, for the conviction of an offence under any of the 19 Acts specified in Part I of Schedule V.

   (b) The managerial person has not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

   (c) The managerial person has completed the age of 21 years and has not attained the age of 70 years, subject to certain exceptions.

   (d) The managerial person must be resident in India.

   It may be assumed that Mr. E and Mr. F fulfil all these conditions.

2. **Remuneration of Mr. E and Mr. F**

   Section II of Part II of Schedule V contains various slabs of remuneration depending on the effective capital of the company. Accordingly, a company having an effective capital of less than Rs. 5 crores may pay a maximum of Rs. 60 lakh per year to each of its managerial person.

   Therefore, it is permissible for M/s Supreme Technologies Limited to pay monthly remuneration of Rs. 80,000 each to Mr. E and Mr. F, as well as to Mr. D, who already holds the office of managing director. However, the payment of such remuneration shall be possible only if the following conditions are satisfied:

   (a) The payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee.

(b) The payment of remuneration as per Section II of Part II of Schedule V is possible if the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor. However, in case the company has made such a default, this condition shall be deemed to be complied with if the company obtains the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting.

In the present case, the company failed to pay the dues of a bank on 1st January, 2018 and the default is still continuing. Therefore, the company is required to obtain the prior approval of the bank concerned before obtaining the approval of the members in the general meeting.

(c) An ordinary resolution has been passed at the general meeting of the company authorising the payment of remuneration. Such ordinary resolution shall remain valid for a period not exceeding 3 years.

(d) A statement shall be given to the shareholders alongwith the notice calling the general meeting.

3. **Procedure for appointing Mr. E and Mr. F as whole time directors**

As is evident, it is permissible to appoint Mr. E and Mr. F as the whole time directors in accordance with Schedule V. The company shall take the following steps to appoint Mr. E and Mr. F as whole time directors:

(a) The company shall obtain the consents of Mr. E and Mr. F to act as directors.

(b) The draft agreement for the appointment of Mr. E and Mr. F shall be prepared in conformity with Schedule V read with section 196. The remuneration of Mr. E and Mr. F shall be fixed at Rs. 80,000 per month each.

(c) The terms and conditions of the appointment of Mr. E and Mr. F shall be approved by the Board of directors at a Board meeting.

(d) The terms and conditions of the appointment of Mr. E and Mr. F shall be approved by the members in the general meeting held immediately after the approval by the Board.

(e) The notice of the Board meeting and of the general meeting called for the purpose of approving the appointment of Mr. E and Mr. F shall include –

(i) the terms and conditions of such appointments;

(ii) remuneration payable to them; and

(iii) such other matters (including interest, of a director or directors in such appointments, if any).

(f) Within 60 days of appointment of Mr. E and Mr. F, the company shall file with the Registrar a return of appointment in Form No. MR-1.

(g) The particulars of Mr. E and Mr. F including the details of securities held by them shall be entered in the register of directors and key managerial personnel and their shareholding maintained under section 170.

Payment of remuneration to non-executive directors – Few cases

P 3.12G. Examine whether the payment of following remuneration to non executive directors (directors who are neither in the whole-time employment of the company nor managing director) is in accordance with the provisions of the Companies Act, 2013:

Sitting fee payable to directors is increased from Rs. 30,000 to Rs. 60,000 per meeting. **[CA (Final) Nov. 2003]**

Ans. As per first proviso to section 197(5), sitting fees payable to a director shall not exceed such sum as may be prescribed. As per Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the sum prescribed is Rs. 1 lakh for every meeting of the Board or any committee of the Board. The said Rule 4 further states that the amount of sitting fees shall be such as may be decided by the Board of directors of the company.

In the present case it is proposed to increase the sitting fees payable to directors from Rs. 30,000 to Rs. 60,000 per meeting. Since, the amount proposed is within the ceiling limits prescribed, the increase in sitting fees from Rs. 30,000 to Rs. 60,000 per meeting is valid. Such increase in sitting fees shall require a resolution of the Board.

Whether it is permissible to increase the sitting fees from Rs. 10,000 to Rs. 25,000 per BM?

P 3.12H.

Case I. A listed company has fixed payment of sitting fee for each meeting of directors at Rs. 75,000. In view of increased responsibilities of independent directors of listed companies, the company proposes to increase the sitting fee to Rs. 1,00,000 per meeting. Advise the company about the requirements under the Companies Act, 2013 to give effect to this proposal.

[CA (Final) Nov. 2006]

Case II. The articles of association of a listed company provides for fixed payment of sitting fee for each meeting of directors subject to maximum of Rs. 30,000. In view of the increased responsibilities of independent directors of listed companies, the company proposes to increase the sitting fee to Rs. 45,000 per meeting. Advise the company about the requirement under the Companies Act, 2013 to give effect to the proposal. **[CA (Final) Nov. 2018]**

Ans. As per first proviso to section 197(5), sitting fees payable to a director shall not exceed such sum as may be prescribed. As per Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the sum prescribed is Rs. 1 lakh for every meeting of the Board or any committee of the Board. The said Rule 4 further states that the amount of sitting fees shall be such as may be decided by the Board of directors of the company.

Ans. to Case I.

In the present case it is proposed to increase the sitting fees payable to directors from Rs. 75,000 to Rs. 1,00,000 per meeting. Since, the amount proposed (*i.e.* Rs. 1 lakh per meeting) is within the ceiling limit prescribed by the Central Government (*i.e.* Rs. 1 lakh per meeting), such increase is permitted. Such increase in sitting fees shall require a resolution of the Board.

Ans. to Case II.

In the present case, it is proposed to increase the sitting fees payable to directors from Rs. 30,000 to Rs. 45,000 per meeting. Since, the amount proposed (*i.e.* Rs. 45,000 per meeting) is within the ceiling limit prescribed by the Central Government (*i.e.* Rs. 1 lakh per meeting), such increase is permitted. Such increase in sitting fees shall require –

(a) a resolution of the Board; and

(b) amendment of articles (to provide that sitting fees upto Rs. 45,000 can be paid by the company) by passing a special resolution.

Whether payment of fees by a Hospital to a doctor who is also a non-executive director, is permissible?

P 3.12I. M/s Star Health Specialities Limited owns a Multi-speciality Hospital in Chennai. Dr. Hamilton, a practising Heart Surgeon, has been appointed by the company as its non-executive ordinary director and it wants to pay him fee, on case to case basis, for surgery performed on the patients at the hospital. A question has arisen whether payment of such fee to him would amount to payment of managerial remuneration to a director subject to any restriction under the Companies Act, 2013.

Advise the company, which seeks to ensure that the same does not contravene any provision of the Companies Act, 2013.

[CA (Final) Nov. 2006 (Modified)]

Ans. As per section 197(4), the remuneration paid to a director for rendering services in any other capacity shall also be covered in 'remuneration payable to the directors' under the provisions of section 197(1).

However, remuneration paid to a director for rendering services in any other capacity shall not be so included, if –

(i) the services rendered are of a professional nature; and

(ii) in the opinion of the Nomination and Remuneration Committee (if the company is required to constitute Nomination and Remuneration Committee under section 178) or the Board of directors (in any other case), the director concerned possesses requisite professional qualifications.

In the given case, M/s Star Health Specialities Limited intends to pay fees for surgery performed by Dr. Hamilton, its non-executive director, on case to case basis. It means that the services rendered by Dr. Hamilton are of a professional nature. Such payment of fees shall not be included in the limits of managerial remuneration specified under section 197(1), if the Nomination and Remuneration Committee (or in its absence, the Board of directors) passes a resolution to the effect that Dr. Hamilton possesses requisite professional qualifications.

Sitting fees – Quantum, whether payable for committee meeting and adjourned meeting, etc.

P 3.12J.

Case I. A Ltd. wants to include the following clause in its articles of association:

"Each director shall be entitled to be paid out of the funds of the company for attending meetings of the Board or a committee thereof including adjourned meetings such sum as sitting fees as shall be determined from time to time by the directors, but not exceeding a sum of Rs. 1,50,000 for each such meeting to be attended by the director."

You are required to advise the company as to the validity of such a clause and the correct legal position.

[CA (Final) May 2004, June 2009, May 2007 (Modified)]

Case II. B Ltd. wants to include the following clause in its articles of association:

"Each director shall be entitled to be paid out of the funds of the company for attending meetings of the Board or a committee thereof including adjourned meetings such sum as sitting fees as shall be determined from time to time by the directors, but not exceeding a sum of Rs. 80,000 for each such meeting to be attended by the director."

You are required to advise the company as to the validity of such a clause and the correct legal position.

Case III. The articles of C Ltd. do not contain any provision with respect to payment of sitting fees. State, with reference to the provisions of the Companies Act, 2013, whether the directors are entitled to receive any sitting fees.

Ans. The provisions relating to payment of sitting fees to the directors are contained in section 197(2) and 197(5) read with Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014. Following points are worth noting regarding payment of sitting fees to directors:

(a) Sitting fees may be paid to a director for attending a Board meeting as well as for attending a meeting of a committee of directors.

(b) Sitting fees may be paid whether or not the meeting proceeds to business or is adjourned for want of quorum or any other reason.

(c) The amount of sitting fees shall not exceed the sum prescribed. As per Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the sum prescribed is Rs. 1 lakh for every meeting of the Board or any committee of the Board.

(d) The amount of sitting fees shall be such as may be decided by the Board of directors of the company.

(e) Where a Board meeting is adjourned for want of quorum or any other reason, the directors who were present to attend such Board meeting shall be entitled to receive the sitting fees.

(f) An adjourned meeting is a continuation of the original meeting. Therefore, where a Board meeting is held and is adjourned to a later date, the sitting fees cannot be paid twice, since it is counted as one Board meeting only.

Ans. to Case I.

The effect of the proposed clause relating to payment of sitting fees is discussed as under:

(a) The proposed clause purports payment of sitting fees at the rate of Rs. 1,50,000 per meeting. Since the amount proposed exceeds the prescribed sum of Rs. 1,00,000 per meeting, such clause is not valid.

(b) Therefore, each director of A Ltd. shall be entitled to receive such amount as sitting fees as may be determined by the Board, but such amount shall not exceed Rs. 1 lakh per meeting of the Board or any committee of the Board.

Ans. to Case II.

The effect of the proposed clause relating to payment of sitting fees is discussed as under:

(a) The proposed clause purports payment of sitting fees at the rate of Rs. 80,000 per meeting. Since the amount proposed is within the prescribed sum of Rs. 1,00,000 per meeting, such clause is valid.

(b) Though the Act does not require any company to specify in its articles any amount or maximum amount with respect to amount of sitting fees, yet the articles may specify the maximum amount of sitting fees which can be paid to the directors. If such maximum limit specified in the articles (*i.e.* Rs. 80,000 per meeting, in this case) does not exceed the amount prescribed by the Central Government (*i.e.* Rs. 1 lakh per meeting), the sitting fees payable to directors shall not exceed the maximum limit specified in the articles.

(c) Therefore, each director of B Ltd. shall be entitled to receive such amount as sitting fees as may be determined by the Board, but such amount shall not exceed Rs. 80,000 per meeting of the Board or any committee of the Board.

(d) However, if B Ltd. intends to pay sitting fees exceeding Rs. 80,000 per meeting but not exceeding Rs. 1 lakh per meeting, it shall require –
   (i) a resolution of the Board; and
   (ii) amendment of articles by passing a special resolution.

Ans. to Case III.

(a) The Act does not require any company to specify in its articles any amount or maximum amount with respect to amount of sitting fees.

(b) As per section 197(5) read with Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the amount of sitting fees shall be such as may be decided by the Board of directors of the company, but it shall not exceed Rs. 1 lakh for every meeting of the Board or any committee of the Board.

(c) Therefore, each director of C Ltd. shall be entitled to receive such amount as sitting fees as may be determined by the Board, but such amount shall not exceed Rs. 1 lakh per meeting of the Board or any committee of the Board.

Whether payment of remuneration of Rs. 50 lakhs by a company having an effective capital of Rs. 150 crores is valid in case of losses

P 3.12K. X, a Director of MJV Ltd., was appointed on 1st April, 2014. One of the terms of appointment was that in the absence of adequacy of profits or if the company had no profits in a particular year, he will be paid remuneration in accordance with Schedule V. For the financial year ended 31st March, 2015, the company suffered heavy losses. The company paid him a remuneration of Rs. 50 lacs for the financial year 2014-15.

The effective capital of the company is Rs. 150 crores. Referring to the provisions of Companies Act, 2013, as contained in Schedule V, examine the validity of the above payment of remuneration to X. [CA (Final) Nov. 2010 (Modified)]

OR

Mr. X, a director of Sunrise Limited., was appointed on 1st April, 2014. One of the terms of appointment was that in the absence of adequacy of profits or if the company had no profits in a particular year, he will be paid remuneration in accordance with Schedule V. The company suffered heavy losses during the financial year ended 31st March, 2018. The company was not in a position to pay any remuneration but he was paid Rs. 50 lakhs for the year, as paid to other directors. The effective capital of the company is Rs. 150 crores. Referring to provisions of the Companies Act, 2013, as contained in Schedule V, examine the validity of the above payment of remuneration to Mr. X. [CA (Final) Nov. 2018]

Ans.

The legal position

1. Section II of Part II of Schedule V empowers a company to pay remuneration to its whole time director, managing director or manager, even in case of inadequacy of profits or in case of a loss.
2. As per Section II of Part II of Schedule V, the remuneration of a whole time director, managing director or manager depends upon the effective capital of the company.
3. In case of a company having an effective capital of Rs. 100 crore or more but less than Rs. 250 crore, the remuneration payable to the whole time director, managing director or manager shall not exceed Rs. 120 lakh per year. However, the remuneration in excess of Rs. 120 lakh per year may be paid if the resolution passed by the shareholders approving the remuneration, is a special resolution.

4. The payment of remuneration as per Section II of Part II of Schedule V is possible if the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor. However, in case the company has made such a default, this condition shall be deemed to be complied with if the company obtains the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting.

The given case and analysis of the case

5. The effective capital of MJV Ltd. is Rs. 150 crores. As per Section II of Part II of Schedule V, MJV Ltd. may, without passing any special resolution, pay to its managerial person, a maximum remuneration of Rs. 120 lakh per year.
6. MJV Ltd. has paid a remuneration of Rs. 50 lakhs to Mr. X, it managing director.

Conclusion

7. The payment of Rs. 50 lakhs to Mr. X for the financial year 2014-15 is within the limit specified under Section II of Part II of Schedule V, and is, therefore, valid.

Increase in remuneration of managing director – Legal requirements

P 3.12L. Mr. Ram was appointed as managing director of Prudential Company Limited in accordance with Schedule V for a period of 5 years with effect from 1st April, 2014 on a remuneration of Rs. 30,00,000 per year. The Board of directors of the company propose to increcse the remuneration of the managing director to Rs. 40,00,000 per year. Advise the Board of directors about the legal requirements under the Companies Act, 2013 to give effect to the proposal. State whether the increased remuneration can be paid as minimum remuneration in the event of loss or inadequacy of profit.

[CA (Final) Nov. 1997 (Modified)]

Ans.

Legal requirements for increasing the remuneration to Rs. 40 lakh per year

As per section 197, a company is empowered to increase the remuneration of its managerial person provided such increase is within the limits laid down in Section II of Part II of Schedule V.

As per Section II of Part II of Schedule V, in the absence or inadequacy of profits, a company having an effective capital of less than Rs. 5 crore may pay a maximum of Rs. 60 lakh as the managerial remuneration. However, if the effective capital of the company is Rs. 5 crore or more but less than Rs. 100 crore, the maximum remuneration shall not exceed Rs. 84 lakh. However, the remuneration in excess of these limits may be paid, if the resolution passed by the shareholders is a special resolution.

In the present case, –

(a) the effective capital of Prudential Company Limited is not given;

(b) Prudential Company Limited proposes to pay to its managing director a sum of Rs. 40 lakh as remuneration for the entire financial year.

Irrespective of the amount of effective capital of Prudential Company Limited, the payment of remuneration of Rs. 40 lakh to the managing director for the entire financial year is in accordance with the provisions of Section II of Part II of Schedule V, and is therefore, valid.

Whether the increased remuneration of Rs. 40 lakh can be paid as minimum remuneration?

Section II of Part II of Schedule V empowers a company to pay remuneration to its whole time director, managing director or manager, even in case of inadequacy of profits or in case of a loss. Thus, remuneration of Rs. 40 lakh per year can be paid to Mr. Ram as minimum remuneration, even if Prudential Company Limited does not make any profits or its profits are inadequate.

Waiver of excess remuneration paid to a director – Legal requirements

P 3.12M. Mr. Weldon was appointed as a director of Esquire Engineering Ltd. with effect from 1st April, 2018. Since the company, namely, Esquire Engineering Ltd. wanted to take full advantage of the wisdom and expertise of Mr. Weldon, it offered him remuneration payable on monthly basis. Esquire Engineering Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2019.

On scrutiny of the accounts, it was established that the company, till 31st March, 2019, has paid to Mr. Weldon a total sum of Rs. 1.20 lakhs in excess of the remuneration permissible under section 197. You are required to state with reference to the provisions of Companies Act, 2013 in respect of recovery and waiver of recovery of the excess remuneration so paid, whether Mr. Weldon can keep the excess remuneration so received and under what conditions.

[CA (Final) Nov. 2004, Nov. 2007, Nov. 2009 (Modified)]

Ans. The given problem relates to section 197(9) and (10) of the Companies Act, 2013.

The legal position

1. As per section 197(9), if any director draws or receives, directly or indirectly, by way of remuneration any sum in excess of the limit prescribed under section 197 or without the approval required under section 197, he shall refund the excess remuneration drawn by him to the company, within 2 years or such lesser period as may be allowed by the company. Until such sum is refunded, he shall hold the excess remuneration in trust for the company.
2. As per section 197(10), the company shall not waive the recovery of any excess remuneration drawn or received by a director, unless approved by the company by passing a special resolution within 2 years from the date the sum becomes refundable.

However, if the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining approval of such waiver by passing a special resolution.

The given case and analysis of the case

3. Rs. 1.20 lakh is the amount of excess remuneration paid to Mr. Weldon by Esquire Engineering Ltd. for the financial year 2018-2019. Mr. Weldon is required to refund to the company this amount of Rs. 1.20 lakh within 2 years or such lesser period as may be allowed by the company. Until such sum is refunded, he shall hold it in trust for the company.
4. Esquire Engineering Ltd. cannot waive the recovery of such excess remuneration unless such waiver is approved by passing a special resolution within 2 years from the date the sum becomes refundable.
   However, if Esquire Engineering Ltd. has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by it before obtaining approval of such waiver by passing a special resolution.

Whether payment of-remuneration of Rs. 50 lakhs by a company having an effective capital of Rs. 150 crores is valid in case of losses

P 3.12N. X was appointed as the managing director of MJV Ltd. on 1st April, 2014. One of the terms of appointment was that in the absence of adequacy of profits or if the company had no profits in a particular year, he will be paid remuneration in accordance with Schedule V. For the financial year ended 31st March, 2015, the company suffered heavy losses. The company paid him a remuneration of Rs. 50 lacs for the financial year 2014-15.

The effective capital of the company is Rs. 150 crores. Referring to the provisions of Companies Act, 2013, as contained in Schedule V, examine the validity of the above payment of remuneration to X. [CA (Final) Nov. 2010 (Modified)]

Ans. Where a company does not make any profits or its profits are inadequate, it may pay remuneration to its managing director or whole time director or manager in accordance with Section II of Part II of Schedule V.

The payment of remuneration as per Section II of Part II of Schedule V is possible if the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor. However, in case the company has made such a default, this condition shall be deemed to be complied with if the company obtains the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting.

In the present case, the effective capital of MJV Ltd. is Rs. 150 crores. As per Section II of Part II of Schedule V, a company having effective capital of Rs. 100 crore or more, but less than Rs. 250 crore may pay to its managerial person, a maximum remuneration of Rs. 120 lakh per year. Thus, payment of remuneration of Rs. 50 lakh to Mr. X by MJV Ltd. for the financial year 2014-15 is within the limit specified under Section II of Part II of Schedule V, and is, therefore, valid.

Increase in remuneration of two executive directors from Rs. 4 lakh per month to Rs. 6 lakh per month – Legal requirements

P 3.12O. Venus Limited is a widely held, listed company having two executive directors who are technocrats. The company has suffered losses in the last four years. The company wants to enhance the remuneration of the executive directors to Rs. 6,00,000 per month from existing remuneration of Rs. 4,00,000. The audited balance sheet as on 31st March 2016 reveals that the paid up capital of the company is Rs. 15 crores, accumulated losses Rs. 11 crores and secured long term borrowings Rs. 5 crores. Besides, the company has long term investments of Rs. 11 crores. The company's remuneration committee has recommended the proposal and the company is regular in repayment of its debts. Analyse the proposition with reference to the provisions of the Companies Act, 2013. [CA (Final) Nov. 2017]

Ans.

Alternative Answer I

As per section 197, where the proposed increase in remuneration is within the limits laid down in Item (A) of Section II of Part II of Schedule V (based upon the effective capital of the company), the company is empowered to increase the remuneration of the managerial person.

For the purpose of Section II of Part II of Schedule V, the 'effective capital' shall be computed as follows:

Items to be added:

- Paid-up share capital (excluding share application money or advances against shares)
- Securities premium account
- Reserves and surplus (excluding revaluation reserve)
- Long-term loans
- Deposits repayable after 1 year (excluding working capital loans, overdrafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements)

Items to be deducted:

- Investments (except in the case of an investment company)
- Accumulated losses
- Preliminary expenses not written off.

The effective capital shall be calculated as on the last day of the financial year preceding the financial year in which the appointment of the managerial person is made.

The effective capital of Venus Limited shall be calculated as on 31.03.2016. Accordingly, the effective capital of Venus Limited is Rs. 15 crore + Rs. 5 crore – Rs. 11 crore – Rs. 11 crore = Rs. 2 crore (negative).

As per Item (A) of Section II of Part II of Schedule V, in the absence or inadequacy of profits, a company having negative effective capital or effective capital of less than Rs. 5 crore may pay a maximum of Rs. 60 lakh per financial year as the managerial remuneration to each managerial person. Thus, based upon the effective capital (*i.e.* negative effective capital of Rs. 2 crore), Venus Limited can pay a maximum of Rs. 60 lakh to each of the two executive directors.

However, the remuneration in excess of Rs. 60 lakh may be paid, if the resolution passed by the shareholders is a special resolution. Thus, Venus Limited shall be entitled to pay Rs. 72 lakh each to the two executive directors, if it is so authorised by the shareholders by passing a special resolution.

Conditions to be satisfied for payment of remuneration as per Section II of Part II of Schedule V

The payment of remuneration of Rs. 72 lakh each to the two executive directors is possible only if the following conditions are satisfied:

(a) The payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee.

This condition has been satisfied as the given problem states that company's remuneration committee has recommended the proposal to increase the remuneration.

(b) The payment of remuneration as per Section II of Part II of Schedule V is possible if the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor. However, in case the company has made such a default, this condition shall be deemed to be complied with if the company obtains the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting.

This condition has been satisfied as the given problem states that the company is regular in repayment of its debts.

(c) A special resolution has been passed at the general meeting of the company authorising the payment of remuneration. Such special resolution shall remain valid for a period not exceeding 3 years.

(d) A statement shall be given to the shareholders alongwith the notice calling the general meeting. The statement shall contain the following information:

(i) General Information

(ii) Information about the appointee

(iii) Other information

(iv) Disclosures.

Sitting fees to independent directors and woman director, maximum sitting fees, minimum number of independent directors, and eligibility for appointment as independent director

P 3.12P. CTC Limited is an unlisted public company having a paid up capital of Rs. 100 crores as on 31st March, 2017. The company made a turnover of Rs. 300 crores for the financial year ended 31st March, 2017. The Articles of Association of the company provides for payment of sitting fee to Directors for each Board Meeting/Committee thereof subject to a maximum of Rs. 40,000 per meeting. The Board of Directors is comprised of Independent Directors and Women Directors also. The Company is having 7 directors in its Audit Committee. Shri PKV, working as Financial Advisor of the company, was designated as Chief Financial Officer from 1st April, 2015.

He retired from service on superannuation on 31st March, 2016. He is in receipt of monthly pension of Rs. 80,000 from the company. It is proposed to appoint Shri PKV as Independent Director of the Company. The Board of Directors proposes to fix sitting fee of Rs. 50,000 per meeting to Independent Director and Rs. 30,000 per meeting to Woman Director, taking into consideration their experience and qualification.

In the light of the provisions of the Companies Act, 2013, advise the Board of Directors in the following matters:

(1) Appointment of Mr. PKV as Independent Director.

(2) Fixing sitting fee of Rs. 50,000 to Independent Director and Rs. 30,000 to Woman Director.

(3) Minimum number of Independent Directors.

(4) Maximum sitting fee to a Director.

Assuming CTC Ltd. is a Government Company, what will be your advice in the matter of appointment of Mr. PKV as Independent Director.

[CA (Final) May 2018]

Ans. The given problem relates to section 149(4) read with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, 149(6) and section 197(5) read with Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

The Legal Position

1. As per section 149(4) read with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the following class(es) of companies shall have at least 2 directors as independent directors:
   (i) Public companies having paid up share capital of Rs. 10 crore or more.
   (ii) Public companies having turnover of Rs. 100 crore or more.
   (iii) Public companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 crore.

   However, the following classes of unlisted public companies shall not be required to have any independent director:
   (a) A joint venture
   (b) A wholly owned subsidiary
   (c) A dormant company as defined under section 455 of the Act.

   The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

   Further, if the company covered in any of the prescribed class(es) of companies, 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.
2. As per section 177, the Audit Committee shall consist of a minimum of 3 directors, and the majority of members of the Audit Committee shall be the independent directors.
3. As per section 149(6), a person can be appointed as an independent director only if he is not a managing director, whole-time director or nominee director and who satisfies the criteria given under clauses (a) to (f) of sub-section (6) of section 149.
4. As per section 149(6)(c), a person cannot be appointed as an independent director if he has or had any pecuniary relationship (other than remuneration as such director or having transaction not exceeding 10% 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 2 immediately preceding financial years or during the current financial year.
5. As per section 149(6)(e)(i), a person cannot be appointed as an independent director if he or any of his relatives holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the 3 financial years immediately preceding the financial year in which he is proposed to be appointed. However, in case of a relative who is an employee, this restriction shall not apply for his employment during preceding 3 financial years.
6. As per section 2(51), Chief Financial Officer is a Key Managerial Personnel.
7. As per section 197(5), the amount of sitting fees shall not exceed such amount as may be prescribed.
8. As per Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 –
   (a) A company may pay sitting fees to a director for attending meetings of the Board or committees thereof.
   (b) The amount of sitting fees shall be such as may be decided by the Board of directors of the company.
   (c) The amount of sitting fees shall not exceed Rupees 1 lakh per meeting of the Board or any committee of the Board.
   (d) The amount of sitting fees payable to Independent Directors and Women Directors shall not be less than the sitting fees payable to other directors.

Answers to the questions asked

(1) Appointment of Mr. PKV as Independent Director.

Mr. PKV cannot be appointed as an independent director since –

(i) Mr. PKV is not qualified for appointment as an independent director as per section 149(6)(c) as he had pecuniary relationship with the company (*i.e.* CTC Limited) during the immediately preceding financial year; and

(ii) Mr. PKV is not qualified for appointment as an independent director as per section 149(6)(e)(i), as he himself held the position of a key managerial personnel (*i.e.* Chief Financial Officer) of the company (*i.e.* CTC Limited) in the preceding financial year.

(2) Fixing sitting fee of Rs. 50,000 to Independent Director and Rs. 30,000 to Woman Director.

(i) Fixing sitting fees of Rs. 50,000 for independent directors is valid since it is not less than the sitting fees payable to other directors (*i.e.* Rs. 40,000), provided the articles of CTC Limited are amended to provide that sitting fees upto Rs. 50,000 may be paid to independent directors.

(ii) Fixing sitting fees of Rs. 30,000 for woman director is not valid since it is less than the sitting fees payable to other directors (*i.e.* Rs. 40,000). In other words, the sitting fees for woman director shall be Rs. 40,000 or more.

(3) Minimum number of Independent Directors.

CTC Limited is an unlisted public company. The paid up capital of CTC Limited is Rs. 100 crore (*i.e.* the criterion of paid up capital of Rs. 10 crore or more is satisfied). The turnover of CTC Limited is Rs. 300 crore (*i.e.* the criterion of turnover of Rs. 100 crore or more is satisfied). Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 is attracted if a public company satisfies any 1 or more of the 3 criteria contained in Rule 4. Since CTC Limited has satisfied 2 criteria contained in Rule 4, it is required to appoint independent directors in accordance with said Rule 4.

As per Rule 4, a company shall have at least 2 independent directors. However, CTC Limited has 7 directors in the Audit Committee, and as per section 177, the majority of its directors (i.e. 4 directors) shall be independent directors. Since a higher number of independent directors (*i.e.* 4 directors) are required to be independent directors due to the composition of Audit Committee, CTC Limited shall have to appoint at least 4 directors as independent directors.

(4) Maximum sitting fee to a Director.

As per Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the amount of sitting fees shall not exceed Rs. 1 lakh per meeting of the Board or any committee of the Board. However, at present, the articles of CTC Ltd. provide for a maximum of Rs. 40,000 per meeting. Thus, CTC Ltd. can pay only upto Rs. 40,000 per meeting. However, if the articles of CTC Ltd. are amended to provide that sitting fees upto Rs. 1 lakh per meeting may be paid, it shall be entitled to pay upto Rs. 1 lakh per meeting.

The said Rule 4 further states that the amount of sitting fees shall be such as may be decided by the Board of directors of the company. Accordingly, any increase in sitting fees shall require a resolution of the Board.

(5) Appointment of Mr. PKV as independent director if CTC Limited were a Government company.

Even if CTC Ltd. were a Government company, Mr. PKV would have been disqualified for appointment as independent director, since exemption vide Notification No. G.S.R. 463(E) dated 5th June, 2015 is available w.r.t. condition of 'pecuniary relationship with the company', but no exemption is available to a person who held the position of key managerial person in the company.

Whether guarantee commission paid to a director forms part of remuneration of the director?

P 3.12Q. Guarantee commission has been paid to one of the non-executive directors for having guaranteed the term loans obtained from a financial institution. Examine whether the payment of such guarantee commission to non-executive directors (directors who are neither in the whole-time employment of the company nor managing director) is in accordance with the provisions of the Companies Act, 2013. [CA (Final) Nov. 2003, May 2010]

OR

Whether guarantee commission paid to a director is remuneration to director when the amount of such commission exceeds the limit prescribed under section 197 of the Companies Act, 2013. [CA (Final) May 2008]

OR

A company wants to pay guarantee commission to directors for guaranteeing overdraft/cash credit limits obtained by the company. Will this be termed as remuneration under section 197 of the Companies Act, 2013 and, if so, will it come under overall ceiling of managerial remuneration under section 197 of the Act? [CS (Final) June 1997; June 1998; June 2001]

Ans. All payments made to the directors are not necessarily managerial remuneration. If a director of a company gives guarantee on the behalf of the company, he has given personal service to the company other than the one normally required of a director.

In ***Suessen Textile Bearings Ltd.* v *Union of India***, it was held that guarantee commission paid by a company to its director for standing surety for loans and credit facilities taken by the company was not remuneration for services rendered within the meaning of section 197. The director giving a guarantee does not render manual, clerical, technical, supervisory or administrative service. He gets the commission for the risk which he bears and that has nothing to do with his directorship. Guarantee commission received by the director is for personal liability which he undertakes.

Therefore, when a director guarantees an advance made by a bank, he renders service to the company in his individual capacity and not in his capacity as a director. In view of the above, the commission payable by the company to its directors for guaranteeing the overdraft and cash credit limits obtained by the company cannot be treated as remuneration payable to the directors for services rendered by them within the meaning of section 197. Therefore, such commission will not form part of the managerial remuneration and not be subject to the provisions of section 197 of the Act.

Accordingly, guarantee commission (for having guaranteed the term loans obtained from a financial institution) can be paid to a non executive director and such payment shall be in addition to the remuneration to which he is entitled under the Companies Act, 2013.

Practical Problems from CS Examinations

Maximum remuneration payable to managing directors, whole-time directors and part-time directors

P 3.12R. Arc Ltd. has two managing directors, three whole-time directors, and two part-time directors. Referring to the provisions of the Companies Act, 2013, state the extent to which the managing directors, whole-time directors and part-time directors can be paid remuneration, when the company has sufficient profits.

Further, what advice would you render when company's profits are inadequate? Can the company continue to make payment of remuneration? [CA (Final) Dec. 2015]

Ans. The given problem relates to section 197 and Section II of Part II of Schedule V of the Companies Act, 2013.

1. As per section 197, a company having profits may pay remuneration to its directors and manager as follows:
   (a) Where the company has appointed 2 or more managing directors and whole time directors, the remuneration payable to them shall not exceed 10% of the net profits of the company for that year.
   (b) Where the company has employed one or more managing director, whole time director or manager, the remuneration payable to all the non-executive directors shall not exceed 1% of net profits of the company for that year. A non-executive director means a director who is neither a managing director nor a whole time director. Non-executive directors are also termed as 'part time directors'.
   (c) The total remuneration payable to all the directors and manager shall not exceed 11% of net profits of the company for that year.
2. Where a company has no profits or its profits are inadequate, the company may pay remuneration to its managing directors, whole time directors or manager, such remuneration as is within the limits specified under Section II of Part II of Schedule V. As per Section II of Part II of Schedule V, the remuneration is based on the effective capital of the company.
3. In the given case, Arc Ltd. can pay a maximum of 10% of net profits to the 2 managing directors and 3 whole time directors. The payment of remuneration to the 2 part time directors shall not exceed 1% of net profits.
4. In case the profits are inadequate, Arc Ltd. can pay remuneration to the 2 managing directors and 3 whole time directors in accordance with Section II of Part II of Schedule V depending upon its effective capital. Remuneration as per Section II of Part II of Schedule V cannot be paid to the 2 part time directors.
5. In addition to remuneration based on profits or Section II of Part II of Schedule V, Arc Ltd. can pay sitting fees to its directors, but sitting fees shall not exceed Rs. 1 lakh per Board meeting for each director.

Practical Problems from CMA Examinations

Whether limits on remuneration apply to a CEO?

P 3.12S. Mr. Balu is a CEO in a public company. State whether the limits on managerial remuneration under section 197 of the Companies Act, 2013 and Schedule V apply to Mr. Balu. [CMA (Final) Dec. 2018]

Ans. The given problem relates to section 197 of the Companies Act, 2013.

Section 197 contains certain limits with respect to remuneration of directors (including managing director and whole time director) and manager. However, these limits do not apply to other key managerial personnel, *i.e.* the Chief Executive Officer (CEO), the Chief Financial Officer (CFO) and the Company Secretary (CS).

Similarly, Schedule V contains certain limits with respect to remuneration of managing director, whole time director and manager. However, these limits also do not apply to other key managerial personnel, *i.e.* the Chief Executive Officer (CEO), the Chief Financial Officer (CFO) and the Company Secretary (CS).

Thus, the limits on managerial remuneration as contained in section 197 and Schedule V shall not apply to Mr. Balu.

Appointment of a person holding 12 directorships, including 10 directorships in public companies, as a woman director in a listed company, and increase in remuneration of a director from Rs. 4 lakh p.m. to Rs. 6 lakh p.m. by a company incurring losses for last 2 years

P 3.12T. Excel limited is a listed company with a turnover of Rs. 60 crores in the FY 2016-2017. The company appoints Ms. R as the woman director on 1st March, 2017. Ms. R is already a director in twelve companies including ten public companies. Also, Ms. R is a chartered accountant in practice.

Further, Ms. R, is a director in Supreme Ltd. where she is acting in a professional capacity. Since lots of proposals for the holding of directorship in various companies are lined up before Ms. R, so in order to retain her, Remuneration and Nomination Committee proposed to enhance the remuneration of Ms. R from Rs. 4 Lac per month to Rs. 6 Lac per month. However, Supreme Limited was running in losses for last 2 years.

Evaluate, in the light of the given facts, the following situations with reference to the provisions of the Companies Act, 2013.

(1) The validity of appointment of Ms. R in Excel Limited.

(2) Analysis the proposition of enhancement of the remuneration of Ms. R in Supreme Ltd. [ICAI, RTP, May 2018]

Ans.

(i) Validity of appointment of Ms. R as a woman director in Excel Limited

1. As per section 165 –
   (a) No person shall hold office as a director (including alternate directorships) in more than 20 companies, whether public or private.
   (b) No person shall hold office as a director (including alternate directorships) in more than 10 public companies (including any private company which is either a holding company or a subsidiary company of a public company).
2. As per section 164, a person shall be disqualified for appointment as a director in any company if he has not complied with the requirement of section 165, as stated in Point (1) above.
3. In the given case, Ms. R is already a director in 10 public companies. Her appointment as a woman director in Excel Limited would result in holding of 11 directorships in public companies, which is not permitted in view of the provisions contained in section 164 and section 165. Accordingly, appointment of Ms. R as a woman director in Excel Limited is not valid.

(ii) Enhancement of remuneration of Ms. R in Supreme Ltd.

Section II of Part II of Schedule V empowers a company to pay remuneration to its whole time director, managing director or manager, even in case of inadequacy of profits or in case of a loss. As per Section II of Part II of Schedule V, the remuneration to a whole time director depends upon the effective capital of the company. In case of a company having an effective capital of less than Rs. 5 crore, the remuneration payable to whole time director shall not exceed Rs. 60 lakh per year.

In the given case, Supreme Ltd. has suffered losses during the last 2 years. Assuming that Supreme Ltd. has also incurred loss during the financial year for which remuneration is to be paid to Ms. R, and further assuming that Ms. R is a whole time director, managing director or manager in Supreme Ltd., the company (i.e. Supreme Ltd.) can pay remuneration to Ms. R in accordance with Section II of Part II of Schedule V.

The effective capital of Supreme Ltd. has not been given.

If it is assumed that the effective capital of Supreme Ltd. is less than Rs. 5 crore, then, as per Section II of Part II of Schedule V, Supreme Ltd. can pay a maximum of Rs. 60 lakh per year to Ms. R. However, remuneration in excess of Rs. 60 lakh per year may be paid if the resolution passed by the shareholders approving the remuneration, is a special resolution. Thus, remuneration of Ms. R can be increased from Rs. 4 lakh per month to Rs. 6 lakh per month only if the resolution passed by the shareholders approving the remuneration is a special resolution.

If it is assumed that the effective capital of Supreme Ltd. is Rs. 5 crore or more, then, as per Section II of Part II of Schedule V, Supreme Ltd. can increase the remuneration of Ms. R from Rs. 4 lakh per month to Rs. 6 lakh per month, and the approval of increase in such remuneration from the shareholders shall require an ordinary resolution.

Legal requirements and steps for appointment of 2 whole time directors in accordance with Schedule V

P 3.12U. The effective capital of Goldsmith Ornaments Limited at the end of the financial year ending 31st March, 2019 is Rs. 4.5 crores and it has been increased to Rs. 5.5 crores on 30th June, 2019 by way of rights issue of equity shares. The company proposes to appoint Mr. Edward and Mr. Robinson as whole time directors for a period of three years with effect from 1st November, 2019. The company proposes to pay a consolidated salary of Rs. 2,00,000 per month to each of them.

Advise the company explaining the relevant provisions, whether it can pay the proposed salary and also on the steps to be taken to comply with the requirements of Section 197 read with Schedule V of the Companies Act, 2013 with regard to the proposed appointment of Mr. Edward and Mr. Robinson as whole time directors. [CA (Final) Nov. 2012 (Modified), Nov. 2019]

Ans. The given problem may be discussed as follows:

(A) Effective capital of the company

The effective capital shall be calculated as on the last day of the financial year preceding the financial year in which the appointment of the managerial person is made.

Therefore, the effective capital of Goldsmith Ornaments Limited shall be calculated on 31.03.2019 and so the right shares issued on 30th June, 2019 shall be ignored. As on 31.03.2019, the effective capital of Goldsmith Ornaments Limited was Rs. 4.5 crores.

(B) Check if the conditions prescribed under Schedule V are complied with

1. **Eligibility for appointment**

   Mr. Edward and Mr. Robinson can be appointed as whole time directors if they satisfy all the conditions prescribed under Part I of Schedule V. As per Part I of Schedule V, a person may be appointed as a managerial person only if –
   (a) He has not been sentenced to imprisonment for any period, or to a fine exceeding Rs. 1,000, for the conviction of an offence under any of the 19 Acts specified in Part I of Schedule V.
   (b) He has not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

(c) He has completed the age of 21 years and has not attained the age of 70 years, subject to certain exceptions.

(d) He must be resident in India.

Assuming that Mr. Edward and Mr. Robinson fulfil all the above conditions, they may be appointed as whole time directors in accordance with Part I of Schedule V.

2. **Remuneration of Mr. Edward and Mr. Robinson**

Section II of Part II of Schedule V contains various slabs of remuneration depending upon the effective capital of the company. Accordingly, a company having an effective capital of less than Rs. 5 crores may pay a maximum of Rs. 60 lakh per year to each of its managerial person.

Therefore, it is permissible for Goldsmith Ornaments Limited to pay monthly remuneration of Rs. 2 lakh each to Mr. Edward as well as Mr. Robinson. However, the payment of such remuneration shall be possible only if the following conditions are satisfied:

(a) The payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee.

(b) The payment of remuneration as per Section II of Part II of Schedule V is possible if the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor. However, in case the company has made such a default, this condition shall be deemed to be complied with if the company obtains the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting.

(c) An ordinary resolution has been passed at the general meeting of the company authorising the payment of remuneration. Such ordinary resolution shall remain valid for a period not exceeding 3 years.

(d) A statement containing the required disclosures shall be given to the shareholders along with the notice calling the general meeting.

3. **Procedure for appointing Mr. Edward and Mr. Robinson as whole time directors**

As is evident, it is permissible to appoint Mr. Edward and Mr. Robinson as the whole time directors in accordance with Schedule V. The company shall take the following steps to appoint Mr. Edward and Mr. Robinson as whole time directors:

(a) The company shall obtain the consents of Mr. Edward and Mr. Robinson to act as directors.

(b) The draft agreement for the appointment of Mr. Edward and Mr. Robinson shall be prepared in conformity with Schedule V read with section 196. The remuneration of Mr. Edward and Mr. Robinson shall be fixed at Rs. 2,00,000 per month each.

(c) The terms and conditions of the appointment of Mr. Edward and Mr. Robinson shall be approved by the Board of directors at a Board meeting.

(d) The terms and conditions of the appointment of Mr. Edward and Mr. Robinson shall be approved by the members in the general meeting held immediately after the approval by the Board.

(e) The notice of the Board meeting and of the general meeting called for the purpose of approving the appointment of Mr. Edward and Mr. Robinson shall include –

(i) the terms and conditions of such appointments;

(ii) remuneration payable to them; and

(iii) such other matters (including interest, of a director or directors in such appointments, if any).

(f) Within 60 days of appointment of Mr. Edward and Mr. Robinson, the company shall file with the Registrar a return of appointment in Form No. MR-1.

(g) The particulars of Mr. Edward and Mr. Robinson including the details of securities held by them shall be entered in the register of directors and key managerial personnel and their shareholding maintained under section 170.

3.13 Compensation for loss of office (Section 202)

Where a director is removed in breach of his service contract or is otherwise removed from office, the company is obliged by the service contract to pay compensation to the director concerned. However, the payment of compensation to a director is governed by section 202, explained as under:

1. Circumstances in which compensation can be paid

Payment can be made to a director –

(a) by way of compensation for loss of office of a director, *e.g.* where he is removed under section 169; *or*

(b) by way of compensation for loss of any other office which terminates along with the office of director, *e.g.* that of a managing director; *or*

(c) as consideration for retirement from office.

2. Persons to whom compensation can be paid

The compensation cannot be paid to an ordinary director. Compensation can be paid only to –

(a) managing director; *or*

(b) whole time director; *or*

(c) manager.

3. Prohibition of compensation

No compensation can be paid to a director in the following cases:

(a) Where the director resigns because of the reconstruction or amalgamation of the company and is appointed as managing director, manager or other officer of the reconstructed or amalgamated company.

(b) Where the director resigns voluntarily.

(c) Where the office of the director is vacated by virtue of section 167;

(d) Where, due to the negligence or default of the director, the company is wound up by the Tribunal.

(e) Where the director is guilty of fraud or breach of trust or gross negligence in the conduct of affairs of the company or its holding or subsidiary company.

(f) Where the director has instigated or is directly or indirectly responsible for the termination of his directorship.

4. Effect of winding up on amount of compensation

No payment can be made to a director if the following two conditions are satisfied:

(a) The winding up of the company commences –
- within 12 months of cessation of office of the director; *or*
- before the date of cessation of office of the director.

(b) The surplus remaining after winding up is not sufficient to repay to the shareholders the share capital (including the premium paid on shares) contributed by them.

5. Restriction on quantum of compensation

(a) Period. The compensation shall be admissible only for the lower of the following periods:

(i) The unexpired residue of his term; or

(ii) 3 years.

(b) Basis. The compensation shall be based on the 'average remuneration'. Average remuneration shall be calculated taking into account the remuneration actually earned by the director/manager during 3 years immediately preceding the date of cessation of office. However, where he has held his office for a period shorter than 3 years, the average remuneration shall be based on such shorter period.

Mere allegations that a director was involved in certain questionable transactions will not disentitle the director from receiving compensation.

Theoretical Questions from CA Examinations

Q 3.13A. Can a company pay compensation to its directors for loss of office? Explain briefly the relevant provisions of the Companies Act, 2013 in this regard. [CA (Final) May 2000]

Q 3.13B. Mr. X, a director of a public company, has been removed by the company before the expiry of the period of office by passing an ordinary resolution under section 169 of the Companies Act, 2013. The director wants to claim compensation for loss of office. Advise Mr. X. [CS (Final) June 1994; Dec. 1996; Dec. 2001]

Practical Problems from CA Examinations

Appointment of managing director terminated by the Board – Whether he is entitled to compensation?

P 3.13A. Mr. Doubtful was appointed as the managing director of Carefree Industries Ltd. for a period of five years with effect from 1.4.2015 on a salary of Rs. 12 lakhs per annum with other perquisites. The Board of Directors of the company, on coming to know of certain questionable transactions, terminated the services of the managing director from 1.3.2018. Mr. Doubtful termed his removal as illegal and claimed compensation from the company. Meanwhile the company paid a sum of Rs. 5 lakhs on *ad hoc* basis to Mr. Doubtful pending settlement of his dues. Discuss whether:

(i) The company is bound to pay compensation to Mr. Doubtful, and, if so, how much.

(ii) The company can recover the amount of Rs. 5 lakhs paid on the ground that Mr. Doubtful is not entitled to any compensation, because he is guilty of corrupt practices. [CA (Final) May 2001, Nov. 2004 (Modified)]

Ans. As per section 202 –
- Compensation can be paid only to a managing director or whole time director or manager.
- The compensation payable shall not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term or for 3 years, whichever is shorter.
- Where the director has been guilty of fraud or breach of trust or gross negligence in the conduct of the affairs of the company, he shall not be paid any compensation.

The answers to the given problems are as under:

(i) The company is not bound to pay compensation to Mr. Doubtful if he has been found guilty of any fraud or breach of trust. However, it is not proper for the company to withhold the payment of compensation on the basis of allegations, unless there is a proper finding on the involvement of Mr. Doubtful in corrupt practices.

If it is found that Mr. Doubtful was not guilty of fraud or breach of trust, he shall be entitled to compensation. The compensation payable to him shall not exceed Rs. 25 lakhs calculated at the rate of Rs. 12 lakhs per annum for unexpired period of 25 months.

(ii) As per the decision in ***Bell v Lever Bros***, the compensation of Rs. 5 lakh already paid by the company to Mr. Doubtful cannot be recovered back if the company later comes to know that Mr. Doubtful was guilty of serious breaches of duty and corrupt practices which would have entitled the company to end the employment of Mr. Doubtful without any compensation. It was also held that the managing director was under no obligation to disclose to the company the breach of duty so as to give an opportunity to the company to remove him without paying any compensation.

Can compensation once paid be recovered back on the ground that MD was guilty of corrupt practices?

P 3.13B. Mr. X was appointed as the Managing Director of ABC Ltd. for a period of 5 years w.e.f. 1st January, 2006. Since his work was found unsatisfactory, his services were terminated from 15th August, 2007 by paying compensation for the loss of office as provided in the agreement entered into by the company. Later, the company discovered that during his tenure of office Mr. Y was guilty of many corrupt practices and that he should have been removed without payment of compensation. Advise the company whether the services of the Managing Director can be terminated without payment of compensation as provided in the agreement and whether the company can recover the amount already paid to Mr. X by filing a suit. [CA (Final) Nov. 2007]

Ans. As per section 202 –

- Compensation can be paid only to a managing director or whole time director or manager.
- The compensation payable shall not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term or for 3 years, whichever is shorter.
- Where the director has been guilty of fraud or breach of trust or gross negligence in the conduct of the affairs of the company, he shall not be paid any compensation.

In the given case, the company removed its managing director and paid compensation to him. Afterwards, the company discovers that the managing director was guilty of corrupt practices, and that he could have been removed without paying any compensation.

The facts of the given case are exactly similar to the facts in ***Bell v Lever Bros***. In this case, Bell was employed by Lever Bros for a period of 5 years. Afterwards, the company removed him by paying compensation of £30,000. However, Lever Bros later came to know that Bell was guilty of serious breaches of duty and corrupt practices which would have entitled Lever Bros to end his employment without any compensation. Accordingly, Lever Bros brought an action against Bell for recovery of compensation on the ground that compensation was paid by mistake. It was held that compensation once paid cannot be recovered back by the company. Also, the managing director was under no obligation to disclose to the company the breach of duty so as to give an opportunity to the company to remove him without paying any compensation.

Thus, the answers to the questions asked in the given problem are as follows:

(a) If compensation has already been paid to Mr. X by ABC Ltd., the compensation cannot be recovered back, as per the decision in Bell v Lever Bros.

(b) If the breach of duty and corrupt practices of Mr. X come to light at the time when his services are terminated and before he is paid the compensation, the company is not liable to pay any compensation to him.

Calculation of amount of compensation payable to managing director for premature termination of his office

P 3.13C. Mr. Gopi is the managing director of LGB Limited. The company wants to vacate the post of managing director on March 31, 2018 and appoint Mr. Lakshmikant in place of Mr. Gopi due to hands on experience and better track records. The tenure of appointment of Mr. Gopi is upto 30th June, 2022 with the condition that he will get compensation in case of early vacation of his office due to the company's requirements. Mr. Gopi was drawing following remuneration during the last five financial years:

Financial Year	**Remuneration (Rs. in lakhs)**
2013-14	**30**
2014-15	**35**
2015-16	**40**
2016-17	**45**
2017-18	**50**

Mr. Gopi approaches you to know the amount of compensation he will be eligible to get from LGB Limited as per the provisions of the Companies Act, 2013. Advise.

What will be your answer if a person is only an ordinary director but neither the managing director nor a whole time director nor a manager of the company? [CA (Final) Nov. 2018]

Ans. As per section 202 –

- Compensation for loss of office can be paid only to a managing director or whole time director or manager.
- The compensation payable shall not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term or for 3 years, whichever is shorter.
- The compensation shall be based on the 'average remuneration'. Average remuneration shall be calculated taking into account the remuneration actually earned by the director/manager during 3 years immediately preceding the date of cessation of office.

The answers to the given problems are as under:

(i) Maximum amount of compensation to which Mr. Gopi is entitled

Average remuneration drawn by Mr. Gopi during 3 years immediately preceding the date of cessation office = (Rs. 40 lakh + Rs. 45 lakh + Rs. 50 lakh) / 3 = Rs. 45 lakh.

The unexpired residue of term of office of Mr. Gopi (as on 31.3.2018) was 4 years and 3 months. The compensation shall be admissible for unexpired residue of his term (*i.e.* 4 years and 3 months) or 3 years, whichever is lower. The lower period is 3 years.

Thus, the maximum amount of compensation to which Mr. Gopi is entitled = Rs. 45 lakh x 3 = Rs. 1 crore and 35 lakhs.

(ii) Whether Mr. Gopi would have been entitled for compensation, if had been an ordinary director?

Had Mr. Gopi been an ordinary director, he would not have been entitled to any compensation, since compensation can be paid only to a managing director or whole time director or manager, *i.e.* section 202 prohibits payment of compensation to an ordinary director.

Advanced Practical Problems

Is the company liable to pay compensation where the managing director resigns from his office and is appointed as the managing director in the amalgamated company?

P 3.13D. Mr. Raman is a Managing Director of X company. He resigns from his office as a result of amalgamation of the X company with the other body corporate. Further he is appointed as the Managing director of the body corporate resulting from the amalgamation. State in the light of the Companies Act, 2013 whether in this situation, is company liable towards Managing Director to compensate for the loss of office after his resignation? [ICAI, Revision Test Paper, May 2016]

Ans. The given problem relates to section 202 of the Companies Act, 2013, as discussed below:

The legal position

1. Compensation can be paid to a managing director or whole time director or manager.
2. However, no compensation can be paid to a managing director or whole time director or manager where such person resigns because of the reconstruction or amalgamation of the company and is appointed as managing director, manager or other officer of the reconstructed or amalgamated company.

The given case, analysis of the case and conclusion

3. Mr. Raman, the managing director of X Company, resigned from his office as a result of amalgamation of X Company with a body corporate. Mr. Raman is appointed as the managing director of the body corporate resulting from the amalgamation.
4. The provisions contained in section 202 prohibiting the payment of compensation are attracted in this case. Therefore, the company is neither bound nor entitled to make payment of any compensation to Mr. Raman.

3.14 Appointment of key managerial personnel (Section 203 and Rules 8 and 8A)

1. Mandatory appointment of whole time KMP

Every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel:

(i) Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
(ii) Company Secretary; and
(iii) Chief Financial Officer.

1. **Prescribed classes of companies for appointment of whole time KMP**

   As per Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the following classes of companies have been prescribed for the purpose of section 203 (*i.e.* the following classes of companies shall have the whole-time key managerial personnel):

   (a) Every listed company
   (b) Every other public company having a paid-up share capital of Rs. 10 crore or more.

2. **Mandatory appointment of whole time company secretary in certain cases**

   As per Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, every private company which has a paid-up share capital of Rs. 10 crore or more shall have a whole-time company secretary.

2. Chairperson not to be MD or CEO except in certain cases

(a) An individual shall not be appointed or reappointed as the chairperson of a 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, –

(i) the articles of such a company provide otherwise; or

(ii) the company does not carry multiple businesses.

(b) However, this provision shall not apply to a company if –

(i) it is engaged in multiple businesses;

(ii) it has appointed one or more Chief Executive Officers for each such business; and

(iii) it belongs to such class of companies as may be notified by the Central Government.

As per Notification No. S. O. 1913(E) dated 25th July, 2014, the prescribed class of companies for this purpose is public companies having paid-up share capital of Rs. 100 crore or more and annual turnover of Rs. 1,000 crore or more. The paid-up share capital and the annual turnover shall be decided on the basis of the latest audited Balance Sheet and Profit and Loss Account.

3. Manner of appointment of whole time KMP

Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board. The Board resolution shall specify –

(a) the remuneration of the key managerial personnel; and

(b) other terms and conditions of appointment.

As per Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014, the power to appoint or remove Key Managerial Personnel (KMP) shall be exercised by the Board by passing a resolution at a Board meeting only.

4. Number of companies in which a person can be whole time KMP

A whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time.

5. No restriction on KMP being a director

A key managerial personnel may be a director of any company with the permission of the Board.

6. Provisions w.r.t. existing companies

A whole-time key managerial personnel holding office in more than one company at the same time on the date of commencement of this Act, shall, within a period of 6 months from such commencement, choose one company, in which he wishes to continue to hold the office of key managerial personnel.

7. Managing directorship in 2 companies

A company may appoint or employ a person as its managing director if such person is already the managing director or manager in any other company, subject to the fulfilment of the following conditions:

(a) Such person is the managing director or manager of one, and of not more than one, other company;

(b) Such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting; and

(c) Specific notice of such meeting, and of the resolution to be moved thereat, has been given to all the directors then in India.

8. Filling of vacancy in the office of whole time KMP

If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of 6 months from the date of such vacancy.

9. Punishment for default

If any company makes any default in complying with the provisions of this section, such company shall be liable to a penalty of Rs. 5 lakh and every director and key managerial personnel of the company who is in default shall be liable to a penalty of Rs. 50,000 and where the default is a continuing one, with a further penalty of Rs. 1,000 for each day after the first during which such default continues but not exceeding Rs. 5 lakh.

Non-applicability of section 203

The provisions of section 203 shall not apply to a managing director or Chief Executive Officer or manager and in their absence, a whole- time director of the Government Company if such Government company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

Theoretical Questions from CA and CS Examinations

Q 3.14A. Explain the concept of KMP (Key Managerial Person) as introduced by the Companies Act 2013. Explain the classes of companies which are required to appoint whole time Key Managerial Person under the provision of the said Act. [CA (Final) May 2015]

Q 3.14B. What are the legal requirements to be complied with by a public company where it proposes to appoint a person as a managing director without remuneration in accordance with the conditions specified in Schedule V to the Companies Act, 2013 when he is already holding position of a managing director in a private company? [CA (Final) May 1995]

Q 3.14C. A, the managing director of Z Ltd. is also appointed as the managing director of Y Ltd., wants to draw remuneration from both the companies. Advise. [CS (Final) June 1999; Dec. 1997]

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Practical Problems from CA Examinations

Whether the same person can be appointed as the CFO as well as the Company Secretary?

P 3.14A. ABC Limited, an unlisted company having a paid up share capital of Ten crores of Rupees during the preceding financial year has appointed Shri X, a fellow member of the Institute of Chartered Accountants of India as Chief Financial Officer of the company who is appointed as Key Managerial Personnel under section 203 of the Companies Act, 2013. Shri X is also a fellow member of the Institute of Company Secretaries of India. The Company Secretary post has become vacant. In order to reduce the administrative expenses, the company proposes to appoint Shri X as Company Secretary in addition to Chief Financial Officer post. Whether the proposal is legally valid under the provisions of the Companies Act, 2013?

[CA (Final) May 2018]

Ans.

The legal position

1. As per section 203, every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel:
   (i) Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
   (ii) Company Secretary; and
   (iii) Chief Financial Officer.
2. As per Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the following classes of companies have been prescribed for the purpose of section 203 (*i.e.* the following classes of companies shall have the whole-time key managerial personnel):
   (a) Every listed company
   (b) Every other public company having a paid-up share capital of Rs. 10 crore or more.

The given case and analysis of the case

3. The paid up share capital of ABC Limited is Rs. 10 crore, and so it is covered by the provisions contained in Rule 8.
4. Since Rule 8 applies to ABC Limited, it is required to appoint the following whole-time key managerial personnel:
   (i) Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
   (ii) Company Secretary; and
   (iii) Chief Financial Officer.
5. Shri X, who is a fellow member of the Institute of Chartered Accountants of India has been appointed as the Chief Financial Officer of ABC Limited.
6. Shri X is also a fellow member of the Institute of Company Secretaries of India.
7. A person who is member of the Institute of Company Secretaries of India is qualified to be appointed as the Company Secretary.
8. It is proposed to appoint Shri X as the Company Secretary.
9. If Shri X is also appointed as the Company Secretary, Shri X would simultaneously hold the position of Chief Financial Officer as well as the position of Company Secretary of ABC Limited.
10. The issue raised in the question is as follow:
    "Where the same person holds the position of Chief Financial Officer as well as the position of Company Secretary, whether the requirements of section 203 read with Rule 8 are satisfied?"
11. Section 203 read with Rule 8 requires appointment of all the following 3 persons:
    (i) Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
    (ii) Company Secretary; and
    (iii) Chief Financial Officer.

12. Applying reasonable interpretation, the words 'whole-time' as well as 'and' used in section 203 read with Rule 8 imply that the company is required to appoint one person as Managing director, or Chief Executive Officer or manager or whole-time director, appoint another person as Company Secretary and appoint some other person as the Chief Financial Officer. In simple words, for the three positions specified in Rule 8, there has to be three different individuals. It would not be reasonable / logical to draw an interpretation that one person can be appointed at all the three positions since in such a case he would not be able to fulfil the responsibilities and duties attached with these three positions.
13. Thus, if a person who already holds the position of Chief Financial Officer of the company is also appointed as the Company Secretary of the company, it does not amount to compliance of section 203 read with Rule 8.

Conclusion

14. The proposal of ABC Limited to appoint Shri X as the Company Secretary, when he is already holding the office of Chief Financial Officer, is not valid since it would result in non-compliance of the provisions of section 203 read with Rule 8.

Four out of six directors present in Board meeting vote for the appointment of a person as a managing director of the company where such person is already a managing director in another company – Consequences

P 3.14B. Mr. AMIT is the managing director of ANJ Limited, which is a non-government public company. The directors of CHH Limited decided to appoint Mr. AMIT as the managing director of the company, even though Mr. AMIT decided not to vacate his place of office of managing director of ANJ Limited. A notice for a Board meeting specifying a resolution containing the proposal of appointment of Mr. AMIT was served to all the eligible directors of CHH Limited. Out of eight directors of the company, six directors attended the meeting and out of them four directors gave consent to the resolution, one director voted against the said appointment and another director abstained from voting. The Board of directors seek your opinion whether Mr. AMIT can be appointed as the managing director of the company in this situation. Referring to the applicable provisions of the Companies Act, 2013, advise them. **[CA (Final) May 2018]**

Ans.

The legal position

1. As per section 203, a company may appoint or employ a person as its managing director if such person is already the managing director or manager in any other company, subject to the fulfilment of the following conditions:
   (a) Such person is the managing director or manager of one, and of not more than one, other company;
   (b) Such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting; and
   (c) Specific notice of such meeting, and of the resolution to be moved thereat, has been given to all the directors then in India.

The given case and analysis of the case

2. The Board of directors of CHH Limited intends to appoint Mr. Amit as the managing director of the company. Mr. Amit is already the managing director of ANJ Limited. Since, Mr. Amit is the managing director of only one other company, the requirement of section 203, that the person should not be managing director of more than one other company, has been fulfilled.
3. For the purpose of making such appointment, a Board meeting of CHH Limited was called. The notice of such Board meeting contained the proposal of appointment of Mr. Amit as the managing director of CHH Limited. Thus, the requirement of section 203, that specific notice of the Board meeting and of the resolution to be moved thereat, has been fulfilled.
4. In such Board meeting, 6 out of total 8 directors were present. The quorum, as required by section 174 (*i.e.* 3 directors, in this case), was present. The proposal for appointment of Mr. Amit as managing director was supported by 4 directors, and 1 director voted against the resolution, and 1 director abstained from voting.
5. As per section 203, appointment of Mr. Amit as the managing director requires voting in favour by all the 6 directors present in the Board meeting. However, all the 6 directors have not voted in favour of his appointment. Therefore, the requirement of section 203, that the appointment is to be approved by all the directors present in the Board meeting, has not been fulfilled.

Conclusion

6. Since the appointment of Mr. Amit as the managing director has not been approved in accordance with the requirements of section 203 (*i.e.* approval by all the 6 directors present in the Board meeting), the proposal for his appointment has failed. Accordingly, Mr. Amit cannot be appointed as the managing director of CHH Limited.

Can a person be appointed as a managing director in three group companies?

P 3.14C. Primus group of companies has three companies, viz., Primus Rolling Mills Ltd., Primus Steel Pipe Manufacturers Ltd. and Primus Marketing Company Ltd. All the three companies want to appoint Mr. Prem as their managing director.

You are required to state with reference to the provisions of the Companies Act, 2013 whether such appointments are permissible. **[CA (Final) May 2008]**

Ans. The given problem relates to section 203 of the Companies Act, 2013, as discussed below:

The legal position

1. As per section 203, a company may appoint or employ a person as its managing director if such person is already the managing director or manager in any other company, subject to the fulfilment of the following conditions:
   (a) Such person is the managing director or manager of one, and of not more than one, other company;
   (b) Such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting; and
   (c) Specific notice of such meeting, and of the resolution to be moved thereat, has been given to all the directors then in India.

The given case and analysis of the case

2. It is proposed to appoint Mr. Prem as the managing director of 3 companies.
3. Section 203 permits a person to be a managing director of maximum 2 companies, subject to the fulfilment of certain conditions as discussed above.
4. However, in no case, it is permissible for any person to be a managing director of more than 2 companies.

Conclusion

5. It is not permissible for the three companies to appoint Mr. Prem as their managing director. He can be appointed as a managing director in maximum 2 companies.

Managing directorship in two companies on a fixed salary – Legal requirements

P 3.14D. Board of directors of Colourful Textiles Ltd. having an effective capital of Rs. 4 crores propose to appoint one of its directors, Mr. Shyam, as managing director for 5 years with effect from 1st December, 2016 on a consolidated monthly salary of Rs. 40,000 per month. Mr. Shyam is already the managing director of Unique Yarn Ltd. receiving a consolidated salary of Rs. 35,000 per month. The effective capital of Unique Yarn Ltd. is Rs. 2 crores. What are the legal requirements to be complied with by Colourful Textiles Ltd. to give effect to the proposed appointment? Will your answer be different if Unique Yarn Ltd. is a private company? **[CA (Final) Nov. 1996]**

Ans. The given problem relates to section 196 and section 203 of the Companies Act, 2013 and Section II and Section V of Part II of Schedule V, as discussed below:

The legal position

1. As per section 196(4), the terms and conditions of the appointment of a managing director, whole-time director or manager and the remuneration payable to him shall be –
   (a) approved by the Board of directors at a meeting;
   (b) approved at a general meeting held immediately after the approval by the Board; and
   (c) approved by the Central Government, in case such appointment is at variance to the conditions specified in Part I of Schedule V.
2. As per section 203, a company may appoint or employ a person as its managing director if such person is already the managing director or manager in any other company, subject to the fulfilment of the following conditions:
   (a) Such person is the managing director or manager of one, and of not more than one, other company;
   (b) Such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting; and
   (c) Specific notice of such meeting, and of the resolution to be moved thereat, has been given to all the directors then in India.
3. As per Section V of Part II of Schedule V, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person. The provisions of Section V of Part II of Schedule V are subject to the provisions of Sections I to IV of Part II of Schedule V.
4. As per Section II of Part II of Schedule V, the remuneration to a managing director depends upon the effective capital of the company. In case of a company having an effective capital of less than Rs. 5 crore, the remuneration payable to a managing director shall not exceed Rs. 60 lakh per year.

The given case and analysis of the case

5. The Board of directors of Colourful Textiles Ltd. intends to appoint Mr. Shyam as the managing director of the company. Mr. Shyam is already the managing director of Unique Yarn Ltd. Since, Mr. Shyam is the managing director of only one other company, the requirement of section 203, that the person should not be managing director of more than one other company, has been fulfilled.
6. For the purpose of making such appointment, a Board meeting of Colourful Textiles Ltd. shall be held. The notice of such Board meeting shall contain the proposal of appointment of Mr. Shyam as the managing director of Colourful Textiles Ltd., so that the requirement of section 203, that specific notice of the Board meeting and of the resolution to be moved thereat is to be given, shall be fulfilled.
7. The appointment of Mr. Shyam as the managing director shall require approval of the Board. Such approval shall be granted by passing a unanimous resolution in a Board meeting, *i.e.* all the directors present in the Board meeting must vote in favour of appointment of Mr. Shyam.

8. The terms and conditions of the appointment of Mr. Shyam and the remuneration payable to him shall be approved at a general meeting held immediately after the approval by the Board.
9. The terms and conditions of the appointment of Mr. Shyam and the remuneration payable to him shall be approved by the Central Government, in case such appointment is at variance to the conditions specified in Part I of Schedule V, *i.e.* if he does not satisfy one or more of the eligibility conditions contained in Part I of Schedule V.
10. The effective capital of Colourful Textiles Ltd. is Rs. 4 crores, i.e. less than Rs. 5 crore. As per Section II of Part II of Schedule V, Colourful Textiles Ltd. may pay a maximum of Rs. 60 lakh per year to Mr. Shyam. Similarly, the effective capital of Unique Yarn Ltd. is Rs. 2 crores, i.e. less than Rs. 5 crore. As per Section II of Part II of Schedule V, Unique Yarn Ltd. may pay a maximum of Rs. 60 lakh per year to Mr. Shyam.
11. As per Section V of Part II of Schedule V, Mr. Shyam may draw –
    (a) a maximum of Rs. 60 lakh per year from Colourful Textiles Ltd.; or
    (b) a maximum of Rs. 60 lakh per year from Unique Yarn Ltd.;
    (c) some remuneration from Colourful Textiles Ltd. and some remuneration from Unique Yarn Ltd., subject to the condition that total remuneration drawn from both these companies shall not exceed Rs. 60 lakh.
12. The payment of proposed remuneration of Rs. 40,000 per month to Mr. Shyam by Colourful Textiles Ltd. and Rs. 35,000 per month by Unique Yarn Ltd. shall result in payment of Rs. 9 lakh per year to Mr. Shyam, which is in accordance with Section II and Section V of Part II of Schedule V.

Conclusions

13. Colourful Textiles Ltd. can appoint Mr. Shayam as its managing director by complying with Points 6, 7, 8 and 9, as stated above.
14. It is permissible for Mr. Shyam to draw a remuneration of Rs. 40,000 per month from Colourful Textiles Ltd. and Rs. 35,000 per month from Unique Yarn Ltd.
15. Even if Unique Yarns Limited were a private company, the answer would have remained same, since the applicability of provisions contained in section 196, section 203, Section II of Part II of Schedule V and Section V of Part II of Schedule V does not depend upon the status of the company (*i.e.* public or private) in which Mr. Shyam was already a managing director.

Issues with respect to appointment of a person as a managing director if he is already a managing director in another company

P 3.14E. Mr. Mania is the managing director of S Limited (and nowhere else), which is a subsidiary of H Limited. Seeing the success of S Limited, the directors of H Limited (which is a listed company) decided and approached Mr. Mania to act as the managing director of H Limited. Mr. Mania agreed with the directors of H Limited subject to a condition that he will continue to act as the managing director of S Limited also. In this direction, the directors of H Limited propose to appoint him by means of a resolution (containing the terms and conditions of appointment excluding remuneration) by circulation. Referring to and analyzing the relevant provisions of the Companies Act 2013, decide whether the decision of appointing and the proposed mode of appointment of Mr. Mania as the managing director of H Limited is valid.

Will your answer differ in case S Limited is not a subsidiary of H Limited? [CA (Final) May 2019]

Ans. The given problem relates to section 196 and section 203 of the Companies Act, 2013, as discussed below:

The legal position

1. As per section 203, a company may appoint or employ a person as its managing director if such person is already the managing director or manager in any other company, subject to the fulfilment of the following conditions:
    (a) Such person is the managing director or manager of one, and of not more than one, other company;
    (b) Such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting; and
    (c) Specific notice of such meeting, and of the resolution to be moved thereat, has been given to all the directors then in India.
2. As per section 196(4), the terms and conditions of the appointment of a managing director and the remuneration payable to him shall be –
    (a) approved by the Board of directors at a meeting;
    (b) approved at a general meeting held immediately after the approval by the Board; and
    (c) approved by the Central Government, in case such appointment is at variance to the conditions specified in Part I of Schedule V.

The given case and analysis of the case

3. The Board of directors of H Limited intends to appoint Mr. Mania as the managing director of the company. Mr. Mania is already the managing director of S Limited. Since, Mr. Mania is the managing director of only one other company, the requirement of section 203, that the person should not be managing director of more than one other company, has been fulfilled.

4. For the purpose of appointing Mr. Mania as the managing director, a resolution by circulation is proposed to be passed by the Board of directors of H Limited. Further, it is proposed that such resolution shall not contain the provisions with respect to remuneration of Mr. Mania, but shall contain other terms and conditions of appointment of Mr. Mania.

   If the proposed mode of appointment is adopted, the provisions of section 196(4) and section 203 shall be contravened, since –

   (a) the proposed appointment shall be made by passing a resolution by circulation, but such appointment can be made only by passing a resolution at a Board meeting as per section 196 and 203;

   (b) the appointment of Mr. Mania requires a unanimous resolution of the Board as per section 203, but in the proposed mode of appointment, unanimous resolution shall not be passed;

   (c) specific notice of the Board meeting and resolution proposed for appointing Mr. Mania as the managing director is required to be given to all the directors as per section 203, but no specific notice shall be given as per the proposed mode of appointment; and

   (d) the Board shall not approve the remuneration payable to Mr. Mania as per the proposed mode of appointment, but section 196(4) requires approval of remuneration by the Board.

Conclusion

5. If Mr. Mania is appointed as the managing director as per the proposed mode of appointment, it would result in contravention of the provisions of section 196(4) and 203. Accordingly, the proposed mode / manner of appointment of Mr. Mania as the managing director of H Limited, is not valid.

6. Even if S Limited were not a subsidiary of H Limited, the answer would have remained same, since the provisions of section 196(4) and section 203 would still be applicable to the appointment of Mr. Mania.

Practical Problems from CMA Examinations

Whether a person can be a whole time director in the company as well as in its subsidiary company at the same time?

P 3.14F. Mr. X is a Whole Time Director (WTD) in a Super Ltd. He is also Whole Time Director (WTD) in its subsidiary company. Discuss the validity of Mr. X as WTD in its subsidiary company. **[CMA (Final) Dec. 2018]**

Ans. The given problem relates to section 203 of the Companies Act, 2013.

As per section 203, a whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. For example, a person can be the manager in a company as well as the manager in its subsidiary company, or a person can be a managing director in a company and the manager in its subsidiary company.

As per section 2(94), 'whole-time director' includes a director in the whole-time employment of the company.

Though section 203 permits a whole-time key managerial personnel to become a whole-time key managerial personnel in its subsidiary company at the same time, yet it is not possible for a person to become a whole time director in a company as well as in its subsidiary company. This is so because the definition of whole time director clearly implies that a whole time director is a whole time employee, and a person cannot become a whole time employee in more than once company at the same time.

Thus, Mr. X cannot validly hold the position of whole time director in Super Ltd. as well as in its subsidiary, at the same time.

Difference in answer as compared to the answer given by the Institute of Cost Accountants of India

The Author's answer differs from the answer given in the Suggested Answers issued by the Institute of Cost Accountants of India. The answer given by the Institute of Cost Accountants of India is as under:

As per section 203(2) of the Companies Act, 2013, 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.

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)]. So accordingly, Mr. X can validly hold the position of Whole time Director in the subsidiary of Super Ltd.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Institute of Cost Accountants of India.

Advanced Practical Problems

Whether appointment of whole-time company secretary is mandatory for all companies having paid up capital of Rs. 10 crore or more?

P 3.14G. Which of the key managerial personnel are required to be appointed by the following companies?

(a) A Ltd., which is a listed company.

(b) B Ltd. is an unlisted company having a paid up share capital of Rs. 12 crore.

(c) C Ltd. is an unlisted company having a paid up share capital of Rs. 8 crore.

(d) D Ltd. is an unlisted company having a paid up share capital of Rs. 4 crore.

(e) E Pvt. Ltd. is an unlisted company having a paid up share capital of Rs. 11 crore.

(f) F Pvt. Ltd. is an unlisted company having a paid up share capital of Rs. 6 crore.

(g) G Pvt. Ltd. is an unlisted company having a paid up share capital of Rs. 3 crore.

OR

The Companies Act, 2013 has made it mandatory for all companies having a paid up capital of Rs. 10 crore or more to have a whole time company secretary. Comment.

Ans. The given problem and statement is based on section 203 of the Companies Act, 2013 and Rule 8 and Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

As per section 203, every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel:

(i) Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;

(ii) Company Secretary; and

(iii) Chief Financial Officer.

As per Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the following classes of companies have been prescribed for the purpose of section 203 (*i.e.* the following classes of companies shall have the whole-time key managerial personnel):

(a) Every listed company

(b) Every other public company having a paid-up share capital of Rs. 10 crore or more.

As per Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, every private company which has a paid up share capital of Rs. 10 crore or more shall have a whole-time company secretary.

The given cases are discussed as under:

Name of the company	Whether Rule 8 applies?	Whether Rule 8A applies?	Appointment of which key managerial personnel is mandatory?
A Ltd.	Yes, since A Ltd. is a listed company	No	(i) Managing director, or Chief Executive Officer or manager or whole-time director; (ii) Company Secretary; and (iii) Chief Financial Officer.
B Ltd.	Yes, since B Ltd. is a public company and its paid up share capital is Rs. 12 crore, i.e. it satisfies the criterion of paid up share capital of Rs. 10 crore or more	No	Same as above.
C Ltd.	No, since its paid up share capital is less than Rs. 10 crore	No, since it is not a private company and also because its paid up share capital is less than Rs. 10 crore	None
D Ltd.	Same as above	Same as above	Same as above
E Pvt. Ltd.	No, since E Pvt. Ltd. is neither a listed company nor a public company	Yes, since it is a private company and its paid up share capital is Rs. 11 crore, i.e. it satisfies the criterion of paid up share capital of Rs. 10 crore or more	Whole-time Company Secretary
F Pvt. Ltd.	No, since F Pvt. Ltd. is neither a listed company nor a public company, and also because its paid up share capital is less than Rs. 10 crore	No, since its paid up share capital is less than Rs. 10 crore	None

G Pvt. Ltd.	No, since G Pvt. Ltd. is neither a listed company nor a public company, and also because its paid up share capital is less than Rs. 10 crore	No, since its paid up share capital is less than Rs. 10 crore	None

Conclusion: Every company (whether listed or unlisted, and whether public or private) shall have to appoint a whole-time company secretary if its paid up share capital is Rs. 10 crore or more.

Filling of casual vacancy in the office of whole time director

P 3.14H. Mr. W has been appointed as a whole time director in X Ltd., a public company having a paid up share capital of Rs. 20 crores. He met with an accident which resulted in vacation of office of whole time key managerial personnel. State the provisions of the Companies Act, 2013 with regard to filling of casual vacancy of KMP. What will be the answer if Mr. W had been appointed as whole time director in a Government Company?

Ans. The given problem relates to section 203 of the Companies Act, 2013 and Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, as discussed below:

The legal position

1. As per section 203, every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel:
   (i) Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
   (ii) Company Secretary; and
   (iii) Chief Financial Officer.
2. As per Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the following classes of companies have been prescribed for the purpose of section 203 (*i.e.* the following classes of companies shall have the whole-time key managerial personnel):
   (i) Every listed company
   (ii) Every other public company having a paid-up share capital of Rs. 10 crore or more.
3. If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of 6 months from the date of such vacancy.
4. The provisions of section 203 and Rule 8 shall not apply to a managing director or Chief Executive Officer or manager and in their absence, a whole- time director of the Government Company if such Government company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015].

The given case and analysis of the case

5. The office of whole time director held by Mr. W in X Ltd. is vacated.
6. X Ltd. is covered in the class of companies prescribed by the Central Government, which are required to appoint whole-time key managerial personnel. Therefore, X Ltd. is required to fill the casual vacancy in the office of whole-time key managerial personnel in accordance with the provisions contained in section 203.

Conclusion

7. The vacancy in the office of Mr. X shall be filled by the Board within a period of 6 months from the date of creation of such vacancy. Such vacancy can be filled up only by passing a resolution in a Board meeting.
8. However, if the company in which Mr. X was appointed as a whole time director had been a Government company, it shall not be required to fill the casual vacancy in the office of Mr. X.

3.15 Secretarial audit for bigger companies (Section 204 and Rule 9)

1. Mandatory secretarial audit for certain companies

Secretarial audit is mandatory for the following companies:

(a) Every listed company

(b) Every company belonging to such other class of companies as may be prescribed.

Rule 9(1) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 prescribes the following classes of companies for this purpose:

(i) Every public company having a paid-up share capital of Rs. 50 crore or more; or

(ii) Every public company having a turnover of Rs. 250 crore or more; or

(iii) Every company having outstanding loans or borrowings from banks or public financial institutions of Rs. 100 crore or more.

The paid-up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

2. Secretarial audit report

(a) Every company to which this section applies, shall annex with its Board's report (prepared as per section 134) a secretarial audit report.

(b) The secretarial audit report shall be prepared by a company secretary in practice.

(c) The secretarial audit report shall be prepared in such form as may be prescribed.

Rule 9(2) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 prescribes Form No. MR-3 for this purpose.

3. Duty of the company to give facilities

It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

4. Duty of the Board to furnish explanations on qualifications

The Board shall, in the Board's report (prepared as per section 134), explain in full any qualification or observation or other remarks made by the company secretary in practice in the secretarial audit report.

5. Punishment for contravention

Contravention of section 204 is punishable with a minimum fine of Rs. 1 lakh and a maximum fine of Rs. 5 lakh.

Duties and functions of directors not to be affected

The provisions contained in section 204 shall not affect the duties and functions of the Board of Directors, chairperson of the company, managing director or whole-time director under this Act, or any other law for the time being in force.

Advanced Practical Problems

Whether Secretarial audit is required to be conducted – Various cases

P 3.15A. Explaining the provisions of the Companies Act, 2013, examine whether the following companies are required to get the Secretarial Audit conducted:

(i) ABC Company Limited is a company listed at Bombay Stock Exchange and has a paid-up share capital of Rs. 40 crore.

(ii) DEF Company Limited is a company which has a paid up equity share capital of Rs. 100 crore but has a turnover of Rs. 100 crore during the financial year 2014-15. The company is not listed on any of the Stock Exchanges. [ICAI, RTP]

Ans. The given problem relates to section 204 of the Companies Act, 2013 and Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, as discussed below:

The legal position

Secretarial audit is mandatory if a company satisfies any of the following 4 conditions:

(a) It is a listed company.

(b) It is a public company having a paid-up share capital of Rs. 50 crore or more.

(c) It is a public company having a turnover of Rs. 250 crore or more.

(d) Its outstanding loans or borrowings from banks or public financial institutions is Rs. 100 crore or more.

The paid-up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

The given cases, analysis of the cases and conclusions

(i) ABC Company Ltd. is a listed company. Since secretarial audit is mandatory for every listed company irrespective of its paid up share capital, ABC Company Ltd. is required to get the secretarial audit conducted.

(ii) DEF Company Ltd. is not a listed company. Also, its turnover is less than Rs. 250 crore. However, it satisfies the condition "It is a public company having a paid-up share capital of Rs. 50 crore or more". Therefore, DEF Company Ltd. is required to get the secretarial audit conducted.

Whether Secretarial audit is required to be conducted where the paid up share capital is Rs. 55 crore or Rs. 35 crore?

P 3.15B. M/s Asian Ltd., a public limited company has a paid up share capital of Rs. 55 crore. Answer the following:

(i) Whether it is obligatory for the company to get the secretarial audit conducted?

(ii) Will it make any difference if the paid up share capital of M/s Asian Ltd. is Rs. 35 crore.

(iii) State as to whether M/s Asian Ltd. is required to appoint whole time key managerial personnel. [ICAI, RTP (Modified)]

Ans. The given problem relates to section 203 and 204 of the Companies Act, 2013 and Rule 8 and 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, as discussed below:

The legal position

1. As per section 204 read with Rule 9, secretarial audit is mandatory if a company satisfies any of the following 4 conditions:

   (a) It is a listed company.

   (b) It is a public company having a paid-up share capital of Rs. 50 crore or more.

(c) It is a public company having a turnover of Rs. 250 crore or more.
(d) Its outstanding loans or borrowings from banks or public financial institutions is Rs. 100 crore or more.
The paid-up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

2. As per section 203, every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel:
 (a) Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
 (b) Company Secretary; and
 (c) Chief Financial Officer.
3. As per Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the following classes of companies have been prescribed for the purpose of section 203 (*i.e.* the following classes of companies shall have the whole-time key managerial personnel):
 (a) Every listed company
 (b) Every other public company having a paid-up share capital of Rs. 10 crore or more.

The given cases, analysis of the cases and conclusions

(i) M/s Asian Ltd. satisfies the condition "It is a public company having a paid-up share capital of Rs. 50 crore or more". Therefore, M/s Asian Ltd. is required to get the secretarial audit conducted.
(ii) If the paid up share capital of M/s Asian Ltd. is Rs. 35 crore, it would not be required to get the secretarial conducted unless it is a listed company or its turnover is Rs. 250 crore or more or its outstanding loans or borrowings from banks or public financial institutions is Rs. 100 crore or more.
(iii) M/s Asian Ltd. satisfies the condition "It is a public company having a paid-up share capital of Rs. 10 crore or more". Therefore, M/s Asian Ltd. is required to appoint following whole-time key managerial personnel:
 (a) Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
 (b) Company Secretary; and
 (c) Chief Financial Officer.

3.16 Functions of company secretary (Section 205 and Rule 10)

1. Functions and duties of Company Secretary

The functions of the company secretary shall include the following:
(a) To report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company.
(b) To ensure that the company complies with the applicable secretarial standards.
(c) To discharge such other duties as may be prescribed.

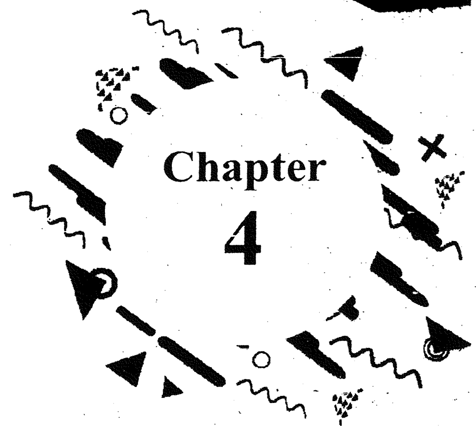
As per Rule 10 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the Company Secretary shall also discharge the following duties:
(1) To provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers.
(2) To facilitate the convening of meetings and attend Board, committee and general meetings and maintain the minutes of these meetings.
(3) To obtain approvals from the Board, general meeting, the government and such other authorities as required under the provisions of the Act.
(4) To represent before various regulators, and other authorities under the Act in connection with discharge of various duties under the Act.
(5) To assist the Board in the conduct of the affairs of the company.
(6) To assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices.
(7) To discharge such other duties as have been specified under the Act or rules.
(8) To discharge such other duties as may be assigned by the Board from time to time.

2. Definition of 'secretarial standards'

For the purpose of section 205, the expression 'secretarial standards' means secretarial standards issued by the Institute of Company Secretaries of India (constituted under section 3 of the Company Secretaries Act, 1980) and approved by the Central Government.

Duties and functions of directors not to be affected

The provisions contained in section 205 shall not affect the duties and functions of the Board of directors, chairperson of the company, managing director or whole-time director under this Act, or any other law for the time being in force.



Inspection, Inquiry and Investigation

(Chapter XIV of the Companies Act, 2013 consisting of Sections 206 to 229 and the Companies (Inspection, Investigation and Inquiry) Rules, 2014) and the Companies (Arrests in connection with Investigation by Serious Fraud Investigation Office) Rules, 2017

Bird's eye-view of the Chapter

Inspection and inquiries

1. Power of Registrar to call for information, inspect books and conduct inquiries (Sec. 206)
2. Manner of conduct of inspection and inquiry (Sec. 207)
3. Report by Registrar with respect to inspection made (Sec. 208)
4. Search and seizure (Sec. 209)

Investigation into the affairs of a company

1. Power and duty of CG to order investigation (Sec. 210)
2. Establishment of Serious Fraud and Investigation Office (Sec. 211 and Rule 3)
3. Investigation by Serious Fraud and Investigation Office (Sec. 212)
4. Investigation on an order made by the Tribunal (Sec. 213)

Procedure, expenses, action w.r.t. investigations

1. Security for payment of costs and expenses of investigation (Sec. 214 and Rule 5)
2. Only individual to be inspector (Sec. 215)
3. Powers of inspectors (Sec. 217 and Rule 6)
4. Protection of employees during investigation (Sec. 218)
5. Seizure of documents by inspector (Sec. 220)
6. Inspector's report (Sec. 223)
7. Actions to be taken in pursuance of inspector's report (Sec. 224)
8. Expenses of investigation (Sec. 225)
10. Legal advisers and bankers not to disclose certain information (Sec. 227)
9. Voluntary winding up of company, etc., not to stop investigation proceedings (Sec. 226)

Other investigations

1. Investigation of membership of a company (Sec. 216)
2. Investigation of related companies, etc. (Sec. 219)
3. Investigation, etc., of foreign companies (Sec. 228)

Powers of Tribunal

1. Freezing of assets of company on inquiry and investigation (Sec. 221)
2. Imposition of restrictions upon securities (Sec. 222)

Miscellaneous

1. Penalty for furnishing false statement, etc. (Sec. 229)

Bird's eye-view of the Companies (Inspection, Investigation and Inquiry) Rules, 2014

Rule No.	Marginal Heading
1	Short title and commencement
2	Definitions
3	Appointment of persons having expertise in various fields
4	Terms and conditions of service
5	Security
6	Letter of Request as per section 217

Bird's eye-view of the Companies (Arrests in connection with Investigation by Serious Fraud Investigation Office) Rules, 2017

Rule No.	Marginal Heading
1	Short title and commencement
2	Competent Authority for arrest
3	Approval of the Central Government required for arrest in certain cases
4	Signing of the arrest order and personal search memo
5	Forwarding of copy of the arrest order, etc. to the office of Director, SFIO
6	Maintenance of the arrest register
7	Entries regarding arrest of a person in the arrest register
8	Preservation of the copy of arrest order and supporting materials
9	Applicability of the provisions of the Code of Criminal Procedure, 1973

Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, –
   (a) any reference to any section means reference to the sections of the Companies Act, 2013; and
   (b) any reference to any rule means reference to the Rules contained the Companies (Inspection, Investigation and Inquiry) Rules, 2014.

4.1 Power to call for information, inspect books and conduct inquiries (Section 206)

1. **Power of Registrar to call for information or documents [Section 206(1)]**
   (a) The Registrar may, by a written notice, require the company –
      (i) to furnish in writing such information or explanation, within such reasonable time, as may be specified in the notice; or
      (ii) to produce such documents, within such reasonable time, as may be specified in the notice.
      No opportunity of being is to be given by the Registrar before issue of such notice.
      No oral information or explanation may be required by, or furnished to, the Registrar.
   (b) The Registrar may exercise such a power, where –
      (i) on a scrutiny of any document filed by a company, he is of the opinion that any further information or explanation or any further documents relating to the company is necessary; or
      (ii) on any information received by him, he is of the opinion that any further information or explanation or any further documents relating to the company is necessary.
2. **Duty of the company to furnish information and documents [Section 206(2)]**
   On the receipt of a notice from the Registrar requiring furnishing of information or documents, it shall be the duty of the company and of its officers concerned to –
   (a) furnish such information or explanation to the best of their knowledge and power, within the time specified or extended by the Registrar; and
   (b) produce the documents to the Registrar within the time specified or extended by the Registrar.
3. **Duty of the past officers to furnish information [Proviso to Section 206(2)]**
   Where the information or explanation required to be furnished to the Registrar relates to any past period, the officers who had been in the employment of the company for such period, if so called upon by the Registrar through a notice served on them in writing, shall also furnish such information or explanation to the best of their knowledge.
4. **Power of Registrar to inspect books of account, etc. [Section 206(3)]**
   (a) The Registrar may, by another written notice, call upon 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.
   (b) The Registrar may exercise such a power where –
      (i) no information or explanation is furnished to the Registrar within the time specified by the Registrar; or
      (ii) the Registrar, on an examination of the documents furnished by the company, is of the opinion that the information or explanation furnished is inadequate; or
      (iii) the Registrar is satisfied, on a scrutiny of the documents furnished by the company, that an unsatisfactory state of affairs exists in the company and does not disclose a full and fair statement of the information required.
   (c) The Registrar shall record the reasons in writing for issuing such notice.
5. **Power of the Registrar to call for information or carry out inquiry [Section 206(4)]**
   (a) The Registrar may call upon the company to furnish in writing any information or explanation on matters specified in the order within such time as he may specify therein. Thereafter, the Registrar may carry out such inquiry as he deems fit after providing the company a reasonable opportunity of being heard.

(b) The registrar may exercise such power if he is satisfied, on the basis of information available with or furnished to him or on a representation made to him by any person, that –

(i) 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

(ii) the grievances of investors are not being addressed.

(c) Before exercising such power, the Registrar shall inform the company of the allegations made against it by a written order.

(d) 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.

The Central Government may, if it is satisfied that the circumstances so warrant, direct the Registrar or an inspector appointed by it to carry out such inquiry.

6. **Power of CG to direct inspection of books by an inspector [Section 206(5)]**

Without prejudice to the foregoing provisions, the Central Government may, if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by an inspector appointed by it for such purpose.

The power to appoint inspectors for inspection of books and papers of a company under section 206(5) has been delegated by the Central Government to the Regional Directors [Notification No. 1626(E) dated 29-04-2016].

7. **Power of CG to authorise any Statutory Authority to carry out the inspection [Section 206(6)]**

The Central Government may, having regard to the circumstances by general or special order, authorise any statutory authority to carry out the inspection of books of account of a company or class of companies.

8. **Punishment for contravention [Section 206(7)]**

If a company fails to furnish any information or explanation or produce any document required under this section, the company and every officer of the company, who is in default shall be punishable with –

(a) fine upto Rs. 1 lakh; and

(b) additional fine upto Rs. 500 per day, in the case of a continuing failure.

Section 206 applies to all companies, whether public or private.

Practical Problems

Whether a past employee is liable to furnish information to the Registrar?

P 4.1A. A notice was sent to Mr. Left by the registrar to furnish the information related to a business transacted during his tenure in the X company. Mr. Left ignored the notice considering that he is no more an employee of X company. Registrar issued the summon against Mr. Left. Explain in the light of the Companies Act, 2013 about the liability of Mr. Left in the given case.

[ICAI, RTP, May 2016]

Ans. The given problem relates to section 206 of the Companies Act, 2013, discussed as follows:

The legal position (Section 206)

1. The Registrar is empowered to issue a written notice to a company requiring such company –
   (i) to furnish in writing such information or explanation, within such reasonable time, as may be specified in the notice; or
   (ii) to produce such documents, within such reasonable time, as may be specified in the notice.
2. Where the information or explanation required to be furnished to the Registrar relates to any past period, the officers who had been in the employment of the company for such period, if so called upon by the Registrar through a notice served on them in writing, shall also furnish such information or explanation to the best of their knowledge.

The given case and analysis of the case

The Registrar sent a notice to Mr. Left requiring Mr. Left to furnish some information relating to certain transactions of X Company. At the time when notice is sent to Mr. Left, he is not an employee of X Company. However, he was an employee of X Company during the past period to which the information relates.

An analysis of section 206 makes it evident that a past employee shall be bound to furnish information to the Registrar if the following 2 conditions are satisfied:

(i) The Registrar has served a written notice to the past employee requiring him to furnish the information.

(ii) The information relates to such past period during which the past employee was an employee of the company.

Conclusion

Since the Registrar has issued a written notice to Mr. Left and the information required by the Registrar relates to the past period during which Mr. Left was an employee of X Company, Mr. Left is bound to furnish to the Registrar the information required by the Registrar.

Power of the Registrar to conduct inquiry where a complaint is made to him by the shareholders and other issues

P 4.1B. A group of shareholders of M/s FMG Limited made a complaint to the concerned Registrar of Companies (RoC), that the business of the company is being carried on for unlawful and fraudulent purposes and filed an application to inquire into the affairs of the company. Referring to and analysing the provisions of the Companies Act, 2013, decide:

(i) Whether the RoC has the power to order for an inquiry into the affairs of the company?

(ii) If yes, state the procedure to be followed by the RoC.

(iii) Whether the inquiry should be pursued by the RoC in case the complaint is withdrawn by the same group of shareholders subsequent to the order for inquiry?

(iv) Whether the Central Government has the power to direct the RoC to carry out the inquiry? [CA (Final) Nov. 2019]

Ans. The given problem relates to section 206(4) of the Companies Act, 2013, discussed as follows:

The legal position [Section 206(4)]

1. Section 206(4) empowers the Registrar to call upon the company to furnish in writing any information or explanation on matters specified in the order within such time as he may specify therein. The Registrar is also empowered to carry out such inquiry as he deems fit, after providing the company a reasonable opportunity of being heard.
2. The registrar may exercise such powers if he is satisfied, on the basis of information available with or furnished to him or on a representation made to him by any person, that –
   (i) 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
   (ii) the grievances of investors are not being addressed.
3. Before exercising the powers conferred on him under section 206(4), the Registrar shall, by a written order, inform the company of the allegations made against it.
4. 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.
5. The Central Government may, if it is satisfied that the circumstances so warrant, direct the Registrar or an inspector appointed by it to carry out such inquiry.

The given case and analysis of the case

6. A complaint has been made to the Registrar by a group of shareholders of M/s FMG Limited alleging that the business of the company is being carried on for unlawful and fraudulent purposes.
7. The complainants have requested the Registrar to conduct an inquiry into the affairs of M/s FMG Limited.

Conclusions

(i) The Registrar is empowered to make an order of inquiry into the affairs of M/s FMG Limited, if he is satisfied, on perusal of the complaint made by the group of shareholders, that the business of M/s FMG Limited is being carried on for a fraudulent or unlawful purpose or not in compliance with the provisions of this Act or the grievances of investors are not being addressed.

(ii) Before making an order for conduct of inquiry, the Registrar shall inform M/s FMG Limited with respect to the allegations made against it. Also, an opportunity of being heard shall be given to M/s FMG Limited before making such order.

(iii) Issue raised in the given question is: If after an inquiry is ordered by the Registrar, the complaint is withdrawn by the group of shareholders who had made such a complaint, whether the Registrar should pursue the inquiry or not? Neither section 206 nor any other section contained in the Companies Act, 2013 makes any provision in this respect. Going by the intention of law, it seems reasonable that once an order for conduct of inquiry is passed, the inquiry should be completed even where the complaint is withdrawn, and on conclusion of such inquiry, if it is established that the business of the company had been conducted for unlawful or fraudulent purposes, necessary consequential steps and actions should be taken in accordance with the provisions contained in the Act. Therefore, once an inquiry is ordered, it should be completed.

(iv) Section 206(4) empowers the Central Government to issue a direction to the Registrar or an inspector appointed by it to carry out an inquiry into the affairs of a company, if the circumstances so warrant. Where it is alleged that the business of a company is being carried on for unlawful or fraudulent purposes, such situation shall be covered within the words 'the circumstances so warrant'. Therefore, in the given case, the Central Government is empowered to direct the Registrar to carry out the inquiry into the affairs of M/s FMG Limited.

4.2 Conduct of inspection and inquiry (Section 207)

1. Duty of officers and employees to furnish documents and information [Section 207(1)]

Where the Registrar or inspector calls for the books of account and other books and papers under section 206, it shall be the duty of every director, officer or other employee of the company to –

(a) produce all such documents to the Registrar or inspector and furnish him with such statements, information or explanations in such form as the Registrar or inspector may require; and

(b) render all assistance to the Registrar or inspector in connection with such inspection.

2. **Power of Registrar or Inspector to make copies and place identification marks [Section 207(2)]**

   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.

3. **Powers of civil court vested in the Registrar and Inspector [Section 207(3)]**

   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, in respect of the following matters:

   (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.

   (c) Inspection of any books, registers and other documents of the company at any place.

4. **Punishment 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 –

   (a) imprisonment upto 1 year, and

   (b) fine, which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh.

Where any director or officer of the company is convicted of an offence under section 207, he shall vacate his office as such, and shall be disqualified from holding any office in any company.

4.3 Report on inspection made (Section 208)

1. After the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, the Registrar or inspector shall submit a report in writing to the Central Government along with such documents, as he may deem fit.
2. The report of the Registrar may include a recommendation that further investigation into the affairs of the company is necessary. The Registrar shall state the reasons supporting such recommendation.

4.4 Search and seizure (Section 209)

1. **Power of Registrar or inspector to enter, search and seize [Section 209(1)]**

   (a) Where the Registrar or inspector has reasonable ground to believe that the books and papers of a company are likely to be destroyed, mutilated, altered, falsified or secreted, he may exercise the following powers:

   (i) Enter and search the place or places where such books or papers are kept. For this purpose, he may take such assistance as may be required.

   (ii) Seize such books and papers as he considers necessary. Before seizure, he shall allow the company to take copies of, or extracts from, such books or papers. The cost of copies or extracts shall be borne by the company.

   (b) The Registrar or inspector may exercise the above powers only after obtaining an order from the Special Court for the seizure of such books and papers.

   The Registrar or inspector is also entitled to seize the books and papers relating to the key managerial personnel or any director or auditor or company secretary in practice if the company has not appointed a company secretary, subject to same conditions and limitations as are applicable to seizure of books and papers of the company.

2. **Return of books and papers seized [Section 209(2)]**

   (a) The seized books and papers shall be returned by the Registrar or inspector, as soon as possible, but within 180 days of such seizure.

   (b) The books and papers may be again called for by the Registrar or inspector for a further period of 180 days by an order in writing if they are needed again.

(c) The Registrar or inspector may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

3. **Applicability of Code of Criminal Procedure [Section 209(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.

Practical Problems from CA Examinations

Whether the Registrar is empowered to seize the books and papers on receipt of a complaint from the creditors?

P 4.4A. The Registrar of Companies, West Bengal has received a complaint from a group of creditors of a company. The complaint alleges that the directors of the company, in order to prevent the unearthing of their embezzlement of company's funds, are engaged in falsification and destruction of original accounting books and records. The complaints urged the Registrar to seize the accounting books and records of the company so that the directors may not be able to tamper the same. You are required to state the powers, if any, of the Registrar in this respect. [CA (Final) May 2004]

OR

A group of creditors of M/s XYZ Co. Ltd. makes a complaint to the registrar of companies, New Delhi, alleging that the management of the company is indulging in destruction and falsification of the accounting records of the company. The complainants request the registrar to take immediate steps to seize the records of the company, so that the management may not be allowed to tamper with the records. Examine the powers, if any, of the registrar in such circumstances.

[CA (Final) Nov. 2001]

Ans. The provisions relating to powers of the Registrar to enter, search and seize the books and papers of a company are contained in section 209 of the Companies Act, 2013.

The legal position (Section 209)

1. The Registrar may exercise the power to enter, search and seize the books and papers of a company, if –
   (i) he has reasonable ground to believe that the books and papers of a company are likely to be destroyed, mutilated, altered, falsified or secreted;
   (ii) on an application made by him to the Special Court, the Special Court makes an order for the seizure of such books and papers.
2. Before seizure, the Registrar shall allow the company to take copies of, or extracts from, such books or papers. The cost of copies or extracts shall be borne by the company.
3. The Registrar is also entitled to seize the books and papers relating to the key managerial personnel or any director or auditor or company secretary in practice, subject to same conditions and limitations as are applicable to seizure of books and papers of the company.
4. The seized books and papers shall be returned by the Registrar, as soon as possible, but within 180 days of such seizure.
5. The books and papers may be again called for by the Registrar for a further period of 180 days by an order in writing if they are needed again.
6. The Registrar may, before returning such books and papers as aforesaid, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

The given case and analysis of the case

In the given case, the Registrar has received a complaint that the directors of the company have embezzled the funds of the company, and the directors are engaged in falsification and destruction of the books and records.

If the Registrar has reasonable ground to believe that the allegations made in the complaint are true, he may make an application to the Special Court seeking an order to seize the books and papers of the company. If the Special Court makes such an order, the Registrar shall be empowered to enter, search and seize the books and papers. The Registrar shall have to return the books and papers within 180 days of such seizure. But, he may again call the books and papers for a further period of 180 days.

Conclusion

The Registrar is empowered to enter, search and seize the books and papers, but only after obtaining an order from the Special Court, and subject to the conditions and limitations contained in section 209, as discussed above.

Whether the Registrar is empowered to seize the books of the company immediately on receipt of complaint?

P 4.4B. A group of creditors of Mac Trading Limited makes a complaint to the Registrar of Companies, Hyderabad alleging that the management of the company is indulging in destruction and falsification of the accounting records of the company. The complainants request the Registrar to take immediate steps to seize the records of the company so that the management may not be allowed to tamper with the records. The complaint was received at 10 A.M. on 1st July 2015 and the ROC entered the premises at 10.30 A.M. for the search. Examine the powers of the Registrar to seize the books of the company.

[CA (Final) May 2016]

OR

A group of creditors of MBIND Bronze Limited makes a complaint to the Registrar of Companies, Himachal Pradesh alleging that the management of the company is indulging in destruction and falsification of the accounting records of the company. The complainants request the Registrar to take immediate steps to seize the records of the company so that the management may not be allowed to tamper with the records. The complaint was received at 11 am on 6th January, 2018 and the Registrar has attempted to enter the premises of the company but has been denied by the company, due to not having order from the special court. Is the contention of company valid in terms of the Companies Act, 2013? Discuss. [ICAI, RTP, Nov. 2018]

Ans. The provisions relating to powers of the Registrar to enter, search and seize the books and papers of a company are contained in section 209 of the Companies Act, 2013.

As per section 209, the Registrar may exercise the above powers only after obtaining an order from the Special Court for the seizure of such books and papers.

In the given case, the Registrar received the complaint on 1st July, 2015 at 10 a.m., and the Registrar entered the premises of the company on the same day at 10:30 a.m., *i.e.* within next 30 minutes. It is evident that the Registrar did not obtain any order from the Special Court to seize the books, which is a mandatory requirement as per section 209. If the Registrar has seized the books and papers of the company, such seizure is *ultra vires* the provisions of section 209, *i.e.* the Registrar is not authorised to enter, search and seize the books and papers.

4.5 Investigation into affairs of company (Section 210)

1. **Power of the Central Government to order investigation [Section 210(1)]**

   Where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company, –

   (a) on the receipt of a report of the Registrar or inspector under section 208;

   (b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or

   (c) in public interest,

   it may order an investigation into the affairs of the company.

2. **Duty of the Central Government to order investigation [Section 210(2)]**

   Where an order is passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated, the Central Government shall order an investigation into the affairs of that company.

3. **Appointment of inspectors by CG [Section 210(3)]**

   For the purposes of this section, the Central Government may appoint one or more persons as inspectors to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct.

Practical Problems from CA Examinations

Application made by 101 shareholders out of 500 shareholders requesting the Central Government for ordering investigation – Consequences

P 4.5A. Shareholders of Hide and Seek Ltd. are not satisfied about performance of the company. It is suspected that some activities being run in the name of the company are not in the interest of the company or its members. 101 out of total 500 shareholders of the company have made an application to the Central Government to appoint an inspector to carry out investigation and find out the true picture. With reference to the provisions of the Companies Act, 2013, mention whether the shareholders' application will be accepted? [CA (Final) Nov. 2015]

Ans. As per section 210 of the Companies Act, 2013, the Central Government is empowered to order an investigation into the affairs of the company if it is of the opinion that such investigation is necessary –

(a) on the receipt of a report of the Registrar or inspector under section 208;

(b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or

(c) in public interest.

In the given case, the application to the Central Government requesting investigation into the affairs of the company has been made by some shareholders. No general meeting of the company has been held, and no special resolution has been passed that the affairs of the company ought to be investigated. Since, the requirement of section 210 with respect to passing of the special resolution has not been complied with, the application made by 101 shareholders is bound to be rejected.

However, section 210 empowers the Central Government to order investigation into the affairs of the company, if the Central Government is of the opinion that such investigation is in public interest. Thus, the Central Government has discretion to order the investigation if it is of the opinion that such investigation is necessary in the public interest. Section 210 does not anyway restrict the power of the Central Government to order investigation, *i.e.* the Central may make an

order of investigation *suo motu* or on receipt of an application from any person, if it is of the opinion that such investigation is necessary in the public interest. Therefore, on receiving the application from 101 shareholders, if the Central Government, after considering the allegations contained in the application, is of the opinion that an investigation into the affairs of the company is necessary in the public interest, the Central Government may order such investigation.

Manner of making an application to the Central Government seeking an order of investigation into the affairs of a company

P 4.5B. Greater DINA Investors Association made a complaint by an informal letter to the Central Government that management of Secret Limited has been indulging in fraudulent activities causing loss to the shareholders and that an investigation should be carried out to find out the whole truth. On receipt of the letter, the Central Government directed the Association to approach them formally after complying with the provisions of the Companies Act, 2013. Advise the Association. [CA (Final) Nov. 2016]

OR

Shareholders of Akash Ltd., not satisfied with the performance of the company, inferred that some activities conducted by the company are against the interest of the members of the company. Group of shareholders of the company filed an application to the Central Government to appoint an inspector to carry out investigation to look into the matter.
With reference to the provisions of the Companies Act, 2013, mention whether the shareholders' application is tenable? Elaborate. [ICAI, RTP, May 2017]

Ans. The given problem relates to section 210 read with section 214 of the Companies Act, 2013.
As per section 210, the Central Government is empowered to order an investigation into the affairs of the company if it is of the opinion that such investigation is necessary –

(a) on the receipt of a report of the Registrar or inspector under section 208;
(b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
(c) in public interest.

As per section 214, where the Central Government receives an intimation of a special resolution under section 210 (that the affairs of the company ought to be investigated), the Central Government is empowered to require the applicants to give such security not exceeding Rs. 25,000 as may be prescribed, as it may think fit, for payment of the costs and expenses of the investigation.
In the given case, Greater DINA Investors Association made a complaint to the Central Government requesting an investigation into the affairs of the company. Such complaint has been made by way of an informal letter. It implies that no general meeting of the company has been held, and no special resolution has been passed that the affairs of the company ought to be investigated.
On receipt of the informal letter, the Central Government has directed Greater DINA Investors Association to make a formal application by complying with the provisions of the Companies Act, 2013.
Greater DINA Investors Association is advised to get a special resolution passed in the general meeting of Secret Limited. The special resolution may be passed at an Extraordinary General Meeting (by complying with the provisions of section 100, *i.e.* Calling of an Extraordinary General Meeting on requisition of members) or at an Annual General Meeting (by complying with section 111, *i.e.* Circulation of members resolution, *i.e.* proposing a resolution at the Annual General Meeting).
The formal application made by Greater DINA Investors Association to the Central Government shall state the date of passing the special resolution in the Extraordinary General Meeting or the Annual General Meeting, as the case may be. Further the application shall be accompanied by such amount, not exceeding Rs. 25,000, as has been prescribed under Rule 5 of the Companies (Inspection, Investigation and Inquiry) Rules, 2014, as the security for payment of the costs and expenses of investigation, as required under section 214. Such security deposit shall be refunded to Greater DINA Investors Association if the investigation results in prosecution.
Comment: Section 210 empowers the Central Government to make an order of investigation into the affairs of a company if the Central Government is of the opinion that such investigation is necessary in the public interest. Thus, in the given case, the Central could exercise its discretionary power to order investigation without requiring Greater DINA Investors Association to make a formal application by complying with the provisions of the Companies Act, 2013. However, the question states that the Central Government has directed Greater DINA Investors Association to make a formal application. It implies that in the given facts and circumstances, the Central Government had decided not to exercise its discretionary power to order investigation in public interest.

Whether the power of the Central Government to order an investigation is mandatory or discretionary, where it receives an intimation of special resolution passed by the company?

P 4.5C. The shareholders of Kumar Ltd. passed a special resolution that the affairs of the company ought to be investigated. The company submitted the special resolution to the Central Government. Examine, explaining the relevant provision of the Companies Act, 2013, whether the power of the Central Government to order an investigation is mandatory or discretionary? [CA (Final) Nov. 2018]

Ans. The given problem relates to section 210(1) read with section 214 of the Companies Act, 2013.

The legal position

1. As per section 210(1), the Central Government is empowered to order an investigation into the affairs of the company if it is of the opinion that such investigation is necessary –
   (a) on the receipt of a report of the Registrar or inspector under section 208;
   (b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
   (c) in public interest.
2. As per section 214, where the Central Government receives an intimation of a special resolution under section 210 (that the affairs of the company ought to be investigated), the Central Government is empowered to require the applicants to give such security not exceeding Rs. 25,000 as may be prescribed, as it may think fit, for payment of the costs and expenses of the investigation.

The given case and analysis of the case

3. In the given case, a special resolution has been passed by the shareholders of Kumar Ltd. to the effect that an investigation into the affairs of the company is required.
4. A copy of the special resolution has been submitted to the Central Government seeking an order of investigation.
5. Section 210(1) has granted a discretionary power to the Central Government to order an investigation into the affairs of a company, where the Central Government receives an intimation of special resolution passed by the company. This is evident by the words "Where the Central Government is of the opinion, that it is necessary to investigate" and "it (*i.e.* the Central Government) may order an investigation into the affairs of the company" used in section 210(1).

   Section 210(1) reads as under:

   "Where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company,—
   (a) on the receipt of a report of the Registrar or inspector under section 208;
   (b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
   (c) in public interest,

   it may order an investigation into the affairs of the company."

Conclusion

6. The power of the Central Government to order an investigation into the affairs of the company is not mandatory, but is discretionary, where it receives an intimation of special resolution passed by the company.

Other Practical Problems

Submission of Report by the Registrar recommending investigation into the affairs of a company – Implications.

P 4.5D. The Registrar, after inspection of the book of accounts of PQR Ltd., submitted its report with further recommendation of investigation into the affairs of the company. Explain the law as to the recommendation for further investigation by the Registrar.

[ICAI, Mock Test Paper, October 2018]

Ans. The given problem relates to section 208 and section 210 of the Companies Act, 2013, discussed as follows:

The legal position (Section 208 and Section 210)

1. As per section 208, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, the Registrar shall submit a report in writing to the Central Government along with such documents, as he may deem fit.
2. Section 208 further provides that the report of the Registrar may include a recommendation that further investigation into the affairs of the company is necessary. The Registrar shall state the reasons supporting such recommendation.
3. As per section 210, if on the receipt of a report of the Registrar under section 208, the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company, the Central Government may order an investigation into the affairs of the company.

The given case and analysis of the case

The Registrar has, in his report made to the Central Government, made a recommendation that further investigation into the affairs of PQR Ltd. is required.

The words 'if the Central Government is of the opinion' and 'may order' used in section 210 makes it evident that where the Central Government receives a report of the Registrar recommending further investigation into the affairs of a company, the Central Government has the discretion whether or not to order an investigation into the affairs of such company.

Conclusion

Section 210 does not require the Central Government to make an order of investigation into the affairs of a company in each and every case where report of the Registrar recommends such investigation. Thus, where the Central Government receives a report of the Registrar which includes a recommendation for investigation into the affairs of a company, the Central Government may order an investigation into the affairs of a company only if it of the opinion that such an investigation is necessary.

4.6 Investigation into the affairs of a company on an order made by the Tribunal (Section 213)

The Central Government shall order an investigation of the affairs of a company if the Tribunal makes an order that an investigation into the affairs of the company is required. For conducting the investigation, the Central Government shall appoint one or more competent persons as inspectors. The inspectors shall conduct the investigation and make a report to the Central Government. The Tribunal may make an order that an investigation into the affairs of the company is required in the following 2 cases:

(i) Where an application is made to the Tribunal by eligible members that the members have a good reason for seeking an order of investigation into the affairs of the company. The application needs to be supported by such evidence as may be necessary to show that an investigation into the affairs of the company is necessary.

Members eligible to make an application to the Tribunal

(a) In case of a company having a share capital, members eligible to make an application to the Tribunal are –
  (i) 100 members; or
  (ii) one or more members holding 10% of total voting power,
  whichever is lower.

(b) In case of a company having no share capital, 1/5th of the total number of members are eligible to make an application to the Tribunal.

(ii) Where –
- an application is made to the Tribunal by any person; or
- otherwise (*i.e. suo motu*)

the Tribunal is satisfied that any of the following circumstances exist:

(a) That the business of the company is being conducted –
  – with intent to defraud its creditors, members or any other persons; *or*
  – for a fraudulent or unlawful purpose; *or*
  – in a manner oppressive of any of its members.

(b) That the company was formed for any fraudulent or unlawful purpose.

(c) That the persons concerned in the formation or management of the company have been guilty of fraud, misfeasance or other misconduct.

(d) That the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to the managing or other director or the manager of the company.

The Tribunal may make such an order only after giving a reasonable opportunity of being heard to all the parties concerned.

Practical Problems from CA Examinations

Whether an application made by 110 members holding 1/9th of total voting power is valid, are the applicants required to furnish security and whether any person other than a member can make an application?

P 4.6A. The business of Weak Fabrication Limited is conducted fraudulently and the management activities are not in the interest of the company. The paid up capital of the company is one crore rupees. A group of shareholders numbering 110 members representing 1/9 of total voting power decided to approach Tribunal (NCLT) to carry out investigation into the company's affairs under the provision of the Companies Act, 2013. They seek your advice in the following matters stating the relevant provisions of the Companies Act, 2013.

(1) Whether the group can make valid application?

(2) Other than member, can any other person make application?

(3) Are the applicants required to furnish security for payment of cost and expenses of investigation? [CA (Final) May 2018]

Ans. The given problem relates to section 213 and 214 of the Companies Act, 2013 as discussed below:

The Legal Position

As per section 213, the Central Government is duty-bound to make an order of investigation into the affairs of a company if the Tribunal makes an order that an investigation into the affairs of the company is required. The Tribunal may make an order that an investigation into the affairs of the company is required in the following 2 cases:

(i) Where an application is made to the Tribunal by eligible members that the members have a good reason for seeking an order of investigation into the affairs of the company. The application needs to be supported by such evidence as may be necessary to show that an investigation into the affairs of the company is necessary.
Members eligible to make an application to the Tribunal are as follows:
(a) In case of a company having a share capital, members eligible to make an application to the Tribunal are –
(i) 100 members; or
(ii) one or more members holding 10% of total voting power,
whichever is lower.
(b) In case of a company having no share capital, 1/5th of the total number of members are eligible to make an application to the Tribunal.

(ii) Where –
- an application is made to the Tribunal by any person; or
- otherwise (*i.e. suo motu*)

the Tribunal is satisfied that any of the following circumstances exist:
(a) That the business of the company is being conducted –
- with intent to defraud its creditors, members or any other persons; or
- for a fraudulent or unlawful purpose; or
- in a manner oppressive of any of its members.

(b) That the company was formed for any fraudulent or unlawful purpose.
(c) That the persons concerned in the formation or management of the company have been guilty of fraud, misfeasance or other misconduct.
(d) That the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to the managing or other director or the manager of the company.

The Tribunal may make such an order only after giving a reasonable opportunity of being heard to all the parties concerned.

As per section 214, the Central Government is empowered to require the applicant to give such security not exceeding Rs. 25,000 as may be prescribed, as it may think fit, for payment of the costs and expenses of the investigation. The Central Government may demand such security before appointing an inspector. The Central Government may demand such security where an investigation is ordered –
(i) in pursuance of section 210(1), *i.e.* on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
(ii) in pursuance of an order made by the Tribunal under section 213.

Answers to the questions asked

(1) Whether the group can make valid application?
The paid up capital of Weak Fabrication Limited is Rs. 1 crore. So, it is evident that the Weak Fabrication Limited is a company having share capital. In case of a company having a share capital, the application made to the Tribunal shall be valid if it satisfies even one of the following two criteria:
(i) The application is made by 100 members; or
(ii) The member(s) making the application hold 1/10th of the total voting power.
The application to the Tribunal has been made by 110 shareholders holding 1/9th of the total voting power. The application satisfies both the criteria mentioned in section 213. Therefore, the application is valid.

(2) Other than member, can any other person make application?
As per section 213, any person may make an application to the Tribunal that the business of the company is being conducted for a fraudulent or unlawful purpose etc. Thus, any person, even though he is not a member, can make an application to the Tribunal.

(3) Are the applicants required to furnish security for payment of cost and expenses of Investigation?
As per section 214, the Central Government is empowered to require the applicant to give security before appointing an inspector. The Central Government may demand such security where investigation is ordered in pursuance of an order made by the Tribunal under section 213.
Thus, where member(s) or any other person makes an application to the Tribunal seeking an order for investigation of affairs of a company, the Central Government may demand security from such member(s) or any other person.

Steps required to be taken where business of the company is conducted prejudicial to interests of the company or its members

P 4.6B. A majority of the Board of directors of M/s High Value Infotech Ltd. have realised that some of the business activities carried out in the name of the company are not in the interest of either the company or its members. They want that the company should make an application to the Central Government to appoint an inspector to carry out an investigation so as to find out the whole truth. Explain the steps that should be taken to achieve the purpose. [CA (Final) Nov. 2001]

OR

A majority of the Board of Directors of M/s Bulk Drugs Ltd. have reasons to believe that some of the business activities carried on in the name of the company are prima facie against the interests of the company and its members. They want the matter to be referred to Central Government in the form of an application for appointment of an inspector to reach to the bottom of the matter and unveil the truth. In this connection you are required to state the steps required to be taken with reference to the provisions of the Companies Act, 2013. [CA (Final) May 2007, May 2005]

Ans. The given problem relates to section 210 and 213 of the Companies Act, 2013 as discussed below:

1. As per section 210, the Central Government may order an investigation into the affairs of the company if it is of the opinion that it is necessary to investigate into the affairs of a company, –
   (a) on the receipt of a report of the Registrar or inspector under section 208;
   (b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
   (c) in public interest.
2. Further, section 210 empowers the Court or Tribunal to make an order that the affairs of a company ought to be investigated. The Court or Tribunal may make such an order during the course of any proceedings before it. When such an order is made, the Central Government shall order an investigation into the affairs of that company.
3. As per section 213, the Central Government shall order an investigation of the affairs of a company if the Tribunal makes an order that an investigation into the affairs of the company is required. The Tribunal may make an order that an investigation into the affairs of the company is required where an application is made to the Tribunal by eligible members that the members have a good reason for seeking an order of investigation into the affairs of the company. The application needs to be supported by such evidence as may be necessary to show that an investigation into the affairs of the company is necessary. The members eligible to make an application to the Tribunal are as follows:
   (a) In case of a company having a share capital, members eligible to make an application to the Tribunal are –
      (i) 100 members; or
      (ii) one or more members holding 10% of total voting power,
      whichever is lower.
   (b) In case of a company having no share capital, 1/5th of the total number of members are eligible to make an application to the Tribunal.
4. Further, as per section 213, the Central Government shall order an investigation of the affairs of a company if the Tribunal makes an order that an investigation into the affairs of the company is required. The Tribunal may make an order that an investigation into the affairs of the company where an application is made to the Tribunal by any person or otherwise (*i.e. suo motu*) the Tribunal is satisfied that any of the following circumstances exist:
   (a) That the business of the company is being conducted –
      (i) with intent to defraud its creditors, members or any other persons; or
      (ii) for a fraudulent or unlawful purpose; or
      (iii) in a manner oppressive of any of its members.
   (b) That the company was formed for any fraudulent or unlawful purpose.
   (c) That the persons concerned in the formation or management of the company have been guilty of fraud, misfeasance or other misconduct.
   (d) That the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to the managing or other director or the manager of the company.

   The Tribunal may make such an order only after giving a reasonable opportunity of being heard to all the parties concerned.
5. In the present case, following options are open to the Board of directors of M/s High Value Infotech Ltd.:
   (a) The Board of directors may get a special resolution passed in a general meeting of the company, and then an application may be made to the Central Government for seeking an order of investigation into the affairs of the company. On receipt of such application, the Central Government may order an investigation of the affairs of the company (Section 210).
   (b) If the directors of M/s High Value Infotech Ltd. satisfy the eligibility criterion contained in section 213, then, they may, in the capacity of members, make an application to the Tribunal under section 213. If the Tribunal makes an order that an investigation into the affairs of the company is required, the Central Government shall order an investigation of the affairs of a company.

(c) Even if the directors of M/s High Value Infotech Ltd. do not satisfy the eligibility criterion contained in section 213, they may make an application to the Tribunal seeking an order of investigation on any of the four grounds mentioned in section 213, as discussed above. If the Tribunal makes an order that an investigation into the affairs of the company is required, the Central Government shall order an investigation of the affairs of a company.

Whether a creditor who is not a member, can make an application to the Tribunal seeking an order of investigation into the affairs of a company?

P 4.6C. Some creditors of NTY Limited approached you to guide them to apply to the Tribunal for seeking an order for conducting an investigation into the affairs of the company due to the fact that the business of the company is being conducted with intention to defraud its creditors. Referring to the provisions of the Companies Act, 2013, guide them regarding the circumstances under which and how a person, not being a member of the company, can apply to the Tribunal to seek an order for conducting an investigation into the affairs of a company. [CA (Final) May 2018]

Ans. The given problem relates to section 213 of the Companies Act, 2013 as discussed below:

The circumstances under which a person, not being a member of the company, can make an application to the Tribunal seeking an order of investigation into the affairs of the company

As per **section 213, the Central Government is duty-bound to make an order of investigation** into the affairs of a company **if the Tribunal makes an order** that an investigation into the affairs of the company is required. The Tribunal **may make an order that an investigation** into the affairs of the company is required where an application is made to the **Tribunal by any person or otherwise** *(i.e. suo motu)* and the Tribunal is satisfied that any of the following circumstances exist:

(a) That the **business of the company** is being conducted –
- with intent to **defraud** its creditors, members or any other persons; or
- for a **fraudulent or unlawful purpose**; or
- in a manner **oppressive** of any of its members.

(b) That the company was **formed** for any **fraudulent or unlawful purpose**.

(c) That the persons concerned in the formation or management of the company have been guilty of fraud, **misfeasance or other misconduct**.

(d) That **the members** of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to the managing or other director or the manager of the company.

The Tribunal may make such an order only after giving a **reasonable opportunity** of being heard to all the parties concerned.

Thus, section 213 empowers any person, even though he is not a member, to make an application to the Tribunal on the ground that the business of the company is being conducted for a fraudulent or unlawful purpose etc.

Therefore, the creditors of NTY Limited are advised to make an application to the Tribunal under section 213 of the Companies Act, 2013.

4.7 Establishment of Serious Fraud Investigation Office (Section 211 and Rule 3)

1. Establishment of SFIO [Section 211(1)]

The Central Government shall, by **notification**, establish an office to be called the Serious Fraud Investigation Office to investigate frauds relating to a company.

2. Situation until SFIO is set up [Proviso to Section 211(1)]

Until the Serious Fraud Investigation Office is established under section 211(1), the Serious Fraud Investigation Office set-up by the Central Government in terms of the **Government of India Resolution** No. 45011/16/2003-Adm-I, dated the 2nd July, 2003 shall be deemed to be the Serious Fraud Investigation Office for the purpose of this section.

3. Composition of SFIO [Section 211(2)]

(a) The Serious Fraud Investigation Office shall be **headed by a Director**.

(b) It shall consist of such number of **experts** as the Central Government may deem fit.

(c) The experts to be appointed in the Serious Fraud Investigation Office shall be the persons of ability, integrity **and experience** in the following fields:

(i) Banking

(ii) Corporate affairs

(iii) Taxation

(iv) Forensic audit
(v) Capital market
(vi) Information technology
(vii) Law
(viii) Such other fields as may be prescribed.

As per Rule 3 of the Companies (Inspection, Investigation and Inquiry) Rules, 2014, the Central Government may appoint persons having expertise in the fields of investigations, cyber forensics, financial accounting, management accounting, cost accounting and any other fields as may be necessary for the efficient discharge of Serious Fraud Investigation Office (SFIO) functions under the Act.

4. **Director of SFIO [Section 211(3)]**
   (a) The Central Government shall appoint a Director in the Serious Fraud Investigation Office. Such appointment shall be made by issue of a notification.
   (b) The Director shall be an officer not below the rank of a Joint Secretary to the Government of India having knowledge and experience in dealing with matters relating to corporate affairs.
5. **Officers and employees of SFIO [Section 211(4)]**
   The Central Government may appoint such experts and other officers and employees in the Serious Fraud Investigation Office as it considers necessary for the efficient discharge of its functions under this Act.
6. **Terms and conditions of officers of SFIO [Section 211(5)]**
   The terms and conditions of service of Director, experts, and other officers and employees of the Serious Fraud Investigation Office shall be such as may be prescribed.

Theoretical Questions

Q 4.7A. Explain the provisions of the Companies Act, 2013 relating to the establishment of Serious Fraud Investigation Office by the Central Government. State its composition. [ICAI, Revision Test Paper, Nov. 2016]

4.8 Investigation into the affairs of a company by Serious Fraud Investigation Office (Section 212)

1. **Power of CG to order investigation by SFIO [Section 212(1)]**
   (a) Without prejudice to the provisions of section 210, where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company by the Serious Fraud Investigation Office, –
      (i) on receipt of a report of the Registrar or inspector under section 208;
      (ii) on intimation of a special resolution passed by a company that its affairs are required to be investigated;
      (iii) in the public interest; or
      (iv) on request from any Department of the Central Government or a State Government,

      the Central Government may, by order, assign the investigation into the affairs of the said company to the Serious Fraud Investigation Office.
   (b) Where any investigation is assigned to the Serious Fraud Investigation Office, the Director may designate such number of inspectors as he may consider necessary for the purpose of such investigation.
2. **No power of any investigating agency to initiate or continue investigation [Section 212(2)]**
   Where any case has been assigned by the Central Government to the Serious Fraud Investigation Office for investigation under this Act, then –
   (a) 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;
   (b) if any investigation in such case in respect of any offence under this Act has already been initiated, it shall not be proceeded further, and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to Serious Fraud Investigation Office.
3. **Investigation by SFIO and submission of report to CG [Section 212(3)]**
   (a) The Serious Fraud Investigation Office shall conduct the investigation in the manner, and follow the procedure provided in this Chapter.
   (b) The Serious Fraud Investigation Office shall submit its report to the Central Government within such period as may be specified in the order.

4. Powers of the Investigating Officer [Section 212(4)]

The Director shall cause the affairs of the company to be investigated by an Investigating Officer who shall have the powers of the inspector under section 217.

5. Duties of officers and employees of the company [Section 212(5)]

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.

6. Offences to be cognizable and conditions for release on bail [Section 212(6)]

(a) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the offences covered under section 447 of this Act shall be cognizable.

(b) No person accused of any such offence shall be released on bail or on his own bond unless –

(i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and

(ii) where the Public Prosecutor opposes the application, the Special Court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

(c) However, a person, who, is under the age of 16 years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs.

(d) The Special Court shall not take cognizance of any offence referred to this sub-section except upon a complaint in writing made by –

(i) the Director, Serious Fraud Investigation Office; or

(ii) any officer of the Central Government authorised, by a general or special order in writing in this behalf by the Central Government.

7. Limitations u/s 212(6) to be in addition to CrPC [Section 212(7)]

The limitation on granting of bail specified in section 212(6) shall be in addition to the limitations under the Code of Criminal Procedure, 1973 or any other law for the time being in force with respect to granting of bail.

8. Arrest of the person guilty of an offence [Section 212(8)]

(a) If any officer not below the rank of Assistant Director of Serious Fraud Investigation Office may arrest any person if he has reason to believe that such person is guilty of any offence punishable under section 212(6).

(b) As soon as a person is arrested, he shall be informed of the grounds on the basis of which he has been arrested.

Any officer not below the rank of Assistant Director of Serious Fraud Investigation Office may exercise the power to arrest any person only if –

(i) he is so authorised by the Central Government by a general or special order; and

(ii) there is some material in his possession on the basis of which, he has reason to believe that such person is guilty of any offence punishable under section 212(6).

The officer who makes an arrest shall record in writing the reasons for such belief.

9. Copy of order of arrest to be forwarded to SFIO [Section 212(9)]

(a) The officer who makes an arrest shall, immediately after arrest of a person, forward to the Serious Fraud Investigation Office –

(i) a copy of the order; and

(ii) the material in his possession.

(b) The copy of the order shall be forwarded in a sealed envelope, in such manner as may be prescribed.

(c) The Serious Fraud Investigation Office shall keep such order and material for such period as may be prescribed.

10. Person arrested to be produced before Magistrate [Section 212(10)]

(a) Every person who is arrested by an officer of Serious Fraud Investigation Office shall, within 24 hours, be taken to a Special Court or Judicial Magistrate or a Metropolitan Magistrate, as the case may be, having jurisdiction.

(b) The period of 24 hours shall exclude the time necessary for the journey from the place of arrest to the Special Court or Magistrate's court.

Provisions contained in the Companies (Arrests in connection with Investigation by Serious Fraud Investigation Office) Rules, 2017:

1. Where the Director, Additional Director or Assistant Director of the Serious Fraud Investigation Office (hereinafter referred to as SFIO) investigating into the affairs of a company other than a Government company or foreign company has, on the basis of material in his possession, reason to believe (the reason for such belief to be recorded in writing) that any person is guilty of any offence punishable under section 212 of the Act, he may arrest such person:
   Provided that in case of an arrest being made by Additional Director or Assistant Director, the prior written approval of the Director SFIO shall be obtained.
2. The Director SFIO shall be the competent authority for all decisions pertaining to arrest.
3. Where an arrest of a person is to be made in connection with a Government company or a foreign company under investigation, such arrest shall be made with prior written approval of the Central Government.
   Provided that the intimation of such arrest shall also be given to the Managing Director or the person in-charge of the affairs of the Government Company and where the person arrested is the Managing Director or person in-charge of the Government Company, to the Secretary of the administrative ministry concerned, by the arresting officer.
4. The Director, Additional Director or Assistant Director, while exercising powers under sub-section (8) of section 212 of the Act, shall sign the arrest order together with personal search memo in the Form appended to these rules and shall serve it on the arrestee and obtain written acknowledgement of service.
5. The Director, Additional Director or Assistant Director shall forward a copy of the arrest order along with the material in his possession and all the other documents including personal search memo to the office of Director, SFIO in a sealed envelope with a forwarding letter after signing on each page of these documents, so as to reach the office of the Director, SFIO within 24 hours through the quickest possible means.
6. An arrest register shall be maintained in the office of Director, SFIO and the Director or any officer nominated by Director shall ensure that entries with regard to particulars of the arrestee, date and time of arrest and other relevant information pertaining to the arrest are made in the arrest register in respect of all arrests made by the arresting officers.
7. The entry regarding arrest of the person and information given to such person shall be made in the arrest register immediately on receipt of the documents, in the arrest register maintained by the SFIO office.
8. The office of Director, SFIO shall preserve the copy of arrest order together with supporting materials for a period of 5 years –
   (a) from the date of judgment or final order of the Trial Court, in cases where the said judgment has not been impugned in the appellate court; or
   (b) from the date of disposal of the matter before the final appellate court, in cases where the said judgment or final order has been impugned,

   whichever is later.
9. The provisions of the Code of Criminal Procedure, 1973, relating to arrest shall be applied *mutatis mutandis* to every arrest made under this Act.

11. Interim report [Section 212(11)]

SFIO shall submit an interim report to the Central Government, if so directed by the Central Government.

12. Investigation report [Section 212(12)]

On completion of the investigation, SFIO shall submit the investigation report to the Central Government.

13. Right to obtain copies of investigation report [Section 212(13)]

Notwithstanding anything contained in this Act or in any other law for the time being in force, a copy of the investigation report may be obtained by any person concerned by making an application in this regard to the court.

14. Direction by CG to SFIO to initiate prosecution [Section 212(14)]

(a) On receipt of the investigation report, the Central Government may direct the Serious Fraud Investigation Office 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.

(b) Before making any such direction, the Central Government shall –

(i) examine the report submitted by the Serious Fraud Investigation Office; and

(ii) take such legal advice, as it may think fit.

15. Application by CG to Tribunal for orders with regard to disgorgement [Section 212(14A)]

Where the report submitted by SFIO to the Central Government states that any fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property or cash and also for holding such director, key managerial personnel, other officer or any other person liable personally without any limitation of liability.

16. Investigation report deemed to be report filed by police officer [Section 212(15)]

Notwithstanding anything contained in this Act or in any other law for the time being in force, the investigation report filed with the Special Court for framing of charges shall be deemed to be a report filed by a police officer under section 173 of the Code of Criminal Procedure, 1973.

17. Investigations under Companies Act, 1956 to continue [Section 212(16)]

Notwithstanding anything contained in this Act, any investigation or other action taken or initiated by Serious Fraud Investigation Office under the provisions of the Companies Act, 1956 shall continue to be proceeded with under that Act as if this Act had not been passed.

18. All other authorities to furnish information to SFIO and sharing of information by SFIO with other authorities [Section 212(17)]

(a) In case Serious Fraud Investigation Office has been investigating any offence under this Act, any other investigating agency, State Government, police authority, income-tax authorities having any information or documents in respect of such offence shall provide all such information or documents available with it to the Serious Fraud Investigation Office.

(b) The Serious Fraud Investigation Office shall share any information or documents available with it, with any investigating agency, State Government, police authority or income tax authorities, which may be relevant or useful for such investigating agency, State Government, police authority or income-tax authorities in respect of any offence or matter being investigated or examined by it under any other law.

Theoretical Questions from CA Examinations

Q 4.8A. Enumerate the procedures to be followed by the Serious Fraud Investigation Office to arrest a person who has been found guilty of an offence committed under section 447 of the Companies Act, 2013. [CA (Final) Nov. 2018]

Practical Problems from CA Examinations

Conditions for release of a lady aged about 32 years

P 4.8A. Mrs. Preeti, a lady aged about 32 years and Managing Director of M/s Growmore plantations Ltd., has been arrested for an offence covered under section 447 of the Companies Act, 2013 on a complaint made by the Director, Serious Fraud Investigation Officer. Mrs. Preeti seeks your legal advice as to the conditions under which she can be released on bail and the role of Special Court in this regard. [CA (Final) Nov. 2017]

Ans. The given problem relates to section 212(6) of the Companies Act, 2013.

As per section 212(6), a person accused of an offence under section 447 may be released on bail or on his own bond, by the Special Court only if –

(a) an opportunity is given to the public prosecutor to oppose the application for such release; and

(b) the Public Prosecutor either does not oppose such application for release, or if the Public Prosecutor opposes the application for release, the Special Court is satisfied that there are reasonable grounds for believing that the accused is not guilty of such offence and that he is not likely to commit any offence while on bail.

However, a person, who, is under the age of 16 years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs.

Further, section 212(6) provides that the Special Court shall not take cognizance of any offence under section 447 except upon a complaint in writing made by –

(i) the Director, Serious Fraud Investigation Office; or

(ii) any officer of the Central Government authorised, by a general or special order in writing in this behalf by the Central Government.

In the given case, the complaint to the Special Court has been made by the Director, Serious Fraud Investigation Office, and so the Special Court shall take cognizance of the offence committed by Mrs. Preeti.

Mrs. Preeti has been arrested for an offence covered under section 447. So, she can be released on bail in accordance with the provisions contained in section 212(6). Since Mrs. Preeti is a woman, she may be released on bail if the Special Court so directs, *i.e.* the Special Court has the discretion to grant bail to Mrs. Preeti even without providing any opportunity to the public prosecutor to oppose the bail application.

4.9 Security for payment of costs and expenses of investigation (Section 214 and Rule 5)

(a) Section 214 applies where an investigation is ordered by the Central Government –

(i) in pursuance of section 210(1), *i.e.* on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or

(ii) in pursuance of an order made by the Tribunal under section 213.

(b) Section 214 empowers the Central Government to require the applicant to give such security not exceeding Rs. 25,000 as may be prescribed, as it may think fit, for payment of the costs and expenses of the investigation. The Central Government may demand such security before appointing an inspector. Such security shall be refunded to the applicant if the investigation results in prosecution.

As per Rule 5 of the Companies (Inspection, Investigation and Inquiry) Rules, 2014, the prescribed amount of security is as follows:

S. No.	*Turnover (as per financial statements of previous financial year) (Rs.)*	*Amount of security (Rs.)*
1.	Turnover upto Rs. 50 crore	Rs. 10,000
2.	Turnover more than Rs. 50 crore and upto Rs. 200 crore	Rs. 15,000
3.	Turnover more than Rs. 200 crore	Rs. 25,000

4.10 Firm, body corporate or association not to be appointed as inspector (Section 215)

No firm, body corporate or other association shall be appointed as an inspector.

4.11 Investigation of membership of a company (Section 216)

1. **Discretion of CG to order investigation [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 materially influence the policy of the company; or

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

2. **Duty of CG to order investigation [Section 216(2)]**

   The Central Government shall appoint one or more inspectors if the Tribunal, by an order, directs that investigation into the membership of the company and other matters relating to the company is necessary. The purpose of the investigation is to determine the true persons –

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

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

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

3. **Scope and period of investigation [Section 216(3)]**

   While appointing an inspector for conducting the investigation of ownership of the company, the Central Government may –

   (a) define the scope of the investigation, whether as respects the matters or the period to which it is to extend or otherwise;

   (b) limit the investigation to matters connected with particular shares or debentures.

4. **Powers of inspectors [Section 216(4)]**

   The powers of the inspector shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding, is or was observed or is likely to be observed in practice and which is relevant for the purposes of his investigation.

4.12 Procedure, powers, etc., of inspectors (Section 217 and Rule 6)

1. **Duties of officers and employees to produce books and render assistance [Section 217(1)]**

   It shall be the duty of all officers and other employees and agents including the former officers, employees and agents of a company which is under investigation, 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 –

   (a) to preserve and to produce before the 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

   (b) otherwise to give to the inspector all assistance in connection with the investigation which they are reasonably able to give.

2. **Duty of any other body corporate [Section 217(2)]**

   The inspector may require any body corporate, other than a body corporate whose affairs are investigated under section 219, to –

   (a) furnish such information as may be relevant or necessary for the purposes of his investigation; or

   (b) produce such books and papers as may be relevant or necessary for the purposes of his investigation.

3. **Period of retention of books by the inspector [Section 217(3)]**

   (a) The inspector shall not keep in his custody any books and papers produced under the provisions of this section for more than 180 days.

   (b) He shall return the same to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced.

   (c) The books and papers may be again called for by the inspector if they are needed again for a further period of 180 days by an order in writing.

4. **Examination on oath [Section 217(4)]**

   (a) An inspector may examine on oath all officers and other employees and agents including the former officers, employees and agents of the company which is under investigation.

   (b) Where the affairs of any other body corporate or a person are investigated under section 219, an inspector may examine on oath all officers and other employees and agents including former officers, employees and agents of such body corporate or person.

   (c) An inspector may examine on oath any other person with the prior approval of the Central Government. However, in case of an investigation under section 212, the prior approval of Director, Serious Fraud Investigation Office shall be sufficient.

5. **Other powers of the inspectors [Section 217(5)]**

   Notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, the inspector, being an officer of the Central Government, making an investigation under this Chapter shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters:

   (a) The discovery and production of books of account and other documents, at such place and time as may be specified by such person.

   (b) Summoning and enforcing the attendance of persons and examining them on oath.

   (c) Inspection of any books, registers and other documents of the company at any place.

6. **Punishment for contravention [Section 217(6)]**

   (a) 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 –

      (i) imprisonment upto 1 year; and

      (ii) fine, which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh.

   (b) If any director or officer of the company is convicted of an offence under section 217, he shall vacate his office as such, and shall be disqualified from holding any office in any company.

7. **Notes of examination [Section 217(7)]**
   (a) Where any person is examined on oath, the notes of such examination shall be –
      (i) taken down in writing;
      (ii) read over to, or by, the person examined;
      (iii) signed by the person examined.
   (b) The notes of examination on oath may be used as evidence against such person.
8. **Punishment for contravention [Section 217(8)]**
   If any person fails without reasonable cause or refuses –
   (a) to produce to an inspector or any person authorised by him in this behalf any book or paper which is his duty to produce;
   (b) to furnish any information which is his duty to furnish;
   (c) to appear before the inspector personally when required to do so or to answer any question which is put to him by the inspector; or
   (d) to sign the notes of any examination,
   he shall be punishable with –
   (i) imprisonment upto 6 months;
   (ii) fine, which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh; and
   (iii) further fine upto Rs. 2,000 for every day after the first during which the failure or refusal continues.
9. **Duty of certain persons to assist the inspector [Section 217(9)]**
   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.
10. **Reciprocal agreements with foreign countries [Section 217(10)]**
   The Central Government may enter into an agreement with the Government of a foreign State for reciprocal arrangements to assist in any inspection, inquiry or investigation under this Act or under the corresponding law in force in that State.
11. **Reference of a matter by Indian Court to the Foreign Court [Section 217(11)]**
   (a) If, in the course of an investigation into the affairs of the company, an application is made to the competent court in India by the inspector stating that evidence is, or may be, available in a country or place outside India, such court may issue a letter of request to a court or an authority in such country or place, competent to deal with such request, to –
      (i) examine orally, or otherwise, any person, supposed to be acquainted with the facts and circumstances of the case;
      (ii) record his statement made in the course of such examination;
      (iii) require such person or any other person to produce any document or thing, which may be in his possession pertaining to the case;
      (iv) forward all the evidence so taken or collected or the authenticated copies thereof or the things so collected to the court in India which had issued such letter of request.
   (b) The letter of request shall be transmitted in such manner as the Central Government may specify in this behalf.
      As per Rule 6 of the Companies (Inspection, Investigation and Inquiry) Rules, 2014, the letter of request shall be transmitted in such manner as may be specified by the Ministry of Corporate Affairs.
   (c) Every statement recorded or document or thing received under this sub-section shall be deemed to be the evidence collected during the course of investigation.
12. **Foreign Court to refer the matter to Indian Court [Section 217(12)]**
   Upon receipt of a letter of request from a court or an authority in a country or place outside India, competent to issue such letter in that country or place for the examination of any person or production of any document or thing in relation to affairs of a company under investigation in that country or place, the Central Government may, if it thinks fit, forward such letter of request to the court concerned, which shall thereupon –
   (i) summon the person before it;
   (ii) record his statement;

(iii) cause any document or thing to be produced;

(iv) send the letter to any inspector for investigation, who shall thereupon investigate into the affairs of company in the same manner as the affairs of a company are investigated under this Act and the inspector shall submit the report to such court within 30 days or such extended time as the court may allow for further action.

13. Transmission of evidence by Indian Court to CG and by CG to Foreign Court [Proviso to Section 217(12)]

The evidence so taken or collected or copies of the evidence so authenticated or the things so collected shall be forwarded by the court, to the Central Government for transmission, in such manner as the Central Government may deem fit, to the court or the authority in country or place outside India which had issued the letter of request.

4.13 Temporary protection of employees (Section 218)

Section 218 seeks to protect the interest of the employees who disclose information to the inspectors during the investigation proceedings. The provisions of section 218 are explained hereunder:

1. Applicability of section 218

Section 218 applies where a company intends to discharge or punish (whether by way of dismissal, suspension, reduction in rank or otherwise, or by way of change in terms of employment to his disadvantage) any employee –

(a) During the pendency of any investigation under section 210, 213, 219, 216 or 212; or

(b) During the pendency of any proceeding against any person concerned in the conduct and management of the affairs of a company under Chapter XVI (*i.e.* Sections 241 to 246 containing provisions with respect to prevention of oppression and mismanagement).

2. Legal requirements

(a) Before discharging or punishing (whether by way of dismissal, suspension, reduction in rank or otherwise, or by way of change in terms of employment to his disadvantage) any employee, the company shall make an application to the Tribunal.

(b) If the company does not receive any objection of the Tribunal within 30 days, the company may proceed to take the proposed action.

The Tribunal is entitled to act unilaterally

The Tribunal is not bound to hear representatives or evidence on behalf of the parties in arriving at its opinion. The principles of natural justice are not attracted to make such a decision. The Tribunal has to form its opinion unilaterally and subjectively **[*Ashoka Marketing Ltd.* v *Additional Registrar of Companies* W.B. (1985) 57 Comp Cas 187 (Cal)].**

(c) If the company is dissatisfied with the objection raised by the Tribunal, it may, within 30 days, prefer an appeal to the Appellate Tribunal. The decision of the Appellate Tribunal shall be final and binding on the company.

As per section 423, any person aggrieved by an order of the Appellate Tribunal may, within 60 days, prefer an appeal, on any question of law, to the Supreme Court. However, as per section 218, the decision of the Appellate Tribunal is final. Thus, there is a contradiction between section 218 and section 423.

In the opinion of the Author, section 423 shall prevail over section 218, *i.e.* an appeal may be preferred to the Supreme Court against the decision of the Appellate Tribunal.

3. Effect of section 218

The provisions of section 218 shall have effect –

(a) notwithstanding anything contained in any other law for the time being in force;

(b) without prejudice to the provisions of any other law for the time being in force.

Practical Problems from CA Examinations

Suspension of employee during investigation without waiting for order of Tribunal – Whether valid?

P 4.13A. Damage Ltd., the Company wanted to suspend Mr. Z, the CFO of the company during the pendency of an investigation being conducted under the provisions of the Companies Act, 2013 on the order of Tribunal. The company approached the Tribunal on 3rd January, 2017 for the proposed action. The company on 15th February, 2017 passed an order of suspension without waiting for the orders from Tribunal. Comment upon the action taken by the company with reference to the relevant provisions of the Act. [CA (Final) May 2017]

Ans. The given problem relates to section 218 of the Companies Act, 2013.

1. Section 218 applies where a company intends to discharge or punish (whether by way of dismissal, suspension, reduction in rank or otherwise, or by way of change in terms of employment to his disadvantage) any employee during the pendency of any investigation under section 210, 213, 219, 216 or 212. Section 218 seeks to protect the interest of the employees who disclose information to the inspectors during the investigation proceedings.

2. Before taking any such action, the company is required to make an application to the Tribunal. If the company does not receive any objection of the Tribunal within 30 days, the company may proceed to take the proposed action.
3. In the given case, the company has made an application to the Tribunal on 3rd January, 2017, but the company has not received any objection of the Tribunal within 30 days (*i.e.* upto 2nd February, 2017). Therefore, the company may take any action like dismissal or suspension of the employee on or after 3rd February, 2017.
4. The suspension of Mr. Z, the CFO of the company, on 15th February, 2017 is in accordance with the provisions of section 218 of the Companies Act, 2013, and is therefore, valid.

Whether any immunity is available to a person who discloses misdeeds during examination by inspector?

P 4.13B. An inspector was appointed to investigate the affairs of a public company. Mr. WM, the works manager of the company, who is aware of certain misdeeds of the management, desires to know whether he is entitled to any protection against dismissal by the company, if he discloses the misdeeds during the course of examination by the inspector. Advise him explaining the relevant provisions of the Companies Act, 2013. [CA (Final) Nov. 2008]

OR

Pursuant to Section 210 of the Companies Act, 2013 an inspector was appointed to investigate the affairs of Sterling Trading Limited. Mr. Ahmed the General Manager (Operations) who is aware of certain misdeeds of the management, desires to know whether he is entitled to any protection against dismissal by the company if he discloses the misdeeds during the course of examination by the Inspector. Advise him explaining the relevant provisions of the Companies Act, 2013. [CA (Final) Nov. 2017]

Ans. The given problem relates to section 218 of the Companies Act, 2013.

1. Section 218 applies where a company intends to discharge or punish (whether by way of dismissal, suspension, reduction in rank or otherwise, or by way of change in terms of employment to his disadvantage) any employee during the pendency of any investigation under section 210, 213, 219, 216 or 212. Section 218 seeks to protect the interest of the employees who disclose information to the inspectors during the investigation proceedings.
2. Before taking any such action, the company is required to make an application to the Tribunal. If the company does not receive any objection of the Tribunal within 30 days, the company may proceed to take the proposed action.
3. In the given case, if Mr. WM discloses to the inspector the misdeeds of the management, he shall enjoy the immunity granted under section 218, *i.e.* the management cannot discharge him or punish him without first making an application to the Tribunal. *In other words*, if the management wishes to discharge him or punish him, the company shall have to first make an application to the Tribunal, and if the company does not receive any objection of the Tribunal within 30 days of making application to the Tribunal, only then the company can discharge or punish Mr. WM.
4. Thus, before discharging or punishing Mr. WM, the company shall have to satisfy the Tribunal that there are reasonable grounds for such action, so that Tribunal does not object to such action of the company.
5. Conclusion: Mr. WM is entitled to protection against dismissal or punishment as per the above stated provisions contained in section 218.

Termination of employee during investigation – Various situations

P 4.13C. Mr. Atul is an employee of the company ABC Limited and investigation is going on him under the provisions of Companies Act, 2013. The company wants to terminate the employee on the ground of investigation is going against him. They have filed the application to Tribunal for approval of termination. Company has not received any reply from the Tribunal within 30 days of filling the application. The company considered it as a deemed approval and terminated Mr. Atul.

(i) Is the contention of company valid at law?

(ii) What is remedy available to Mr. Atul?

(iii) What is remedy available to Mr. Atul, if reply of Tribunal has been received within 30 days of application?

[ICAI, Questions for Practice]

Ans. The given problem relates to section 218 of the Companies Act, 2013, as discussed below:

The legal position

1. Section 218 applies where a company intends to discharge or punish (whether by way of dismissal, suspension, reduction in rank or otherwise, or by way of change in terms of employment to his disadvantage) any employee during the pendency of any investigation under section 210, 213, 219, 216 or 212. Section 218 seeks to protect the interest of the employees who disclose information to the inspectors during the investigation proceedings.
2. Before taking any such action, the company is required to make an application to the Tribunal. If the company does not receive any objection of the Tribunal within 30 days, the company may proceed to take the proposed action.

The given case and analysis of the case

3. ABC Ltd. intends to terminate an employee during the pendency of an investigation. The company has made an application to the Tribunal seeking the approval of the Tribunal with respect to such termination. However, the company has not received any objection from the Tribunal within 30 days of filing of application.

Conclusions

(i) As per section 218, the company shall not terminate an employee if, within 30 days of application made to the Tribunal by the company, the company receives any objection from the Tribunal. Thus, it is evident that where the Tribunal neither makes any objection nor grants its approval within 30 days of application made to it by the company, the company is not required to wait for any reply or order of the Tribunal after the said period of 30 days.

Since the Tribunal has neither made any objection nor granted its approval within 30 days of application made to it by ABC Ltd., ABC Ltd. is entitled to terminate Mr. Atul. Thus, non-receipt of any reply from the Tribunal within 30 days of filing application can be considered as deemed approval for terminating Mr. Atul. Therefore, the contention of the company is valid.

(ii) If the Tribunal does not make any objection within 30 days of application made to it, section 218 does not grant any remedy to Mr. Atul. Thus, in such a case, ABC Ltd. shall be entitled to terminate Mr. Atul, and Mr. Atul shall have no remedy under the Companies Act, 2013. However, Mr. Atul may claim damages from ABC Ltd. under the provisions of the Contract Act, 1872, if his termination amounts to breach of contract entered into between him and ABC Ltd.

(iii) In case the Tribunal makes an order granting its approval for termination of Mr. Atul, section 218 does not grant any remedy to Mr. Atul since as per section 218, only the company is entitled to prefer an appeal to the Appellate Tribunal against the order of the Tribunal (*i.e.* where the Tribunal objects to termination). However, Mr. Atul shall be entitled to prefer an appeal to Appellate Tribunal against the order of the Tribunal, in accordance with the provisions of section 421. As per section 421, any person aggrieved by an order of the Tribunal may, within 45 days, prefer an appeal to the Appellate Tribunal. However, the Appellate Tribunal may entertain an appeal after the expiry of the said period of 45 days but within a further period not exceeding 45 days, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within that period.

Note: The Author's answers as given in (ii) and (iii) above differ from the answer given by the Board of Studies, ICAI. The answers given by ICAI are reproduced hereunder:

(ii) In this scenario, Mr. Atul has not any remedy available. As per the provision of the law appeal to the Appellate Tribunal can be made only if the person is dissatisfied with the objection raised by the Tribunal. Hence, in this case the Tribunal has not replied Mr. Atul cannot refer an appeal to Appellate Tribunal.

(iii) In this case, Mr. Atul can refer and appeal to Appellate Tribunal within 30 days of the receiving letter of objection raised by the Tribunal and with payment of Fees on Rs. 1,000 as per schedule of Fees.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

4.14 Power of inspector to conduct investigation into affairs of related companies, etc. (Section 219)

(a) If an inspector appointed under section 210 or section 212 or section 213 considers it necessary for the purposes of the investigation, he shall also investigate the affairs of –

(i) 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;

(ii) 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;

(iii) 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

(iv) any person who is or has at any relevant time been the company's managing director or manager or employee.

(b) The inspector may conduct such investigation only after obtaining the prior approval of the Central Government.

(c) If the inspector considers that the results of such investigation are relevant to the investigation of the affairs of the company for which he is appointed, he shall report the results of such investigation.

Theoretical Questions

Q 4.14A. What are the circumstances in which an inspector appointed under section 210 of the Companies Act, 2013, can investigate into affairs of related companies also? [ICAI, Revision Test Paper, Nov. 2016]

Q 4.14B. Discuss the powers of inspectors regarding investigation into affairs of related companies. [ICAI, Questions for Practice]

Practical Problems from CA Examinations

Whether inspector is empowered to conduct investigation of the holding company?

P 4.14A. During investigations conducted on the affairs of a company in the public interest, the inspector observed that the directors of the company had been acting on the instructions of the holding company and he proceeded to investigate the holding company. Is inspector permitted to do under the provisions of the Companies Act, 2013? [CA (Final) May, 2017]

Ans. The given problem relates to section 219 of the Companies Act, 2013.

1. As per section 219, an inspector is entitled to investigate into the affairs of 'related companies etc.' as specified under section 219, if the inspector considers that the results of investigation of 'related companies etc.' would be relevant to the investigation of the affairs of the company for which he has been appointed.
2. The holding company is also covered under 'related companies etc.' for the purpose of section 219.
3. Before conducting investigation of any 'related companies etc.', the inspector is required to obtain the prior approval of the Central Government.
4. In the given case, the inspector proceeded to investigate the holding company. However, the inspector has not obtained the prior approval of the Central Government.
5. The conduct of investigation of the holding company by the inspector is in violation of the provisions of section 219 of the Companies Act, 2013. So, the inspector is not permitted to conduct the investigation of the holding company until the Central Government grants approval for the same.

Difference in answer as compared to the answer given by ICAI

The Author's answer to this question differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. The relevant portion of the answer given in the Suggested Answers is reproduced hereunder:

"...Therefore, 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 for 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. In view of above, the Inspector is permitted to investigate the holding company."

In the opinion of the Author, the language used in the question makes it clear that the inspector has proceeded to investigate the affairs of the holding company without obtaining any approval of the Central Government, and therefore, the Author has concluded that it is not permitted for the inspector to conduct the investigation of the holding company. Also, to make sure that the students do not lose marks in case ICAI takes the other view in its answer (*i.e.* the assumption that the inspector had obtained the prior approval of the Central Government), the Author has made it clear in the answer that the inspector is not permitted to conduct the investigation of the holding company until the Central Government grants approval for the same.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Whether inspector is empowered to conduct investigation of the subsidiary company?

P 4.14B. Members of Sarat Solutions Ltd. are concerned about the performance of the company as they suspect gross negligence and mismanagement of the affairs of the company that may be detrimental to the interests of the company and therefore filed an application to the Central Government to appoint an inspector to carry on the investigation. Mr. X, who was appointed as inspector, is of the view that to find out the true picture it is necessary to investigate into the affairs of M/s. Hemant Softech Solutions Ltd., which is a subsidiary of Sarat Solution Ltd. Referring to and analysing the provisions of the Companies Act, 2013 decide, whether the inspector has powers to investigate into the affairs of M/s. Hemant softech Solutions Ltd.

[CA (Final) May, 2019]

Ans. The given problem relates to section 219 of the Companies Act, 2013.

1. As per section 219, an inspector is entitled to investigate into the affairs of 'related companies etc.' as specified under section 219, if the inspector considers that the results of investigation of 'related companies etc.' would be relevant to the investigation of the affairs of the company for which he has been appointed.
2. The subsidiary company is also covered under 'related companies etc.' for the purpose of section 219.
3. Before conducting investigation of any 'related companies etc.', the inspector is required to obtain the prior approval of the Central Government.
4. In the given case, the inspector is conducting the investigation of Sarat Solutions Ltd. and intends to conduct the investigation of its subsidiary company, viz. M/s Hemant Softech Solutions Ltd.
5. The inspector shall be empowered to conduct the investigation of M/s Hemant Softech Solutions Ltd., but only after obtaining the prior approval of the Central Government.

4.15 Seizure of documents by inspector (Section 220)

1. Conditions for seizure of documents

(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 are likely to be destroyed, mutilated, altered, falsified or secreted, the inspector may exercise the following powers:

(i) Enter the place or places where such books and papers are kept in such manner as may be required. For this purpose, he may take such assistance as may be required.

(ii) Seize books and papers as he may consider necessary. Before seizure, he shall allow the company to take copies of, or extracts from, such books and papers. The cost of copies or extracts shall be borne by the company.

(b) The inspector is also entitled to seize the books and papers relating to other body corporate or managing director or manager of such company, subject to same conditions and limitations as are applicable to seizure of books and papers of the company.

2. **Time period of retention of documents**

(a) The inspector shall be entitled to keep in his custody the seized books and papers for such period as he may consider necessary, but not later than the conclusion of the investigation.

(b) Thereafter, the inspector shall return the seized books and papers to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person from whose custody or power they were seized.

3. **Powers of inspector w.r.t. seized documents**

Before returning such books and papers, the inspector may take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such manner as he may consider necessary.

4. **Applicability of Code of Criminal Procedure**

The provisions of the Code of Criminal Procedure, 1973, relating to searches or seizures shall apply mutatis mutandis to every search or seizure made under this section.

4.16 Freezing of assets of company on inquiry and investigation (Section 221)

The Tribunal is empowered to impose restrictions upon (*i.e.* freeze) the assets of a company in accordance with the provisions of section 221, as explained below:

1. **Power of the Tribunal to impose restrictions on transfer of funds and assets**

(a) Discretion of the Tribunal. The Tribunal is empowered to make an order that the removal, transfer or disposal of funds, assets, properties of the company shall not take place or may take place subject to such conditions and restrictions as the Tribunal may deem fit.

(b) Freeze period. The period during which the assets shall be subject to freeze shall be specified in the order of the Tribunal. Such period shall not exceed 3 years.

2. **When can Tribunal make an order under section 221?**

The Tribunal may make an order under section 221 if it has a reasonable ground to believe that the removal, transfer or disposal of funds, assets or properties of the company is likely to take place in a manner that is prejudicial to the interests of the company or its shareholders or creditors or in public interest.

The Tribunal may make such an order –

(a) on a reference made to it by the Central Government; or

(b) in connection with any inquiry or investigation into the affairs of a company; or

(c) on receipt of any complaint made by such number of members as are specified under section 244(1); or

(d) on receipt of any complaint made by a creditor having an outstanding amount of Rs. 1 lakh against the company; or

(e) on receipt of any complaint made by any other person.

3. **Punishment for contravention**

In case of any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal, the punishment shall be as follows:

(a) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 25 lakh.

(b) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5 lakh, or with both.

Practical Problems

25 out of 100 total members make a complaint to the Tribunal seeking an order of freezing of assets of the company – Eligibility of members, and consequences of contravention of order of Tribunal

P 4.16A. The members of a company having no share capital filed a complaint against change in management of the company due to which it was likely that the affairs of the company will be conducted in a manner that it will be prejudicial to the interest of its 25 members. Total number of members of company were 100. On inquiry and investigation on the complaint, having a reasonable ground to believe that the transfer or disposal of assets of the company may be against the interests of its shareholders, the Tribunal passed an order that such transfer or disposal of assets shall not be made for one year from the date of such order.

Evaluate on the basis of the given facts, the following situations according to the Companies Act, 2013:

(a) Eligibility of the members to file a complaint.

(b) What shall be the consequences if the management disposes of certain assets in contravention of the order of the Tribunal? **[ICAI, Mock Test Paper, March 2018]**

Ans. The given problem relates to section 221 of the Companies Act, 2013, as discussed below:

1. The Tribunal is empowered to make an order that the removal, transfer or disposal of funds, assets, properties of the company shall not take place or may take place subject to such conditions and restrictions as the Tribunal may deem fit.
2. The period during which the assets shall be subject to freeze shall be specified in the order of the Tribunal. Such period shall not exceed 3 years.
3. The Tribunal may make an order under section 221 if it has a reasonable ground to believe that the removal, transfer or disposal of funds, assets or properties of the company is likely to take place in a manner that is prejudicial to the interests of the company or its shareholders or creditors or in public interest.
4. The Tribunal may make such an order –
   (a) on a reference made to it by the Central Government; or
   (b) in connection with any inquiry or investigation into the affairs of a company; or
   (c) on receipt of any complaint made by such number of members as are specified under section 244(1); or
   (d) on receipt of any complaint made by a creditor having an outstanding amount of Rs. 1 lakh against the company; or
   (e) on receipt of any complaint made by any other person.
5. As per section 244(1), the members eligible to make an application are as follows:
   (a) In case of a company having a share capital, the eligible members shall be lowest of the following:
      (i) 100 members; or
      (ii) 1/10th of the total number of members; or
      (iii) One or more members holding not less than 1/10th of the issued share capital of the company.
   (b) In case of a company having no share capital, the eligible members shall be 1/5th of total number of members.
   (c) The Tribunal has the discretion to waive the requirements as to eligibility (in the case of a company having a share capital and also in the case of a company having no share capital). Thus, the Tribunal may permit a lesser number of members to make an application.

The answers to the given questions are as under:

(i) The application to the Tribunal has been made by 25 members. The company has a total of 100 members. The application made by 25 members satisfies the criterion of '1/5th of total number of members' (*i.e.* 1/5th of 100, *i.e.* 20), and so the application satisfies the eligibility criterion.

(ii) In case of any removal, transfer or disposal of funds, assets, or properties of the company in contravention of the order of the Tribunal, the punishment shall be as follows:
   (a) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 25 lakh.
   (b) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5 lakh, or with both.

4.17 Imposition of restrictions upon securities (Section 222)

1. When can the Tribunal impose restriction upon securities?

The powers of the Tribunal become exercisable in the following cases:

(a) Where, in connection with any investigation into the membership of a company under section 216, it appears to the Tribunal, that such an order is required.

(b) Where any person makes a complaint to the Tribunal.

2. **Conditions for an order under section 222**
The Tribunal has the power to impose restrictions upon the securities for such period as it may deem fit, but not exceeding 3 years, if it is satisfied that –
(a) there is good reason to find out the relevant facts about any securities of the company; and
(b) such facts cannot be found out unless certain restrictions are imposed upon the securities.
3. **Nature of restrictions**
The Tribunal may impose such restrictions upon the securities as it may deem fit.
4. **Punishment for contravention**
Where securities of any company are issued or transferred or acted upon in contravention of the order of the Tribunal, the punishment shall be as follows:
(a) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 25 lakh.
(b) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh, or with both.

Practical Problems from CA Examinations

What is the remedy if there is an apprehension of cornering the shares of the company?

P 4.17A. Remedial Pharma Limited, over the years, enjoys a high reputation in the market and its general reserves are ten times more than the paid up capital of the company. There is a serious apprehension of cornering the shares of the company by a group of unscrupulous persons likely to result in change in the Board of directors which may be prejudicial to the public interest. The company seeks your advice as to how it can block the transfer of shares of the company under the provisions of the Companies Act, 2013. [CA (Final) Nov. 2017]

OR

ABC Limited, over years, enjoys high reputation and its general reserve is many times more than the paid up capital of the company. There is apprehension of cornering the shares of the company by some persons likely to result in change in the Board of directors which may be prejudicial to the public interest. Advise, as to how can ABC Limited block the transfer of shares of the company under the provisions of the Companies Act, 2013. [CA (Final) May 2010]

OR

Big Ball Ltd., a reputed public company, over the years, has performed excellently and its general reserve is many times more than the paid up capital of the company. The chairman of the company came to know that a group of unscrupulous persons is cornering the shares of the company and may lodge them for transfer in their names. It is apprehended that such transfer may lead to change in the composition of Board of directors which may be prejudicial to the public interest. You are required to state with reference to the provisions of the Companies Act, 2013 as to how Big Ball Ltd. can block the above stated transfer of shares. [CA (Final) May 2008]

Ans. The given problem relates to section 222 of the Companies Act, 2013.
As per section 222, the Tribunal is empowered to make an order imposing restrictions upon securities of a company. The relevant provisions of section 222 are explained as under:
1. The Tribunal may make an order imposing such restrictions upon securities as it may deem fit.
2. The Tribunal may make such an order on receipt of a complaint from any person.
3. The Tribunal may make such an order if it is satisfied that –
(a) it is necessary to find out the relevant facts about any securities of a company; and
(b) it is not possible to find out such facts unless certain restrictions are imposed upon securities.
4. The period of restrictions shall not exceed 3 years.

In the given case, there is a serious apprehension of cornering of shares of Remedial Pharma Limited. So, the company or any director of the company or any other person may make a complaint to the Tribunal that it is necessary to find out the relevant facts about the shares of the company which cannot be found out unless restrictions are imposed upon shares. If on receipt of such complaint, the Tribunal is satisfied as to the genuineness of the complaint (*e.g.* that certain unscrupulous persons might acquire the shares of Remedial Pharma Ltd. which may result in change in the composition of the Board of directors, which may consequently result in prejudice to public interest), the Tribunal may make an order imposing restrictions on transfer of the shares.

Is the Tribunal empowered to restrict further issue of securities for a period of 4 years?

P 4.17B. An investigation was ordered by the Central Government under section 216 of the Companies Act, 2013, against PKR Limited for determining the true membership of the company. In connection with this investigation, it appears to the Tribunal that there is good reason to find out the relevant facts about 9% Redeemable Cumulative Preference Shares (RCPS) issued by the company on 15.10.2017 and the Tribunal is of the opinion that unless restriction is imposed on further issue of such shares, the purpose cannot be solved.

Accordingly, the Tribunal, by an order dated 15.08.2018, directed the company that the further issue of RCPS shall be subject to restrictions for a period of four years. Despite the order of the Tribunal as above, PKR Limited proceeded with further issue of RCPS on 20.08.2018 in order to fund the working capital requirements for its expansion project.

Referring to the provisions of the Companies Act, 2013, examine the following:

(i) Can the Tribunal restrict further issue of RCPS? If yes, then to what period?

(ii) What are the penal provisions in case of contravention to the above order? [CA (Final) Nov. 2018]

Ans. The given problem relates to section 222 of the Companies Act, 2013 as discussed below:

The legal position

1. The Tribunal is empowered to make an order imposing such restrictions upon securities of a company, as it may deem fit.
2. The Tribunal may make such an order –
   (a) where, in connection with any investigation into the membership of a company under section 216, it appears to the Tribunal, that such an order is required.
   (b) where any person makes a complaint to the Tribunal.
3. The Tribunal may make such an order if it is satisfied that –
   (a) it is necessary to find out the relevant facts about any securities of a company; and
   (b) it is not possible to find out such facts unless certain restrictions are imposed upon securities.
4. The period of restrictions shall not exceed 3 years.

The given case and analysis of the case

5. The Tribunal is satisfied that there is a good reason to find out the relevant facts about 9% Redeemable Cumulative Preference Shares (RCPS) issued by PKR Ltd. and that it is not possible to find out such facts unless certain restrictions are imposed on further issue of RCPS.
6. The Tribunal has made an order imposing restrictions on further issue of RCPS by PKR Ltd.
7. The Tribunal has made such an order in connection with an investigation into the membership of PKR Ltd. under section 216.
8. The Tribunal has imposed restrictions on further issue of RCPS by PKR Ltd. for a period of 4 years.

Conclusions and answer to the problems asked

(i) Yes, the Tribunal is empowered to restrict further issue of RCPS by PKR Ltd. in accordance with the above-stated provisions of section 222. The period of restrictions on further issue of RCPS shall be such as may be ordered by the Tribunal, but such period shall not exceed 3 years.
   Thus, the order of the Tribunal is not in order in so far as further issue of RCPS has been restricted for a period of 4 years.

(ii) As per section 222, if the securities of company are issued or transferred or acted upon in contravention of the order of the Tribunal, the punishment shall be as follows:
   (a) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 25 lakh.
   (b) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh, or with both.

Power of the Tribunal to restrict further issue of shares, and period of restriction

P 4.17C. The Central Government ordered an investigation under section 216 of the companies Act, 2013 against M/s Green Wood Limited for determining the true membership of the company. In connection with this investigation a reference was made to the Tribunal. It appears to the Tribunal that there is a good reason to find out the relevant facts about the equity shares with Differential Voting Rights (DVRs) issued by the company and the Tribunal is of the opinion that unless restrictions are imposed on further issue of such equity shares for two years, the purpose cannot be solved.

Referring to the provisions of the companies Act, 2013 and Rules framed in this regard, answer:

(i) Can the Tribunal put such a restriction on further issue of shares?

(ii) Period for which such a restriction can be imposed by the Tribunal? [CA (Final) Nov. 2018]

Ans. The given problem relates to section 222 of the Companies Act, 2013 as discussed below:

The legal position

1. The Tribunal is empowered to make an order imposing such restrictions upon securities of a company, as it may deem fit.
2. The Tribunal may make such an order –
   (a) where, in connection with any investigation into the membership of a company under section 216, it appears to the Tribunal, that such an order is required.
   (b) where any person makes a complaint to the Tribunal.

3. The Tribunal may make such an order if it is satisfied that –
   (a) it is necessary to find out the relevant facts about any securities of a company; and
   (b) it is not possible to find out such facts unless certain restrictions are imposed upon securities.
4. The period of restrictions shall not exceed 3 years.

The given case and analysis of the case

5. The Tribunal is of the opinion that there is good reason to find out the relevant facts about the equity shares with Differential Voting Rights (DVRs) issued by M/s Green Wood Ltd. and that it is not possible to find out such facts unless certain restrictions are imposed on further issue of such shares.
6. The Tribunal has made an order imposing restrictions on further issue of equity shares with Differential Voting Rights by M/s Green Wood Ltd.
7. The Tribunal has made such an order in connection with an investigation into the membership of M/s Green Wood Ltd. under section 216.
8. The order of the Tribunal has imposed restrictions on further issue of equity shares with Differential Voting Rights by M/s Green Wood Ltd. for a period of 2 years.

Conclusions and answer to the problems asked

(i) Yes, the Tribunal is empowered to restrict further issue of equity shares with Differential Voting Rights by M/s Green Wood Ltd. for a period of 2 years. Such an order of the Tribunal is in accordance with the above-stated provisions of section 222.

(ii) As per section 222, the period of restrictions on further issue of equity shares with Differential Voting Rights shall be such as may be ordered by the Tribunal, but such period shall not exceed 3 years.

4.18 Inspector's report (Section 223)

1. **Interim and final report [Section 223(1)]**
   (a) On the conclusion of the investigation, the inspector shall submit a final report to the Central Government.
   (b) Before conclusion of the investigation, the inspector –
      (i) may submit interim reports to the Central Government;
      (ii) shall submit interim reports to the Central Government, if so directed by the Central Government.
2. **Report to be in writing or printed [Section 223(2)]**
   Every report of the inspector shall be in writing or printed as the Central Government may direct.
3. **Copy of report [Section 223(3)]**
   A copy of the report of the inspector may be obtained from the Central Government by –
   (a) members; or
   (b) creditors; or
   (c) any other person whose interest is likely to be affected.
4. **Authentication of report [Section 223(4)]**
   (a) The report of the inspector shall be authenticated –
      (i) by the seal, if any, of the company whose affairs have been investigated; or
      (ii) by a certificate of a public officer having the custody of the report, as provided under section 76 of the Indian Evidence Act, 1872.
   (b) Such report shall be admissible in any legal proceeding as evidence in relation to any matter contained in the report.
5. **Non-applicability [Section 223(5)]**
   Nothing in this section shall apply to the report referred to in section 212, *i.e.* investigation report of the Serious Fraud Investigation Office.

4.19 Actions to be taken in pursuance of inspector's report (Section 224)

1. **Prosecution [Section 224(1)]**
   (a) If, from an inspector's report, it appears to the Central Government that any person is guilty of any offence for which he is criminally liable, the Central Government may prosecute such person for the offence.
   (b) 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.

2. **Application for winding up of company or an order for relief from oppression or mismanagement [Section 224(2)]**

   If, after perusal of the inspector's report, it appears to the Central Government, that –

   (i) a company is liable to be wound up under this Act or under the Insolvency and Bankruptcy Code, 2016; and

   (ii) it is expedient so to do by reason of any such circumstances as are referred to in section 213,

   it may cause to be presented to the Tribunal –

   (a) a petition for the winding up of the company on the ground that it is just and equitable that it should be wound-up;

   (b) an application under section 241 (*i.e.* an application for claiming relief from oppression or mismanagement); or

   (c) both.

3. **Recovery of damages or property [Section 224(3)]**

   If from an inspector's report, it appears to the Central Government that proceedings ought, in the public interest, to be brought by the company or any body corporate whose affairs have been investigated under this Chapter –

   (a) 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

   (b) 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 that purpose in the name of such company or body corporate.

4. **Indemnity to the Central Government [Section 224(4)]**

   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 for recovery of damages or recovery of any property.

5. **Disgorgement of gain and personal liability of directors, etc. [Section 224(5)]**

   Where the report made by the inspector states that any fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement, and also for holding such person personally liable without any limitation of liability.

Practical Problems from CA Examinations

Action that may be taken by the Central Government against the managing director of the company where it appears that he might have misappropriated substantial funds

P 4.19A. The report submitted by the inspector appointed under section 210 / 213 of the Companies Act, 2013 to investigate the affairs of a company revealed that substantial funds of the company have been misappropriated by the Managing Director of the company. The Central Government is of the opinion that effective action may not be taken by the company for recovery of the funds misappropriated by the Managing Director. Examine with reference to the provisions of the Companies Act, 2013 the action that can be taken by the Central Government for recovery of damages or funds misappropriated by the Managing Director.

[CA (Final) Nov. 2009]

Ans. The given problem relates to section 224 of the Companies Act, 2013. Section 224 contains the provisions with respect to action that may be taken by the Central Government after receiving the report of the inspector.

The legal position

As per section 224, the Central Government may take any of the following actions

1. If any person appears to be guilty of an offence for which he is criminally liable, the Central Government may prosecute such person.
2. The Central Government may cause to be presented to the Tribunal, a petition for the winding up of the company.
3. The Central Government may cause to be presented to the Tribunal, an application under section 241 (*i.e.* an application for claiming relief from oppression or mismanagement.
4. If it appears to the Central Government that proceedings ought, in the public interest, to be brought by the company or any body corporate whose affairs have been investigated –

   (a) 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

   (b) 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 that purpose in the name of such company or body corporate.

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 for recovery of damages or recovery of any property.

5. Where the report made by the inspector states that any fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement, and also for holding such person personally liable without any limitation of liability.

The given case and analysis of the case

From the inspector's report, it appears that managing director of the company has misappropriated substantial funds. However, it is likely that no effective action may be taken against the managing director for recovery of such funds.

Since it is unlikely that any action would be taken by the company against the managing director for recovery of funds, and it is in the public interest that the proceedings for recovery of funds should be brought against the managing director, so, the Central Government should itself bring proceedings for the recovery of damages in the name of such company. The Central Government shall be indemnified by the company against any costs or expenses incurred by it in connection with any such proceedings.

Further, the Central Government may file an application before the Tribunal seeking an order of disgorgement and an order that the managing director shall be personally liable for taking any undue advantage or benefit.

Conclusion

The Central Government may itself bring proceedings in the name of the company for recovery of damages and file an application before the Tribunal seeking an order of disgorgement.

4.20 Expenses of investigation (Section 225)

1. The expenses of, and incidental to, an investigation by an inspector appointed by the Central (other than expenses of inspection under section 214) shall be defrayed in the first instance by the Central Government.
2. All such expenses shall be reimbursed by the following:
   (a) Any person who is convicted on a prosecution instituted, to such extent as may be specified by the court.
   (b) Any person who is ordered to pay damages or restore any property in proceedings brought against him, to such extent as may be specified by the court.
   (c) Any company or body corporate or person in whose name proceedings are brought as aforesaid, to the extent of the amount or value of any sums or property recovered by it or him as a result of such proceedings.
   With respect to such amount, there shall be a first charge on the sums or property recovered.
   (d) Unless, as a result of the investigation, a prosecution is instituted under section 224, –
      (i) any company, body corporate, or person dealt with by the report of the inspector; and
      (ii) the applicants for the investigation, where the inspector was appointed under section 213, to such extent as the Central Government may direct.

4.21 Voluntary winding-up of company, etc., not to stop investigation proceedings (Section 226)

1. **No effect of certain events on investigation**
   An investigation under Chapter XIV (*i.e.* investigation u/s 210, 213, 219, 216 or 212) may be initiated and an investigation initiated under Chapter XIV shall not be stopped or suspended because of the mere fact that –
   (a) an application has been made u/s 241 (*i.e.* an application for claiming relief from oppression or mismanagement); or
   (b) the company has passed a special resolution for voluntary winding up; or
   (c) any other proceeding for the winding up of the company is pending before the Tribunal.
2. **Situation where company is order to be wound up by the Tribunal**
   If in any proceedings pending before the Tribunal, an order of winding up is passed by the Tribunal, –
   (a) the inspector shall inform the Tribunal about the pendency of the investigation proceedings before him; and
   (b) the Tribunal shall pass such order as it may deem fit.
3. **Directors and employees not absolved from liability**
   Even if the order of winding up is passed by the Tribunal, no director or employee of the company shall be absolved from –
   (a) participating in the proceedings before the inspector; or
   (b) any liability as a result of the finding by the inspector.

Practical Problems from CA Examinations

Whether investigation may be ordered where a company has passed a special resolution for voluntary winding up?

P 4.21A. M/s Genesis paper Ltd. has been incurring business losses for past couple of years. The company, therefore, passed a special resolution for voluntary winding up. Meanwhile, complaints were made to the Tribunal and to the Central Government about foul play of the directors of the company, which adversely affected the interests of shareholders of the company as well as the public. In this situation advise whether investigation may be initiated against the company under the provisions of the Companies Act, 2013. **[CA (Final) Nov. 2017]**

Ans. The given problem relates to section 226 read with section 210 of the Companies Act, 2013.

As per section 210, the Central Government is empowered to order an investigation into the affairs of a company where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company, –

(a) on the receipt of a report of the Registrar or inspector under section 208;
(b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or
(c) in public interest.

As per section 226, an investigation under Chapter XIV (*i.e.* investigation u/s 210, 213, 219, 216 or 212) may be initiated and an investigation initiated under Chapter XIV shall not be stopped or suspended because of the mere fact that –

(a) an application has been made u/s 241 (*i.e.* an application for claiming relief from oppression or mismanagement); or
(b) the company has passed a special resolution for voluntary winding up; or
(c) any other proceeding for the winding up of the company is pending before the Tribunal.

In the given case, the Central Government may, as per section 210, order an investigation into the affairs of M/s Genesis Paper Ltd. if it is of the opinion that such an investigation is in public interest. As per section 226, the Central Government may make such an order of investigation notwithstanding that the M/s Genesis Paper Ltd. has passed a special resolution for voluntary winding up.

4.22 Saving for legal advisers and bankers (Section 227)

Section 227 grants professional immunity to the legal advisers and bankers by making the following provisions:

(a) A legal adviser shall not be bound to disclose to the Tribunal, Central Government, Registrar or inspector, any privileged communication made to him except the name and address of his client.
(b) The bankers of any company, body corporate, or other person, shall not be bound to disclose to the Tribunal, Central Government, Registrar or inspector, any information relating to the affairs of any of their customers, other than such company, body corporate, or person.

Section 227 constitutes a basic norm of professional communication incorporated in the Indian Evidence Act, 1872. Sections 126 to 129 of the Indian Evidence Act, 1872 lay down the principle that no advocate or legal advisor shall be compelled to disclose as to what communication was made to him by the client. The rule of professional communication is based on public policy and protects the interest of the client.

Theoretical Questions from CA Examinations

Q 4.22A. State the provisions relating to professional immunity to legal advisers and bankers under the Companies Act, 2013.
[CA (Final) Nov. 1998]

Practical Problems from CA Examinations

Whether the legal adviser of the company be compelled by the Registrar to disclose communication made by him to the company?

P 4.22A. Mr. Sharma is a legal advisor of M/s ABC Ltd. and in that capacity he has rendered legal advice by way of a written communication to the company. The registrar of companies, Mumbai, issues an order to Mr. Sharma to disclose and furnish a copy of the communication made by him. Examine the power of the registrar to call for the said document from Mr. Sharma.
[CA (Final) Nov. 2002]

Ans. The given problem relates to section 227 of the Companies Act, 2013.

As per section 227, a legal adviser shall not be bound to disclose to the Tribunal, Central Government, Registrar or inspector, any privileged communication made to him except the name and address of his client.

Section 227 constitutes a basic norm of professional communication incorporated in the Indian Evidence Act, 1872, according to which no advocate or legal advisor shall be compelled to disclose as to what communication was made to him by the client. The rule of professional communication is based on public policy and protects the interest of the client.

As per section 206, the Registrar is empowered to issue a written notice and demand information or explanation and require production of documents from –

(a) the company;

(b) any officer or employee of the company;

(c) any past officer or employee of the company.

As is evident from a study of section 206, the Registrar has no power to demand any information or explanation or require production of books from the legal adviser of the company.

In the given case, Mr. Sharma is a legal adviser of M/s ABC Ltd., and the Registrar issued an order to Mr. Sharma requiring him to disclose the communication made by him to ABC Ltd. The Registrar has also demanded a copy of the communication made by Mr. Sharma to M/s ABC Ltd.

The Registrar is not empowered to issue an order requiring Mr. Sharma to disclose any communication made by him to the company under section 206 or any other provision of the Act. Rather, section 227 expressly restricts the Registrar from issuing any order to any legal adviser of the company, requiring him to disclose any communication between him and the company.

Conclusion: The Registrar is not empowered to call for the said document from Mr. Sharma.

4.23 Inquiry, inspection and investigation of foreign companies (Section 228)

As per section 228, the provisions of Chapter XIV of the Companies Act, 2013 consisting of Sections 206 to 229 shall also apply to foreign companies.

4.24 Penalty for furnishing false statement, mutilation, destruction of documents (Section 229)

Where a person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation, or an officer or other employee of a company or other body corporate which is also under investigation, –

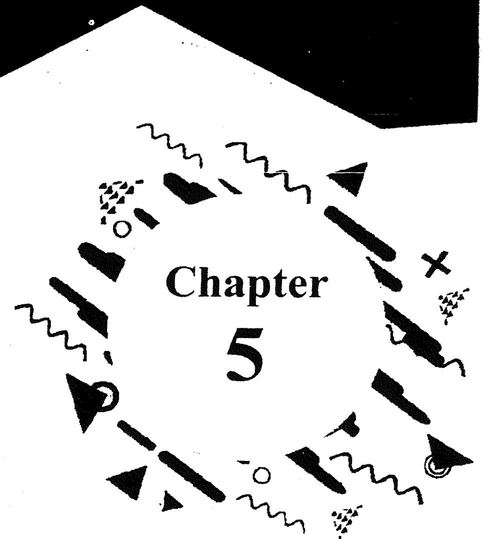
(a) destroys, mutilates or falsifies, or conceals or tampers or unauthorisedly removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company or the body corporate;

(b) makes, or is a party to the making of, a false entry in any document concerning the company or body corporate; or

(c) provides an explanation which is false or which he knows to be false,

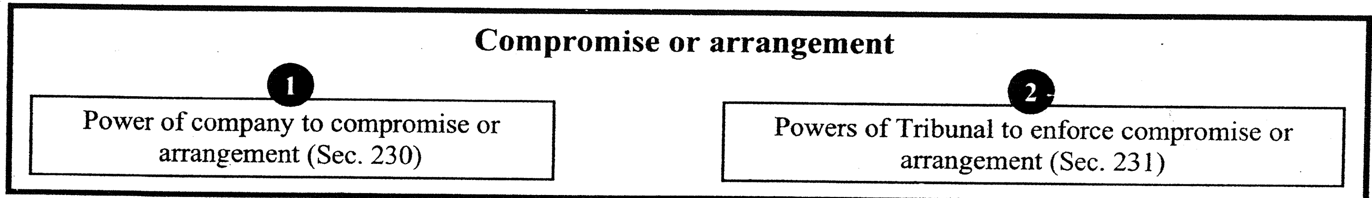
he shall be punishable for fraud in the manner as provided in section 447.

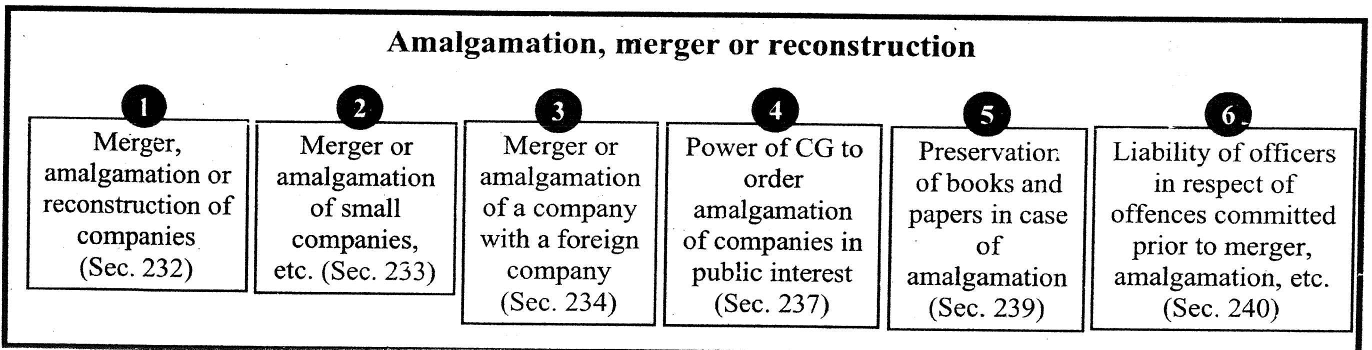
Compromises, Arrangements and Amalgamations

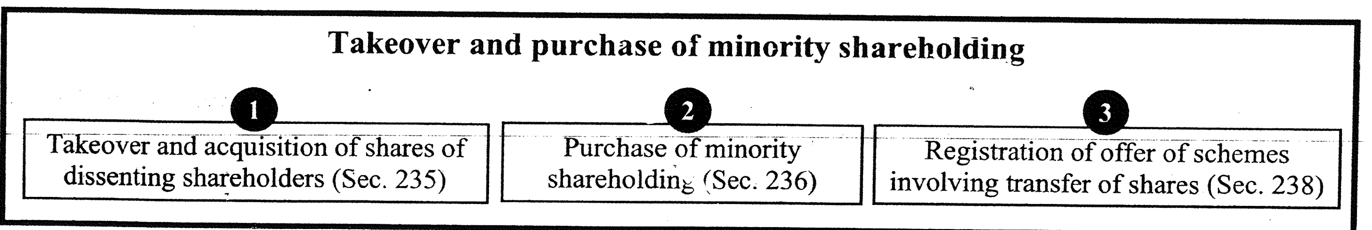


(Chapter XV of the Companies Act, 2013 consisting of Sections 230 to 240)

Bird's eye-view of the Chapter







Bird's eye-view of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016

Rule No.	Marginal Heading
1	Short Title and Commencement
2	Definitions

3	Application for order of a meeting
4	Disclosures in application made to the Tribunal for compromise or arrangement – Creditors Responsibility Statement
5	Directions at hearing of the application
6	Notice of meeting
7	Advertisement of the notice of the meeting
8	Notice to statutory authorities
9	Voting
10	Proxies
11	Copy of compromise or arrangement to be furnished by the company
12	Affidavit of service
13	Result of the meeting to be decided by voting
14	Report of the result of the meeting by Chairperson
15	Petition for confirming compromise or arrangement
16	Date and notice of hearing
17	Order on petition
18	Application for directions under section 232 of the Act
19	Directions at hearing of application
20	Order under section 232 of the Act
21	Statement of compliance in mergers and amalgamations
22	Report on working of compromise or arrangement
23	Liberty to apply
24	Liberty of the Tribunal
25	Merger or Amalgamation of certain companies
25A	Merger or amalgamation of a foreign company with a Company and vice versa
26	Notice to dissenting shareholders for acquiring the shares
27	Determination of price for purchase of minority shareholding
28	Circular containing scheme of amalgamation or merger
29	Appeal under sub-section (2) of section 238 of the Act

Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, any reference to any section means reference to the sections of the Companies Act, 2013.
3. In the latest Study Material issued by ICAI, only the Rule Numbers and Marginal Headings of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 have been incorporated (that too, at very few places), *i.e.* the provisions contained in these Rules have not been incorporated. Therefore, in this Chapter, the Author of this Book has included the Rule Numbers and Marginal Headings of these Rules, but has not included the provisions contained in these Rules.

5.1 Power to compromise or make arrangements with creditors and members (Section 230)

1. **Compromise or arrangement is proposed**

   A compromise or arrangement may be proposed –

   (a) between a company and its creditors or any class of them; or

   (b) between a company and its members or any class of them.

   Meaning of 'arrangement'

   Arrangement includes a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both of those methods.

2. **Application by whom?**

   An application proposing a compromise or arrangement may be made to the Tribunal by –

   (a) the company; or

   (b) any creditor of the company;

   (c) any member of the company;

   (d) the liquidator appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be, in the case of a company which is being wound up.

3. **Disclosures along with the application**

   The company or any other person, by whom an application is made, shall make the following disclosures to the Tribunal by filing an affidavit:

   (a) All material facts relating to the company, such as –

   (i) the latest financial position of the company;

   (ii) the latest auditor's report on the accounts of the company; and

   (iii) the pendency of any investigation or proceedings against the company.

   (b) Reduction of share capital of the company, if any, included in the compromise or arrangement.

   (c) Any scheme of corporate debt restructuring consented to by not less than 75% of the secured creditors in value, including–

   (i) a creditor's responsibility statement in the prescribed form;

   (ii) safeguards for the protection of other secured and unsecured creditors;

   (iii) 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;

   (iv) where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and

   (v) 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.

4. **Discretion of Tribunal to make an order calling a meeting**

   (a) When an application proposing a compromise or arrangement is made to the Tribunal, the Tribunal may –

   (i) dismiss such application; or

   (ii) order a meeting of –

   - the creditors or class of creditors; or
   - the members or class of members.

   (b) Where a meeting is called by the Tribunal, the Tribunal may also order that such meeting shall be called, held and conducted in such manner as may be directed by the Tribunal.

5. **Notice of the meeting**

   (a) Where a meeting is proposed to be called in pursuance of an order of the Tribunal, a notice of such meeting shall be sent to –

   (i) all the creditors or class of creditors;

   (ii) all the members or class of members; and

   (iii) all the debenture-holders of the company,

   individually at their addresses registered with the company.

   (b) The notice of the meeting may also be issued by way of an advertisement. In such a case, the notice 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.

6. Enclosures to the notice of meeting

The notice of the meeting shall be accompanied by –

(a) a statement disclosing the details of the compromise or arrangement;

(b) a copy of the valuation report, if any;

(c) a Statement explaining the effect of the compromise or arrangement on the creditors, key managerial personnel, promoters and non-promoter members, debenture-holders, directors, debenture trustees; and

(d) a Statement containing such other matters as may be prescribed.

7. Placing of notice and documents on the website

(a) The notice of meeting and other documents shall be placed on the website of the company, if any.

(b) In the case of a listed company, these documents shall be sent to the SEBI and stock exchange where the securities of the companies are listed, for placing on their websites.

(c) The notice shall also be published in newspapers in such manner as may be prescribed.

8. Disclosures in notice of meeting w.r.t. manner of voting in the meeting

The notice of meeting shall disclose that the persons to whom the notice is sent may vote on the compromise or arrangement –

(a) either themselves; or

(b) through proxies; or

(c) by postal ballot, within 1 month of receipt of such notice.

9. Objection to the compromise or arrangement

Any objection to the compromise or arrangement may be made only by –

(a) persons holding not less than 10% of the shareholding; or

(b) persons having outstanding debt amounting to not less than 5% of the total outstanding debt as per the latest audited financial statement.

10. Notice and documents to be sent to certain statutory authorities, and their right to make representations

(a) The notice of meeting along with all the documents in such form as may be prescribed shall also be sent to –

(i) the Central Government;

(ii) the income-tax authorities;

(iii) the Reserve Bank of India;

(iv) the Securities and Exchange Board;

(v) the Registrar;

(vi) the respective stock exchanges;

(vii) the Official Liquidator;

(viii) the Competition Commission of India, if necessary; and

(ix) such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement.

(b) All the above authorities shall have a right to make their representations within a period of 30 days from the date of receipt of such notice. If any of the above authorities does not make any representation within the said period of 30 days, it shall be presumed that such authority has no representation to make with respect to such compromise or arrangement.

(c) Where any representation is made by any authority, the Tribunal shall consider such representation, but the Tribunal shall not be bound to accept such representation.

11. Discretion of the Tribunal to sanction the compromise or arrangement

(a) The meeting shall be held and conducted as per the directions of the Tribunal.

(b) If, at a meeting held in pursuance of order of the Tribunal, majority of persons representing 3/4th 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, the Tribunal may, by an order, sanction the compromise or arrangement.

(c) No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the Accounting Standards prescribed under section 133.

(d) Where the Tribunal makes an order sanctioning the compromise or arrangement, and such order provides for reduction of share capital of the company, the provisions of section 66 with respect to reduction of share capital shall not apply.

(e) If a compromise or arrangement is sanctioned by the Tribunal, the same shall be binding on –

(i) the company;

(ii) all the creditors or class of creditors, as the case may be;

(iii) all the members or class of members, as the case may be;

(iv) the liquidator appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be, in case of a company being wound up; and

(v) the contributories of the company.

12. Contents of order of the Tribunal

An order made by the Tribunal shall provide for all or any of the following matters:

(a) Where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable.

(b) The protection of any class of creditors.

(c) 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.

(d) If the compromise or arrangement is agreed to by the creditors, any proceedings pending before the Board for Industrial and Financial Reconstruction established under the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate.

(e) 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. Filing of order of the Tribunal

The order of the Tribunal shall be filed with the Registrar by the company within 30 days of receipt of the order.

14. Power of Tribunal to dispense with the meeting

The Tribunal may dispense with calling of a meeting of creditors or class of creditors where such creditors or class of creditors, having at least 90% in value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.

15. Condition for buy-back of securities

No compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68.

16. Takeover offer

(a) Any compromise or arrangement may include takeover offer made in such manner as may be prescribed.

(b) In case of listed companies, takeover offer shall be as per the regulations framed by SEBI.

17. Application to Tribunal and order of Tribunal

(a) An aggrieved party may make an application to the Tribunal in the event of any grievances with respect to the takeover offer of companies other than listed companies, in such manner as may be prescribed.

(b) The Tribunal may, on application, pass such order as it may deem fit.

Jurisdiction in case of Government companies

In case of Government companies, while applying the provisions of section 230, for the word 'Tribunal', wherever it occurs, the words 'Central Government' shall be substituted if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 582(E) dated 13th June, 2017].

Theoretical Questions

Q 5.1A. At the meeting of the members of M/s QRS Limited, a scheme of compromise and arrangement was approved by requisite majority. The National Company Law Tribunal (NCLT) after complying with the provisions issued an order, approving the scheme of compromise and arrangement.

List out the matter to be provided in the order issued by NCLT under section 230(7) of the Companies Act, 2013. When shall the order be filed with ROC? [CA (Final) Nov. 2019]

Practical Problems in CA Examinations

Whether the scheme has been approved or not - Various cases

P 5.1A. Examine with reference to the relevant provision of the Companies Act, 2013 whether the scheme is approved by the required majority in the following cases:

Case I. A meeting of members of a company was convened under the orders of the Tribunal to consider a scheme of compromise and arrangement. The meeting was attended by 200 members holding 5,00,000 shares in aggregate. 70 members holding 4,00,000 shares voted for the scheme. The remaining members voted against the scheme. [CA (Final) May 2006]

Case II. A meeting of members of Jaora Agricultural Equipments Limited was convened under the orders of the Tribunal for the purpose of considering a scheme of compromise and arrangement. The meeting was attended by 200 members holding 5,00,000 shares. 70 members holding 4,00,000 shares in the aggregate voted for the scheme. 120 members holding 90,000 shares in aggregate voted against the scheme. 10 members holding 10,000 shares abstained from voting. [CA (Final) Nov. 2012]

Case III. A meeting of members of ABC Limited was convened as per the orders of the Court to consider a scheme of compromise and arrangement. Notice of the meeting was sent to 1000 members holding in aggregate 500000 equity shares. The meeting was attended by 800 members holding 350000 shares. 450 members holding 240000 shares voted in favour of the scheme; 200 members holding 60000 shares voted against the scheme. The remaining 150 members abstained from voting. Explain with reference to the provisions of the Companies Act, 2013, whether the scheme is approved by the requisite majority. [CA (Final) May 2019]

Case IV. A meeting of members of DEF Limited was convened under the orders of the Tribunal for the purpose of considering a scheme of compromise and arrangement. The meeting was attended by 300 members holding 9,00,000 shares. 120 members holding 7,00,000 shares in the aggregate voted for the scheme. 140 members holding 2,00,000 shares in aggregate voted against the scheme. 40 members holding 1,00,000 shares abstained from voting. Examine with reference to the relevant provisions of the Companies Act, 2013 whether the scheme was approved by the requisite majority? [ICAI, RTP, Nov. 2017]

Case V. A meeting of members of ABC Limited was convened under the orders of the Tribunal to consider a scheme of compromise and arrangement. Notice of the meeting was sent in the prescribed manner to all the 600 members holding in the aggregate 25,00,000 shares. The meeting was attended by 450 members holding 15,00,000 shares. 210 members holding 11,00,000 shares voted in favour of the scheme. 180 members holding 3,00,000 shares voted against the scheme. The remaining members abstained from voting.

Examine with reference to the relevant provisions of the Companies Act, 2013 whether the scheme is approved by the requisite majority. [ICAI, Questions for Practice]

Ans. The given problems relate to section 230 of the Companies Act, 2013.

The legal position

Where a meeting of members is called by the Tribunal for approving a scheme of compromise or arrangement, such scheme is required to be approved by a majority of number of members who are present and voting, and such majority of members must also be the members representing 3/4th in the value of members present and voting at the meeting. *In other words*, a scheme of arrangement between the company and members must be approved by more than 50% of the number of members who hold at least 3/4th of the value of shares. It is to be noted that members or creditors not present in the meeting or present in the meeting but abstaining from voting (*i.e.* remaining neutral) are not to be considered.

Voting by proxy shall be permitted, provided a proxy in the prescribed form duly signed by the person entitled to attend and vote at the meeting is filed with the company at its registered office not later than 48 hours before the meeting. However, a minor shall not be appointed as a proxy.

Case I.

■ Members who attended the meeting	200 members
■ Shares held by the members who attended the meeting	5,00,000 shares
■ Members who voted in favour of the scheme	70 members
■ Shares held by the members who voted in favour of the scheme	4,00,000
■ Members who voted against the scheme	130 members
■ Shares held by the members who voted against the scheme	1,00,000
■ Number of members who have voted, whether in favour of, or against, the scheme	200
■ Number of shares held by the members who have voted, whether in favour of, or against, the scheme	5,00,000
■ Number of members who should have voted in favour, for the purpose of approving the scheme	101 or more
■ Number of shares that should have been held by the members who have voted in favour, for the purpose of approving the scheme	3,75,000

Conclusion of Case I.

The scheme has been approved by members holding 4,00,000 shares. Thus, the requirement of approval of the scheme by the members representing 3/4th in the value of members present and voting at the meeting (*i.e.* members holding 3,75,000 or more shares, in this case) has been satisfied.

The scheme has been approved by 70 members only. Thus, the requirement of approval of scheme by the majority of number of members, present and voting at the meeting (*i.e.* 101 or more members, in this case) has not been satisfied.

It is evident that the requirements of approval by members in terms of 'majority of number of members' and '3/4th in the value of members' are cumulative, *i.e.* these are two separate compliances. Accordingly, the scheme has not been approved by the requisite majority, and therefore, this scheme shall not be sanctioned by the Tribunal.

Case II.

- Members who attended the meeting — 200 members
- Shares held by the members who attended the meeting — 5,00,000 shares
- Members who voted in favour of the scheme — 70 members
- Shares held by the members who voted in favour of the scheme — 4,00,000
- Members who voted against the scheme — 120 members
- Shares held by the members who voted against the scheme — 90,000
- Members who abstained from voting — 10 members
- Shares held by the members who abstained from voting — 10,000
- Number of members who have voted, whether in favour of, or against, the scheme — 190
- Number of shares held by the members who have voted, whether in favour of, or against, the scheme — 4,90,000
- Number of members who should have voted in favour, for the purpose of approving the scheme — 96 or more
- Number of shares that should have been held by the members who have voted in favour, for the purpose of approving the scheme — 3,67,500 or more

Conclusion of Case II.

The scheme has been approved by members holding 4,00,000 shares. Thus, the requirement of approval of the scheme by the members representing 3/4th in the value of members present and voting at the meeting (*i.e.* members holding 3,67,500 or more shares, in this case) has been satisfied.

The scheme has been approved by 70 members only. Thus, the requirement of approval of scheme by the majority of number of members, present and voting at the meeting (*i.e.* 96 or more members, in this case) has not been satisfied.

It is evident that the requirements of approval by members in terms of 'majority of number of members' and '3/4th in the value of members' are cumulative, *i.e.* these are two separate compliances. Accordingly, the scheme has not been approved by the requisite majority, and therefore, this scheme shall not be sanctioned by the Tribunal.

Case III.

- Members who attended the meeting — 800 members
- Shares held by the members who attended the meeting — 3,50,000 shares
- Members who voted in favour of the scheme — 450 members
- Shares held by the members who voted in favour of the scheme — 2,40,000
- Members who voted against the scheme — 200 members
- Shares held by the members who voted against the scheme — 60,000
- Members who abstained from voting — 150 members
- Shares held by the members who abstained from voting — 50,000
- Number of members who have voted, whether in favour of, or against, the scheme — 650
- Number of shares held by the members who have voted, whether in favour of, or against, the scheme — 3,00,000
- Number of members who should have voted in favour, for the purpose of approving the scheme — 326 or more
- Number of shares that should have been held by the members who have voted in favour, for the purpose of approving the scheme — 2,25,000 or more

Conclusion of Case III.

The scheme has been approved by members holding 2,40,000 shares. Thus, the requirement of approval of the scheme by the members representing 3/4th in the value of members present and voting at the meeting (*i.e.* members holding 2,25,000 or more shares, in this case) has been satisfied.

The scheme has been approved by 450 members. Thus, the requirement of approval of scheme by the majority of number of members, present and voting at the meeting (*i.e.* 326 or more members, in this case) has also been satisfied.

Since the requirements of approval by members in terms of 'majority of number of members' as well as '3/4th in the value of members' have been satisfied, the scheme has been approved by the requisite majority, and therefore, the Tribunal may exercise its discretionary power to sanction the scheme.

Tutorial Note:

The Question has used the word 'Court' instead of the word 'Tribunal'. Under the Companies Act, 1956, the power to sanction the scheme of compromise or arrangement was vested with the Court. However, under the Companies Act, 2013, such power vests with the Tribunal. Therefore, the Author has answered this Question as if the word 'Tribunal' had been used in this Question.

Case IV.

- Members who attended the meeting — 300 members
- Shares held by the members who attended the meeting — 9,00,000 shares
- Members who voted in favour of the scheme — 120 members

- Shares held by the members who voted in favour of the scheme — 7,00,000
- Members who voted against the scheme — 140 members
- Shares held by the members who voted against the scheme — 2,00,000
- Members who abstained from voting — 40 members
- Shares held by the members who abstained from voting — 1,00,000
- Number of members who have voted, whether in favour of, or against, the scheme — 260
- Number of shares held by the members who have voted, whether in favour of, or against, the scheme — 9,00,000
- Number of members who should have voted in favour, for the purpose of approving the scheme — 131 or more
- Number of shares that should have been held by the members who have voted in favour, for the purpose of approving the scheme — 6,75,000 or more

Conclusion of Case IV.

The scheme has been approved by members holding 7,00,000 shares. Thus, the requirement of approval of the scheme by the members representing 3/4th in the value of members present and voting at the meeting (*i.e.* members holding 6,75,000 or more shares, in this case) has been satisfied.

The scheme has been approved by 120 members only. Thus, the requirement of approval of scheme by the majority of number of members, present and voting at the meeting (*i.e.* 131 or more members, in this case) has not been satisfied.

It is evident that the requirements of approval by members in terms of 'majority of number of members' and '3/4th in the value of members' are cumulative, *i.e.* these are two separate compliances. Accordingly, the scheme has not been approved by the requisite majority, and therefore, this scheme shall not be sanctioned by the Tribunal.

Case V.

- Members who attended the meeting — 450 members
- Shares held by the members who attended the meeting — 15,00,000 shares
- Members who voted in favour of the scheme — 210 members
- Shares held by the members who voted in favour of the scheme — 11,00,000
- Members who voted against the scheme — 180 members
- Shares held by the members who voted against the scheme — 3,00,000
- Members who abstained from voting — 60 members
- Shares held by the members who abstained from voting — 1,00,000
- Number of members who have voted, whether in favour of, or against, the scheme — 390
- Number of shares held by the members who have voted, whether in favour of, or against, the scheme — 14,00,000
- Number of members who should have voted in favour, for the purpose of approving the scheme — 196 or more
- Number of shares that should have been held by the members who have voted in favour, for the purpose of approving the scheme — 10,50,000 or more

Conclusion of Case V.

The scheme has been approved by members holding 11,00,000 shares. Thus, the requirement of approval of the scheme by the members representing 3/4th in the value of members present and voting at the meeting (*i.e.* members holding 10,50,000 or more shares, in this case) has been satisfied.

The scheme has been approved by 210 members. Thus, the requirement of approval of scheme by the majority of number of members, present and voting at the meeting (*i.e.* 196 or more members, in this case) has also been satisfied.

Since the requirements of approval by members in terms of 'majority of number of members' as well as '3/4th in the value of members' have been satisfied, the scheme has been approved by the requisite majority, and therefore, the Tribunal may exercise its discretionary power to sanction the scheme.

Procedure for giving effect to compromise or arrangement

P 5.1B. The shareholders and creditors of Superfine Limited, in a meeting convened for approval of a scheme of reconstruction of the company, passed resolutions. The scheme of reconstruction provided for the following:

(i) Sale of plant and machineries and appropriation of proceeds for payment of outstanding wages, tax dues and repayment of loan.

(ii) Unsecured creditors to forego 60% of their claims against the company and receive debentures for the balance amount. A few shareholders and creditors raised objections against the said arrangements.

Advise the directors about the steps to be taken to give effect to the proposed scheme under the Companies Act, 2013.

[CA (Final) May 2017]

OR

Overambitious Limited became sick. The shareholders and creditors of the company passed resolutions in meetings convened by the company approving a scheme of reconstruction of the company. The scheme provides for sale of vacant land and utilisation of the sale proceeds for payment of outstanding wages, sales tax dues and repayment of part of the loan taken from the bank. The unsecured creditors will have to forego 50% of their claims against the company and receive debentures for the

balance amount. Advise the directors about the steps to be taken to give effect to the proposed scheme in spite of objections raised by a few shareholders and creditors. **[CA (Final) May 2003]**

OR

What procedure must a company adopt to give effect to a compromise, when such a company is a going concern? **[CA (Final) Nov. 1986; May 1991]**

OR

M/s. Eternal Health Ltd. was facing acute financial difficulty as operations were continuously disrupted due to (a) non-availability of raw material (b) successive drought in its marketing areas and loss of demand and (c) frequent breakdown due to non-replacement of old plant and machinery. On the verge of liquidation, the Management proposes one last arrangement between creditors and the company, whereby the creditors have to forego 50% of their dues to the company. This has evoked strong protest from some of the creditors who may block the arrangement. You are requested to examine the arrangement in the light of the Companies Act, 2013 and advise the course of action/procedure to be adopted by the company to implement the same. **[CA (Final) Nov. 2014]**

Ans. The given problem relates to section 230 of the Companies Act, 2013. Section 230 contains the provisions with respect to the power of a company to compromise or make arrangement with creditors and members.

The steps to be taken by the directors / company for giving effect to the proposed scheme of compromise or arrangement are as under:

1. An application proposing a compromise or arrangement shall be made to the Tribunal. Such application may be made by –
   (a) the company; or
   (b) any creditor of the company;
   (c) any member of the company;
   (d) the liquidator.
2. All material facts relating to the company shall be disclosed to the Tribunal by way of an affidavit.
3. On receipt of an application proposing a compromise or arrangement, the Tribunal may order a meeting of the creditors and members. The Tribunal may also order that the meeting shall be called, held and conducted in such manner as may be directed by the Tribunal. However, the Tribunal may dispense with calling of a meeting of creditors, if the creditors having at least 90% in value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.
4. The notice of the meeting called by the Tribunal shall be sent to all the creditor and members. The notice shall be accompanied by –
   (a) a statement disclosing the details of the compromise or arrangement;
   (b) a copy of the valuation report, if any;
   (c) a Statement explaining the effect of the compromise or arrangement on the creditors, key managerial personnel, promoters and non-promoter members, debenture-holders, directors, debenture trustees; and
   (d) a Statement containing such other matters as may be prescribed.
5. The notice of the meeting shall also be issued by way of an advertisement.
6. The notice of the meeting and other documents shall be placed on the website of the company, if any.
7. The notice of the meeting shall be sent to the SEBI and stock exchange, in case of a listed company. Such notice shall be placed on the website of the SEBI and stock exchange.
8. The notice of meeting shall disclose that the members and creditors may vote on the compromise or arrangement –
   (a) either themselves; or
   (b) through proxies; or
   (c) by postal ballot, within 1 month of receipt of such notice.
9. Any objection to the compromise or arrangement may be made only by –
   (a) persons holding not less than 10% of the shareholding; or
   (b) persons having outstanding debt amounting to not less than 5% of the total outstanding debt as per the latest audited financial statement.
10. The notice of meeting along with all the documents shall also be sent to –
    (i) the Central Government;
    (ii) the income-tax authorities;
    (iii) the Reserve Bank of India;
    (iv) the Securities and Exchange Board;
    (v) the Registrar;
    (vi) the respective stock exchanges;
    (vii) the Official Liquidator;
    (viii) the Competition Commission of India, if necessary; and
    (ix) such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement.

11. All the above authorities shall have a right to make their representations within a period of 30 days from the date of receipt of such notice.
12. Where any representation is made by any of the above authorities, the Tribunal shall consider such representation, but the Tribunal shall not be bound to accept such representation.
13. The meeting shall be held and conducted as per the directions of the Tribunal. If, at a meeting held in pursuance of order of the Tribunal, majority of persons representing 3/4th 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, the Tribunal may, by an order, sanction the compromise or arrangement.
14. If a compromise or arrangement is sanctioned by the Tribunal, the same shall be binding on the company, all the creditors and members.
15. The order made by the Tribunal shall contain provisions with respect to variation of shareholders' rights.
16. The order of the Tribunal shall be filed with the Registrar by the company within 30 days of the receipt of the order.

Application for compromise or arrangement

P 5.1C. Who can apply to the Tribunal for compromise or arrangement? **[CA (Final) May 1989]**

Ans. As per section 230, an application proposing a compromise or arrangement may be made to the Tribunal by –

(a) the company; or
(b) any creditor of the company;
(c) any member of the company;
(d) the liquidator appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be, in the case of a company which is being wound up.

5.2 Power of Tribunal to enforce compromise or arrangement (Section 231)

1. Power to give directions

Where the Tribunal makes an orde under section 230 sanctioning a compromise or an arrangement in respect of a company, it–

(a) shall have the power to supervise the implementation of the compromise or arrangement; and
(b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

2. Power to order winding up

If the Tribunal is satisfied that the compromise or arrangement sanctioned under section 230 cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding up the company and such an order shall be deemed to be an order made under section 273.

3. Applicability of section 231 to companies for which compromise or arrangement was sanctioned before the commencement of the Companies Act, 2013

The provisions of this section shall, so far as may be, also apply to a company in respect of which an order has been made before the commencement of this Act sanctioning a compromise or an arrangement.

Jurisdiction in case of Government companies

In case of a Government company, while applying the provisions of section 231, for the word 'Tribunal', wherever it occurs, the words 'Central Government' shall be substituted if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 582(E) dated 13th June, 2017].

5.3 Merger and amalgamation of companies (Section 232)

1. Application to Tribunal for reconstruction or merger or amalgamation

As per section 232, an application may be made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement, and it may be shown to the Tribunal –

(a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction or merger or amalgamation; and

(b) that under the scheme, –

(i) the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company); or

(ii) the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is proposed to be divided among and transferred to two or more companies.

2. Order of Tribunal to call, hold and conduct the meeting, and applicability of section 230

On receipt of application, the Tribunal may 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.

When such a direction is made by the Tribunal, following provisions of section 230 shall apply *mutatis mutandis*:

- Notice of the meeting (Point No. 5 of Topic 5.1)
- Enclosures to the notice of meeting (Point No. 6 of Topic 5.1)
- Placing of notice and documents on the website (Point No. 7 of Topic 5.1)
- Disclosures in notice of meeting w.r.t. manner of voting in the meeting (Point No. 8 of Topic 5.1)
- Objection to the compromise or arrangement (Point No. 9 of Topic 5.1)
- Notice and documents to be sent to certain statutory authorities (Point No. 10 of Topic 5.1)
- Discretion of the Tribunal to sanction the compromise or arrangement (Point No. 11 of Topic 5.1)

3. Circulation of certain documents by the companies

Where the Tribunal makes an order to call, hold and conduct a meeting, merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following documents:

(a) The draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging companies.

(b) Confirmation that a copy of the draft scheme has been filed with the Registrar.

(c) A report adopted by the directors of the merging companies explaining the effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties.

(d) The report of the expert with regard to valuation, if any.

(e) A supplementary accounting statement if the last annual accounts of any of the merging companies 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.

4. Order of the Tribunal and contents of the order

If the Tribunal is satisfied that the procedure specified in this section has been complied with, it may, by order, sanction the compromise or arrangement and may make provision for the following matters:

(a) The transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company.

Such transfer shall be effective from a date to be determined by the parties unless the Tribunal, for reasons to be recorded by it in writing, decides otherwise.

(b) 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 by the transferee company to any person.

The transferee company shall not, as a result of the compromise or arrangement, hold any shares in its own name or in the name of any trust or on behalf of any of its subsidiary or associate companies, and any such shares shall be cancelled or extinguished.

(c) The continuation by or against the transferee company of any legal proceedings pending by or against any transferor company on the date of transfer.

(d) Dissolution, without winding-up, of any transferor company.

(e) 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.

(f) 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.

(g) The transfer of the employees of the transferor company to the transferee company.

(h) Where the transferor company is a listed company and the transferee company is an unlisted company, –
   (i) the transferee company shall remain an unlisted company until it becomes a listed company;
   (ii) 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 in accordance with a pre-determined price formula or after a valuation is made, and the arrangements in this regard may be made by the Tribunal.

   The amount of payment or valuation under this clause for any share shall not be less than what has been specified by the SEBI under any regulations framed by it.

(i) 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.

(j) Such incidental, consequential and supplemental matters as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out.

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

5. Power of the Tribunal to order vesting of property free from charge

Where an order of the Tribunal provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to the transferee company and the liabilities shall be transferred to and become the liabilities of the transferee company.

The Tribunal may, at its discretion, order that any property of the transferor company shall vest in the transferee company free from any charge, and consequently any such charge shall cease to have effect.

6. Filing of order of the Tribunal

Every company in relation to which an order is made by the Tribunal, shall file a certified copy of the order of the Tribunal with the Registrar within 30 days of the receipt of certified copy of the order.

7. Effective date of the scheme

The scheme 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.

Clarification under section 232(6) of the Companies Act, 2013 (General Circular No. 09/2019 dated 21st August, 2019)

(a) The provisions of section 232(6) of the Act enables the companies in question to choose and state in the scheme an 'appointed date'. This date may be –
   (i) a specific calendar date; or
   (ii) tied to the occurrence of an event such as –
      - grant of license by a competent authority; or
      - fulfilment of any preconditions agreed upon by the parties (which are relevant to the scheme); or
      - meeting any other requirement as agreed upon between the parties, etc.(which are relevant to the scheme).

(b) The 'appointed date' identified under the scheme shall also be deemed to be the 'acquisition date' and date of transfer of control for the purpose of conforming to accounting standards (including Ind-AS 103 Business Combinations).

(c) Where the 'appointed date' is chosen as a specific calendar date, it may precede the date of filing of the application for scheme of merger/amalgamation. However, if the 'appointed date' is significantly ante-dated beyond a year from the date of filing, the justification for the same would have to be specifically brought out in the scheme and it should not be against public interest.

(d) The scheme may identify the 'appointed date' based on the occurrence of a trigger event which is key to the proposed scheme and agreed upon by the parties to the scheme. This event would have to be indicated in the scheme itself upon occurrence of which the scheme would become effective. However, in case of such event based date being a date subsequent to the date of filing the order with the Registrar under section 232(5), the company shall file an intimation of the same with the Registrar within 30 days of such scheme coming into force.

8. Filing of statement until scheme is completed

(a) Every company in relation to which the order is made by the Tribunal, shall file with the Registrar a statement in such form and within such time as may be prescribed.

(b) The statement shall be filed every year until the completion of the scheme.

(c) The statement shall be duly certified by –
   (i) a chartered accountant in practice; or
   (ii) a cost accountant in practice; or
   (iii) a company secretary in practice.

(d) The statement shall indicate as to whether or not the scheme is being complied with in accordance with the orders of the Tribunal.

9. **Punishment for contravention**

If a transferor company or a transferee company contravenes the provisions of this section, then, the punishment shall be as follows:

(a) The transferor company or the transferee company, as the case may be, shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 25 lakh.

(b) Every officer of such transferor or transferee company who is in default, shall be punishable as follows:

(i) Imprisonment upto 1 year; or

(ii) Fine, which shall not be less than Rs. 1 lakh but which may extend to Rs. 3 lakh; or

(iii) Both.

10. **Meaning of certain terms for the purpose of section 232**

(i) In a scheme involving a merger, where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption, or where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, it is a merger by formation of a new company.

(ii) References to merging companies are in relation to a merger by absorption, to the transferor and transferee companies, and, in relation to a merger by formation of a new company, to the transferor companies.

(iii) A scheme involves a division, where under the scheme the undertaking, property and liabilities of the company in respect of which the compromise or arrangement is proposed are to be divided among and transferred to two or more companies each of which is either an existing company or a new company.

(iv) Property includes assets, rights and interests of every description and liabilities include debts and obligations of every description.

Jurisdiction in case of Government companies

In case of Government companies, while applying the provisions of section 232, for the word 'Tribunal', wherever it occurs, the words 'Central Government' shall be substituted if it has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92 [Notification No. G.S.R. 463(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 582(E) dated 13th June, 2017].

Theoretical Questions

Q 5.3A. Long Lasting Ltd. applied to the Tribunal for the approval of proposed merger scheme. State the process to be complied with for the approval of the proposed merger scheme drawn by the directors of Long Lasting Ltd. under the Companies Act, 2013.

[ICAI, Mock Test Paper, March, 2018]

Practical Problems from CA Examinations

Majority required for scheme of amalgamation, and when is dissolution of transferor company ordered?

P 5.3A. Answer the following with reference to a scheme of amalgamation of companies explaining the relevant provisions of the Companies Act, 2013.

(i) What is the majority required for approving the scheme of amalgamation in a meeting of members of a company called as per directions of the Tribunal? Is the scheme to be approved by preference shareholders?

(ii) When will the Tribunal order dissolution of the transferor company? [CA (Final) May 2000 (Modified)]

OR

What is the majority required for approving the scheme of amalgamation in a meeting of members of a company called as per the directions of the Tribunal? Is the scheme required to be approved by the preference shareholders? [CA (Final) May 2019]

Ans.

(i) As per section 232, for effecting the amalgamation or reconstruction of two or more companies, an application shall be made to the Tribunal under section 230, and the scheme for amalgamation or reconstruction shall be approved as per the provisions contained in section 230. As per section 230, the scheme is required to be approved by a majority of the members, who are present and voting, and such majority of members must also be the members representing 3/4th in the value of members present and voting at the meeting. *In other words*, the scheme requires approval of more than 50% of the number of members who hold at least 75% of the value of shares. It is to be noted that members not present in the meeting or present in the meeting but abstaining from voting (*i.e.* remaining neutral) are not to be counted.

Voting by proxy shall be permitted, provided a proxy in the prescribed form duly signed by the person entitled to attend and vote at the meeting is filed with the company at its registered office not later than 48 hours before the meeting. However, a minor shall not be appointed as a proxy.

Section 230 uses the expression 'member', which includes a preference shareholder also. As such, the scheme requires the approval of equity shareholders as well as preference shareholders. If a separate meeting of preference shareholders and equity shareholders is ordered, then the scheme shall be approved by preference shareholders and equity shareholders in their separate meetings.

(ii) As per section 232, the order of the Tribunal may provide for the dissolution, without winding up, of any transferor company. However, the Tribunal shall not make such an order unless it is satisfied that the procedure and legal requirements as contained in section 232 have been complied with.

Whether power to amalgamate is required in object clause?

P 5.3B. At the time of filing of the petition for amalgamation, the object clause of both the transferor and transferee companies does not contain power to amalgamate. With reference to the provisions of the Companies Act, 2013, examine the validity of the scheme of amalgamation. **[CA (Final) May 2004 (Modified)]**

OR

Explaining the relevant provisions of the Companies Act, 2013, answer whether the companies seeking sanction of the Tribunal for a scheme of amalgamation must have specific power to amalgamate in the object clause of their Memorandum of Association? **[CA (Final) Nov. 2009 (Modified)]**

Ans. The memorandum of association explains the scope of operations of a company beyond which the company cannot go. Anything done by a company outside the objects clause of memorandum is *ultra vires* the company.

However, to amalgamate with another company is a power of the company, and not an object of the company. Therefore, no power to amalgamate is required in the memorandum of a company before making an application to the Tribunal for effecting amalgamation. Also, the power to amalgamate has been given by the statute under section 232. Since there is a statutory provision dealing with amalgamation of companies (which does not require that such a provision must be present in the memorandum or articles of the company), no special power in the objects clause of the memorandum is necessary for its amalgamation with another company. Section 232 is a complete code which gives full jurisdiction to the Tribunal to sanction amalgamation of companies, even though there may be no power in the objects clause of memorandum ***[Re, EITA India Ltd.*, AIR 1997 Cal 208; *United Bank of India v United India Credit & Development Co. Ltd.* (1977) 47 Comp Cas 689, 730 (Cal)].**

Workers of the transferor company refuse to join the transferee company – Are they entitled to compensation?

P 5.3C. ABC Co. Ltd. was amalgamated with, and merged in XYZ Co. Ltd. Some workers of ABC Co. Ltd. refuse to join as workers of XYZ Co. Ltd. and claim compensation for premature termination of services. XYZ Co. Ltd. resists the claim on the ground that their services are transferred to XYZ Co. Ltd. by the order of amalgamation and merger and, therefore, the workers must join service of XYZ Co. Ltd. and cannot claim any compensation. Who will succeed the workers of ABC Co. Ltd. or the XYZ Co. Ltd.? Give reasons. **[CA (Final) Nov. 2003, Nov. 1998 (Modified)]**

OR

Sunrise Company Limited was merged with Moonlight Company Limited on account of amalgamation. Some workers of Sunrise Company Limited refused to join as workers of Moonlight Company Limited and claimed compensation on the ground of premature termination of their services. Moonlight Company Limited resists the claim of the workers on the ground that their services have been transferred to Moonlight Company Limited in view of the order of amalgamation and merger and hence the workers must join the service of Moonlight Company Limited and cannot claim any compensation.

State the powers of the Tribunal about the matters that would be considered while sanctioning the scheme of amalgamation under the provisions of the Companies Act, 2013. Decide whether the contention of the workers is justified. **[CA (Final) Nov. 2008 (Modified)]**

OR

ABC Limited was amalgamated and merged in XYZ Limited. Some workers of ABC Limited refuse to join as workers of XYZ Limited and claim compensation for premature termination of service. XYZ Limited resists the claim on the ground that their services are transferred to XYZ Limited by the order of amalgamation and merger and, therefore, the workers must join service of XYZ Limited and cannot claim any compensation. According to the provisions of the Companies Act, 2013, examine whether the workers' contention is correct. **[ICAI, Mock Test Paper, October 2018]**

Ans. Where a company (*i.e.* transferor company) is amalgamated with another company, its property, rights, undertaking and liabilities are transferred to the amalgamated company (*i.e.* transferee company). As per section 232, the order of the Tribunal sanctioning the reconstruction or amalgamation shall be sufficient to vest all the properties or liabilities in the transferee company without execution of any further document.

However, the workers of the transferor company are not 'property, rights, undertakings or liabilities'. Therefore, a question arises as to whether the services of the workers are automatically transferred to the transferee company in case of amalgamation or reconstruction. This issue was raised in ***Nokes v Doncaster Amalgamated Collieries Ltd.* (1940) 3 All ER 549**. It was held that the order of the Tribunal sanctioning the amalgamation or reconstruction does not result in automatic transfer of contracts of personal service, and in the absence of the consent of the workers, no contract of

service is created between the workers and the transferee company, and so the services of the workers cannot be transferred to the transferee company. Accordingly, where the workers refused to join the services of the transferee company, they were entitled to compensation. The decision in *Nokes* v *Doncaster Amalgamated Collieries Ltd.* was given as per the provisions contained in section 394 of the Companies Act, 1956.

As per section 232(3)(e) of the Companies Act, 2013, where the Tribunal sanctions a compromise or arrangement, it may also make an order for the transfer of the employees of the transferor company to the transferee company. Thus, section 232(3)(e) empowers the Tribunal to make an order that the services of workers shall also be transferred to the transferee company. However, no such provision existed in the Companies Act, 1956. Thus, the legal position under the Companies Act, 2013 is altogether different as compared to the legal position under the Companies Act, 1956. Under section 232 of the Companies Act, 2013, where the Tribunal makes an order that the services of workers of the transferor company shall be transferred to the transferee company, such transfer of services is binding on all the parties, *i.e.* the transferor company, the transferee company and the workers. Such transfer of services is the result of operation of law, and so no agreement or contract is required for this purpose. Accordingly, if the Tribunal makes an order for transfer of services of workers, but the workers refuse to join the services of the transferee company, the decision given in *Nokes* v *Doncaster Amalgamated Collieries Ltd.* shall not apply, and so, the workers shall not be entitled to claim any compensation.

Therefore, in the given case, the workers of ABC Co. Ltd. / Sunrise Company Limited shall not succeed against XYZ Co. Ltd. / Moonlight Company Limited, and they shall not be entitled to receive any compensation, if the Tribunal has made an order transferring the services of workers to the transferee company, *i.e.* XYZ Co. Ltd. / Moonlight Company Limited.

Procedure for demerger

P 5.3D. HPC Ltd. for a number of years was in various types of business. In order to exit from its non-core business, its management decided to hive off the business of Food Processing by demerging the said business with an associate company, namely, BCD Ltd. You are required to advise briefly, with reference to the provisions of the Companies Act, 2013, the steps the management should take to give effect to the proposed demerger. [CA (Final) May 2008, Nov. 2005 (Modified)]

OR

M/s Over-ambitious Consultants Ltd. had, in the course of its operations over the years acquired various other ventures like plantations and tourism businesses. With a view to consolidate its core business activities, the management decided to hive off its non-core activities by demerging them with an associate company. Advise briefly the steps the management should take to achieve the purpose of demerger. [CA (Final) Nov. 2001 (Modified)]

OR

Hi-tech Engineering Limited engaged in the business of engineering construction and cement manufacturing, decided to concentrate on its core business of engineering construction and hive off (demerge) its cement business in favour of Premier Cement Limited. State the steps to be taken by Hi-tech Engineering Limited to give effect to the proposed demerger under the provisions of the Companies Act, 2013. [CA (Final) May 2013]

Ans. Section 232 is required to be complied with where whole or any part of the undertaking, property or liabilities of any company is proposed to be divided among and transferred to two or more companies. Accordingly, HPC Ltd. may demerge Food Processing business by complying with the provisions of section 232. Section 232 requires that an application shall be made to the Tribunal under section 230 for the sanctioning of a compromise or arrangement, and the application shall be accompanied by a scheme which shall provide that the undertaking, property or liabilities of a company shall be transferred to another company or shall be divided among and transferred to 2 or more companies.

The procedure for demerger shall be as follows:

1. HPC Ltd. (termed as 'transferor company') shall prepare a draft scheme under which the assets and liabilities of HPC Ltd. as comprised in the Food Processing business shall be transferred to the associate company (termed as 'transferee company'). The scheme shall specify the necessary details like –
   (a) agreed values for transfer of assets and liabilities;
   (b) the consideration for the transfer;
   (c) where the transferee company issues shares to the shareholders of HPC Ltd., the exchange ratio of the shares;
   (d) other terms and conditions.
2. An application shall be made to the Tribunal by HPC Ltd. jointly with the transferee company.
3. All material facts relating to the company shall be disclosed to the Tribunal by way of an affidavit.
4. The Tribunal may order a meeting of the creditors and members. The Tribunal may also order that the meeting shall be called, held and conducted in such manner as may be directed by the Tribunal. However, the Tribunal may dispense with calling of a meeting of creditors, if the creditors having at least 90% in value, agree and confirm, by way of affidavit, to the scheme of demerger.
5. The notice of the meeting called by the Tribunal shall be sent to all the creditor and members. The notice shall be accompanied by –
   (a) a statement disclosing the details of the demerger;
   (b) a copy of the valuation report, if any;

(c) a Statement explaining the effect of the demerger on the creditors, key managerial personnel, promoters and non-promoter members, debenture-holders, directors, debenture trustees; and
(d) a Statement containing such other matters as may be prescribed.

6. The notice of the meeting shall also be issued by way of an advertisement.
7. The notice of the meeting and other documents shall be placed on the website of the company, if any.
8. The notice of the meeting shall be sent to the SEBI and stock exchange, in case of a listed company. Such notice shall be placed on the website of the SEBI and stock exchange.
9. The notice of meeting shall disclose that the members and creditors may vote on the scheme for demerger –
   (a) either themselves; or
   (b) through proxies; or
   (c) by postal ballot, within 1 month of receipt of such notice.
10. Any objection to the scheme for demerger may be made only by –
   (a) persons holding not less than 10% of the shareholding; or
   (b) persons having outstanding debt amounting to not less than 5% of the total outstanding debt as per the latest audited financial statement.
11. The notice of meeting along with all the documents shall also be sent to –
   (i) the Central Government;
   (ii) the income-tax authorities;
   (iii) the Reserve Bank of India;
   (iv) the Securities and Exchange Board;
   (v) the Registrar;
   (vi) the respective stock exchanges;
   (vii) the Official Liquidator;
   (viii) the Competition Commission of India, if necessary; and
   (ix) such other sectoral regulators or authorities which are likely to be affected by the scheme for demerger.
12. All the above authorities shall have a right to make their representations within a period of 30 days from the date of receipt of such notice.
13. Where any representation is made by any of the above authorities, the Tribunal shall consider such representation, but the Tribunal shall not be bound to accept such representation.
14. The meeting shall be held and conducted as per the directions of the Tribunal. If, at a meeting held in pursuance of order of the Tribunal, majority of persons representing 3/4th 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 scheme for demerger, the Tribunal may, by an order, sanction the scheme for demerger.
15. If the scheme for demerger is sanctioned by the Tribunal, the same shall be binding on the company, all the creditors and members.
16. The order made by the Tribunal shall contain provisions with respect to variation of shareholders' rights.
17. The order of the Tribunal shall be filed with the Registrar by the company within 30 days of the receipt of the order.

Whether scheme of amalgamation shall be rejected where exchange ratio is questioned by dissenting shareholders or the Central Government?

P 5.3E. The scheme of amalgamation was approved by overwhelming majority of the members of the merging companies, namely, ABC Ltd. and XYZ Ltd. at meetings called as per directions of the Tribunal. When the scheme of amalgamation was awaiting sanction of the Tribunal, the exchange ratio was questioned by a small group of dissenting shareholders of ABC Ltd. The exchange ratio was fixed by a firm of reputed Chartered Accountants. Examine with reference to the Tribunal rulings, whether the dissenting shareholders will succeed.

Would your answer be different, if the exchange ratio was objected to by the Central Government and not by the members of the merging companies? [CA (Final) Nov. 2006 (Modified)]

OR

A scheme of amalgamation was approved by overwhelming majority of members of both the merging companies. The exchange ratio was fixed by a firm of reputed Chartered Accountants. When the scheme of amalgamation was awaiting sanction of the Tribunal, a small group of members of one of the merging companies raised objection on the ground that the exchange ratio was unfair. Examine with reference to decided case law whether the objection is likely to be sustained. What would be your answer in case similar objection was raised by the Central Government? [CA (Final) Nov. 2008 (Modified)]

OR

The members of both Sugam Synthetix Limited and Gaurav Textiles Limited approved the scheme of amalgamation by overwhelming majority. A reputed firm of Chartered Accountants fixed the exchange ratio. The scheme of amalgamation was submitted, as per procedure, for the sanction of the Tribunal. During pendency of the matter a small group of members of one of the merging companies objected to the amalgamation on the ground that the exchange ratio was unfair.

Decide whether the said objection is likely to be sustained. Would your answer be different if similar objection was raised by the Central Government? [CA (Final) May 2011 (Modified)]

OR

A scheme of amalgamation was approved by overwhelming majority of members of both the merging companies at meetings called as per directions of the Tribunal. When the scheme of amalgamation was awaiting sanction of the Tribunal, the exchange ratio was questioned by a small group of members of one of the merging companies. The exchange ratio was fixed by a reputed firm of Chartered Accountants.

Examine with reference to the decided case law under the Companies Act, 2013 whether the dissenting shareholders will succeed. Would your answer be different if the exchange ratio was objected to by the Central Government?

[CA (Final) May 2016 (Modified)]

OR

In the context of judicial rulings in the matter of merger, answer the following:

Whether exchange ratio approved by shareholders of merging companies can be questioned by a small group of dissenting shareholders? [CA (Final) Nov. 2018]

Ans. The given problem relates to section 232 read with section 230 of the Companies Act, 2013.

As per section 232, where an application made to the Tribunal under section 230 states that the compromise or arrangement has been proposed for the purposes of merger or the amalgamation of two or more companies, the Tribunal has the discretion to make an order sanctioning it.

Once statutory formalities are complied with, the onus lies on those opposing the scheme to satisfy the Tribunal that the scheme is unfair or unreasonable or fraudulent ***[Re, Hindustan General Electric Corporation Ltd.* (1959) 29 Comp Cas 46; *Re, Sussex Brick Co. Ltd.* (1960) 30 Comp Cas 536]**.

Where, the valuation is confirmed to be fair by eminent firm of Chartered Accountants and is also approved by overwhelming majority, the Tribunal will not find fault with the exchange ratio ***[Re, Tata Oil Mills Co. Ltd., Re, Hindustan Lever Ltd.]***.

Where the exchange ratio was fixed by two reputed firms of chartered accountants who had examined the accounts, annual reports, working results and financial positions of the two companies and certified on that basis that the share exchange ratio of 5:2 was fair and reasonable, and the scheme was widely advertised, unanimously approved and no objection was raised by any of the affected parties, and the Central Government had not affirmatively established that the valuation of assets was unfair or inequitable, the Tribunal refused to interfere. It was held that the role played by the Central Government is that of an impartial observer who acts in public interest and advises the Tribunal as to whether it is feasible or not for the two companies to merge or amalgamate. Thus, in case of objection by the Central Government, the Tribunal shall not reject the scheme unless the Central Government establishes that the exchange ratio is unfair or that such scheme of merger or amalgamation is not in public interest **[*M.G. Investment & Industrial Co. Ltd.* v *New Shorrock Spg. & Mfg. Co. Ltd.*]**.

Thus, if, on overall consideration the Tribunal is satisfied as to feasibility of the scheme, it should not hesitate to grant sanction ***[Re, Ucal Fuel Systems Ltd.]***.

Applying the above rulings, the given problems are answered as under:

(a) The Tribunal would not generally find faults in the exchange ratio fixed by reputed firms of chartered accountants. Therefore, the dissenting shareholders shall not succeed unless they satisfy the Tribunal that the valuation is grossly unfair ***[Re, Piramal Spg. & Wvg. Mills Ltd.]***.

(b) Section 230(5) requires that the notice of the meeting and all the prescribed documents shall be given to the Central Government, and the Central Government shall have a right to make its representation within 30 days. The Tribunal shall take into account such representation while passing any order in respect of the scheme of merger or amalgamation. However, the Tribunal is not bound to accept the opinion expressed by the Central Government.

Thus, even where the exchange ratio is objected by the Central Government, the Tribunal may sanction the scheme, since the representation or opinion made by the Central Government to the Tribunal is not binding on the Tribunal. However, if the Central Government establishes that the exchange ratio is unfair or that such scheme of merger or amalgamation is not in public interest, the Tribunal may reject the scheme **[*M.G. Investment & Industrial Co. Ltd.* v *New Shorrock Spg. & Mfg. Co. Ltd.*]**.

Whether it is permissible to requisition an extraordinary general meeting for the purpose of negotiating the exchange ratio, where a scheme of amalgamation is pending before the Tribunal?

P 5.3F. Pioneer Textiles Limited desired to amalgamate its enterprise with Latex Textiles Limited. A scheme of amalgamation for this purpose was approved by an overwhelming majority of shareholders and all creditors of both companies at meetings held under the provisions of section 232 of the Companies Act, 2013. Thereupon it was presented to the Company Law Tribunal for its sanction. While the scheme was pending in the Tribunal, some of the dissentient shareholders of Pioneer Textiles Limited requisitioned an extraordinary general meeting to negotiate with Latex Textiles Limited as according to the requisitionists the exchange ratio was not fair and reasonable.

Examine whether the directors may refuse to call the extraordinary general meeting. Also discuss the powers of the Tribunal in this respect. [CA (Final) May 2018]

Ans. The given problem relates to section 232 read with section 100 of the Companies Act, 2013, and the legal position as decided in ***Pravin Kantilal Vakil v Mrs. Rohini Ramesh Save [1985] 57 Comp Case 31 (Bombay)***.

Issue No. 1. Whether the directors can refuse to call the extraordinary general meeting?

As per section 100, where a valid requisition is made by the eligible members, the Board is bound to call an extraordinary general meeting of the company to consider and pass such matters and resolutions as have been specified in the requisition made by the eligible members. The 'eligible members' in case of a company having a share capital means one or more members holding at least 1/10th of the paid up share capital of the company.

In the given case, assuming that the shareholders who have requisitioned the extraordinary generally meeting hold at least 1/10th of the paid up share capital, and other requirements contained in section 100 are also satisfied, the directors are duty bound to call the extraordinary general meeting.

The facts in ***Pravin Kantilal Vakil v Mrs. Rohini Ramesh Save*** were exactly same as are in the given situation.

In ***Pravin Kantilal Vakil v Mrs. Rohini Ramesh Save***, it was held as under:

It is not legitimate to call an extraordinary general meeting for the purpose of withdrawing the petition pending before the Tribunal for sanctioning of the scheme of amalgamation or to pass a resolution to examine any alternative scheme.

However, where an extraordinary general meeting is called for passing a resolution to renegotiate only a term in the scheme of amalgamation, *i.e.* the exchange ratio, as the same was, according to the requisitionist, not fair and equitable to the shareholders of the company for the reasons mentioned in the explanatory note, it was, therefore, clear that what the shareholders were seeking to do by proposing the said resolution was to discuss only the modification to the scheme already before the Tribunal for sanction. The question was whether the Tribunal could prevent the shareholders from doing so on the ground that a scheme of amalgamation was already pending before the Tribunal for sanction.

Section 232 of the Companies Act, 2013 gives wide powers to the Tribunal to give such directions in regard to any matter or make such modification in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement, arrived at. It is not disputed that under the said section 232 any such modification in the scheme could be considered by the Tribunal even at the instance of any shareholder.

In that event, a mere discussion by the shar holders at a properly requisitioned meeting about the proposed modification to the scheme pending before the Tribunal for sanction and if approved, passing a resolution to that effect, would not by itself affect either the scheme or the Tribunal's powers to consider the modification and sanction the scheme with or without modification.

On the basis that at the properly requisitioned meeting, the shareholders were to discuss and if necessary to approve by a resolution only a modification to the scheme pending sanction by the Tribunal, there was nothing in the Companies Act, 2013 empowering the Tribunal to prevent the company from doing so.

Therefore, the Tribunal or the directors of the company would not be justified in preventing the requisitionists from calling an extraordinary general meeting.

Since the facts in the given situation are exactly same as in ***Pravin Kantilal Vakil v Mrs. Rohini Ramesh Save***, it can be concluded that the requisitions cannot be restrained from calling the extraordinary general meeting.

Difference in answer as compared to the answer given by ICAI

The Author's answer as given above differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. The answer in the Suggested Answers is as under:

According to Section 235 of the Companies Act, 2013,

(1) Where a scheme or contract involving the transfer of shares or any class of shares in a Company (the "Transferor Company") to another company (the "Transferee Company") has, within four months after making of an offer in that behalf by the transferee company, been approved by the holders of not less than nine-tenths in value of the shares whose transfer is involved, other than shares already held at the date of the offer by, or by a nominee of the transferee company or its subsidiary Companies, the transferee Company may, at any time within two months after the expiry of the said four months, give notice in the prescribed manner to any dissenting shareholder that it desires to acquire his shares.

(2) Where a notice under sub-section (1) is given, the transferee Company shall, unless on an application made by the dissenting shareholder to the Tribunal, within one month from the date on which the notice was given and the Tribunal thinks fit to order otherwise, be entitled to and bound to acquire those shares on the terms on which, under the scheme or contract, the shares of the approving shareholders are to be transferred to the transferee Company.

According to Section 232(3) of the Companies Act, 2013, the Tribunal, after satisfying itself that the procedure specified in 232(1) and (2) has been complied with, may, by order, sanction the compromise or arrangement or by a subsequent order, make 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. In the light of the above stated provisions,

(i) Once the scheme of amalgamation has been approved by an overwhelming majority, transferee company gets the right to give notice to any dissenting shareholder that it desires to acquire his shares. Further, as per the facts of the question, the dissenting shareholders has not applied to the Tribunal against the scheme of amalgamation. Hence, it is not mandatory for the directors to call the extraordinary general meeting.

(ii) According to section 232(3) of the Companies Act, 2013, the Tribunal may make 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.

[Note: It is assumed that overwhelming majority as specified in the question signifies approval by the holders of not less than nine-tenths in value of the shares (which is a pre- requisite to apply the provisions of section 235 of the Companies Act, 2013)].

In the opinion of the Author, reference to section 235 in the answer to the given question is not at all correct, as the provisions of section 235 are not attracted at all. However, ICAI has answered that it is not mandatory for the directors to call the extraordinary general meeting by applying the provisions of section 235, and so this conclusion derived by ICAI appears to be incorrect. Also, ICAI has completely ignored the facts and decision given in *Pravin Kantilal Vakil* v *Mrs. Rohini Ramesh Save*, which should have been the basis for answering this question.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Issue No. 2. What are the powers of the Tribunal in this respect?

1. The Tribunal is empowered to sanction the scheme of amalgamation and make provision for all such matters as are contained in section 232, *e.g.* transfer of undertaking, property or liabilities of the transferor company to the transferee company, allotment of securities by the transferee company to the shareholders of transferor company, provision to be made for dissenting shareholders, dissolution without winding up of transferor company, continuation of legal proceedings, etc. However, before sanctioning the scheme, the Tribunal shall take into account the representations made by the Central Government, the Reserve Bank of India and other Authorities who are entitled to make the representations as per section 232.
2. Since the scheme of amalgamation has been approved by overwhelming majority, the Tribunal shall not reject the scheme unless it is established before the Tribunal that the exchange ratio is unfair or that such scheme of amalgamation is not in public interest.

Assets held on lease and licence arrangement not to be transferred to the transferee company – Whether scheme is malafide

P 5.3G. In the context of judicial rulings in the matter of merger, answer the following:

Whether transferor company is justified in excluding assets held on lease and license arrangement, from those transferred to the transferee company? [CA (Final) Nov. 2018]

Ans. The given problem relates to section 232 of the Companies Act, 2013.

1. As per section 232, an application may be made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement, and it may be shown to the Tribunal –
   (a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction or merger or amalgamation; and
   (b) that under the scheme, –
      (i) the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company); or
      (ii) the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is proposed to be divided among and transferred to two or more companies.
2. The issue raised in the given problem is same as the issue raised before the Supreme Court in ***Hindustan Lever Employees' Union* v *Hindustan Lever Ltd.*** The detailed facts and the decision of this case are as under:
   (a) A scheme of amalgamation provided for transfer of all assets, properties, undertaking and liabilities of the transferor company (*viz.* TOMCO) to the transferee company (*viz.* HLL). However, there were 3 properties which were not to be transferred to HLL under the scheme. The scheme of amalgamation was objected on various grounds including the ground that the scheme was malafide since these properties were excluded from the assets to be transferred to the transferee company.
   (b) It was held by the Supreme Court that these 3 properties were being used by TOMCO purely under a gratuitous licence with no enforceable rights. TOMCO had a mere gratuitous permission to hold such properties and TOMCO had no right, power, authority or privilege over such properties. The owner of such properties could, at any time, revoke the 'permission to use' given to TOMCO. If the owner of these properties chose to get back the possession of these properties, they could do so without any difficulty by merely revoking the gratuitous licence. TOMCO had no right to transfer such properties as such properties were not the assets of TOMCO. These properties were not included in the balance sheet of TOMCO. Thus, there were no *malafides* in excluding these properties.
3. The facts in the given problem are similar to the facts in ***Hindustan Lever Employees' Union* v *Hindustan Lever Ltd.*** Applying the decision given by the Supreme Court in Hindustan Lever Employees' Union v Hindustan Lever Ltd. to the given problem, it can be said that the transferor company is justified in excluding the assets held by it on lease and licence arrangement, from those transferred to the transferee company.

5.4 Merger or amalgamation of certain companies (Section 233)

1. Eligibility for availing the benefit of section 233

A scheme of merger or amalgamation between two or more companies may be entered into in accordance with the provisions of section 233, only if –

(a) such companies are small companies; or

(b) one company is a holding company and the other company is its wholly-owned subsidiary company; or

(c) such companies belong to such class or classes of companies as may be prescribed.

A company which is eligible for availing the benefit of section 233 may, instead of using the provisions of this section (*i.e.* section 233), use the provisions of section 232 for the approval of any scheme of merger or amalgamation.

2. Notice inviting objections to be issued by the companies, and approval of the scheme

(a) Issue of notice inviting objections or suggestions.

(i) A notice shall be issued by the transferor company or companies and the transferee company to the Registrar and Official Liquidators.

(ii) The notice shall state that objections or suggestions with respect to the proposed scheme of merger or amalgamation are invited from the Registrar and Official Liquidators.

(iii) The Registrar and the Official Liquidators shall have the right to send their objections or suggestions within 30 days.

(b) Objections and suggestions to be considered by the companies. The objections and suggestions received by the companies shall be considered by the companies in their respective general meetings.

(c) Approval of the scheme by the members. The scheme is required to be approved by the members or class of members at a general meeting of respective companies. The scheme shall be approved only if the members or class of members holding at least 90% of the total number of shares vote in favour.

(d) Filing of declaration of solvency. Each of the companies involved in the merger shall file a declaration of solvency, in the prescribed form, with the Registrar of the place where the registered office of the company is situated.

(e) Approval of creditors. The scheme is required to be approved by majority representing 9/10th in value of the creditors or class of creditors of respective companies. Such approval of creditors shall be obtained –

(i) in a meeting convened by the company of which 21 day's notice, along with the scheme, is given to all the creditors; or

(ii) in writing.

The provisions of section 233 shall apply notwithstanding anything contained in the provisions of sections 230 and section 232.

3. Filing of the approved scheme

The transferee company shall file a copy of the approved scheme in the prescribed form with –

(a) the Central Government;

(b) Registrar; and

(c) the Official Liquidator.

4. Situation where no objection or suggestion is made

(a) On 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.

(b) The registration of the scheme shall be deemed to have the effect of dissolution of the transferor company without the process of winding-up.

5. Situation where objection or suggestion is made

(a) If the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of 30 days.

If no communication is made by the Registrar or the Official Liquidator, it shall be presumed that they have no objection to the scheme.

(b) (i) The Central Government may file an application before the Tribunal, stating its objections and requesting that the Tribunal may consider the scheme under section 232, if the Central Government is of the opinion that such scheme is not in the public interest or in the interest of creditors.

(ii) The Central Government may form such an opinion on the basis of objections or suggestions received from the Registrar of Companies or Official Liquidator or otherwise.

(iii) The Central Government may file such an application before the Tribunal within 60 days of the receipt of the objections or suggestions from the Registrar of Companies or Official Liquidator.

If the Central Government does not file any application before the Tribunal, it shall be deemed that it has no objection to the scheme.

(c) On receipt of an application from the Central Government or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per the procedure laid down in section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it may deem fit.

(d) Where the scheme is confirmed by the Tribunal, a copy of the order of the Tribunal confirming the scheme shall be filed with the Registrar and the Registrar shall register the scheme and issue a confirmation thereof.

(e) The registration of the scheme shall be deemed to have the effect of dissolution of the transferor company without the process of winding-up.

6. Effects of registration of the scheme

(a) The property and liabilities of the transferor company shall be transferred 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.

(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.

7. Transferee company not to hold shares

The transferee company shall not, as a result of merger or amalgamation, hold any shares in its own name or in the name of any trust or on behalf of any of its subsidiary or associate companies, and any such shares shall be cancelled or extinguished.

8. Filing of particulars of revised authorised share capital

The transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital.

The fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

9. Applicability of section 233 to compromise or arrangement or division or transfer of a company

If a company or companies fulfil the eligibility for availing the benefit of section 233, then, the provisions of this section shall *mutatis mutandis* apply to such company or companies in respect of –

(a) a scheme of compromise or arrangement referred to in section 230; or

(b) division or transfer of a company referred to in section 232.

10. Procedure for merger or amalgamation to be prescribed

The Central Government may provide for the merger or amalgamation of companies in such manner as may be prescribed.

For the purpose of section 233, –

(a) the term 'Registrar' means the Registrar of the place where the registered office of the company is situated;

(b) the term 'Official Liquidator' means the Official Liquidator of the place where the registered office of the company is situated.

Practical Problems

Whether an application for merger of holding company with its wholly owned subsidiary company be made in accordance with section 232?

P 5.4A. ABC Limited is a wholly owned subsidiary company of XYZ Limited. The company wants to make application for merger of holding and subsidiary companies under section 232. The Company Secretary of XYZ Limited is of the opinion that company cannot apply for merger as per section 232. Is the contention of the Company Secretary valid as per law?

[ICAI, Questions for Practice]

Ans. The given problem relates to sections 232 and 233 of the Companies Act, 2013.

A merger or amalgamation of a holding company with its wholly owned subsidiary company may be entered into by complying with the special provisions contained in section 233. The process of merger or amalgamation in accordance with section 233 is less time consuming and less complicated as compared to the process of merger or amalgamation in accordance with the provisions of section 232. Therefore, mergers as per section 233 are generally termed as 'fast track mergers'.

Though a merger of holding company with its wholly subsidiary company is possible in accordance with the provisions of section 233, yet these companies may instead of using the provisions of section 233, use the provisions of section 232 for the approval of any scheme of merger or amalgamation. This is evident by section 233(14) which reads as under:

"A company covered under this section may use the provisions of section 232 for the approval of any scheme for merger or amalgamation."

Thus, where any merger or amalgamation falls within the purview of section 233, the companies concerned have the following two options:

(a) The companies may use the provisions of fast track merger as contained in section 233.

(b) The companies may, instead of using the provisions of fast track merger as contained in section 233, use the provisions contained in section 232.

In the given case, a merger of holding company with its wholly owned subsidiary company is proposed in accordance with the provisions contained in section 232. The Company Secretary of the holding company is of the view that such merger is not possible in accordance with the provisions of section 232.

In view of the provisions contained in section 233(14) as discussed above, it is evident that merger of holding company (*viz.* XYZ Limited) with its wholly owned subsidiary (*viz.* ABC Limited) is possible in accordance with the provisions of section 232. Thus, the contention of the Company Secretary is not correct.

5.5 Merger or amalgamation of company with foreign company (Section 234)

1. **Applicability of provisions in case of merger or amalgamation between an Indian company and a foreign company**

   The provisions of Chapter XV (*i.e.* Sections 230 to 240) shall apply *mutatis mutandis* to schemes of mergers and amalgamations between –

   (a) companies registered under this Act; and

   (b) companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government.

   The mergers and amalgamations between an Indian company and a foreign company are generally termed as cross-border mergers and amalgamations.

2. **Requirement of prior approval of the Reserve Bank of India**

   Prior approval of the Reserve Bank of India shall be required for –

   (a) Merger of a foreign company into a company registered under this Act; or

   (b) Merger of a company registered under this Act into a foreign company.

3. **Provisions contained in the rules to be complied with**

   (a) The Central Government may make rules in connection with the mergers and amalgamations covered under this section.

   (b) Before making such rules, the Central Government shall consult the Reserve Bank of India.

4. **Terms and conditions of such merger**

   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 as per the scheme drawn up for such purpose, and such payment may be made –

   (a) in cash; or

   (b) in Depository Receipts; or

   (c) partly in cash and partly in Depository Receipts.

The provisions contained in this section (*i.e.* Section 234) shall be subject to the provisions of any other law for the time being in force. *In other words*, the provisions contained in the Chapter XV (*i.e.* Sections 230 to 240) shall not apply to mergers or amalgamations between a company and a foreign company, if –

(a) any other law for the time being in force, so provides; or

(b) the provisions contained in any other law are inconsistent with the provisions contained in Chapter XV.

Theoretical Questions

Q 5.5A. Global Limited, a foreign company, proposed to Desi Limited, an Indian company for merger of companies. State the requirements of merger as per the Companies Act, 2013. [ICAI, Mock Test Paper, April, 2018]

Practical Problems from CA Examinations

Whether companies being amalgamated must be companies registered in India?

P 5.5A. With reference to the provisions of the Companies Act, 2013, state whether companies being amalgamated must be companies registered in India. [CA (Final) May 2000 (Modified)]

OR

Examine with reference to the provisions of the Companies Act, 2013 the validity of a scheme providing for amalgamation of a 'foreign company' with a company registered under the Companies Act, 2013. [CA (Final) May 2004 (Modified)]

OR

A scheme provides for amalgamation of PQL International Limited, a foreign company, with DHP Limited, an Indian company registered under the Companies Act, 2013. Referring to the provisions of the above Act, decide whether the scheme providing amalgamation of a foreign company as a transferor company can be sanctioned by the Tribunal.
[CA (Final) May 2015 (Modified)]

OR

Explaining the relevant provisions of the Companies Act, 2013, answer whether the companies being amalgamated must be companies registered under the Companies Act, 2013? [CA (Final) Nov. 2009 (Modified)]

OR

M/s. Unicorn Rubber Sheets Limited is incorporated and registered in the United Kingdom. M/s. Artha Rubber Sheets Manufacturing and Trading Limited is an Indian Company incorporated and registered under the provisions of the Companies Act, 2013. A scheme of compromise between the above two companies provided for an amalgamation of the English Company with the Indian Company. The CFO of the Indian Company is of the opinion that the companies being amalgamated must be companies registered in India and therefore an amalgamation with a company registered outside India is not possible. Explaining the relevant provisions of the Companies Act, 2013, examine whether the contention of the CFO is correct that the companies being amalgamated must be companies registered in India? [CA (Final) May 2019]

Ans. Section 234 of the Companies Act, 2013 is a specific provision with respect to merger or amalgamation of an Indian company and a foreign company. As per section 234, a merger of an Indian company and a foreign company may be effected by –

(a) complying with the provisions of sections 230 to 232;
(b) obtaining prior approval of Reserve Bank of India; and
(c) complying with the Rules prescribed by the Central Government in this behalf.

However, a merger of an Indian company and a foreign company may be effected only if the foreign company has been incorporated in the jurisdictions of any such country as has been notified by the Central Government in this behalf.

Also, the transferee company shall –

(a) ensure that valuation is conducted by valuers who are members of a recognised professional body in the jurisdiction of the transferee company;
(b) ensure that such valuation is in accordance with internationally accepted principles on accounting and valuation; and
(c) file a declaration along with the application made to Reserve Bank of India for obtaining its approval.

The application for obtaining the approval of the Tribunal as per the provisions of sections 230 to section 232 shall be filed after obtaining the approval of the Reserve Bank of India.

For the purposes of section 234, the term 'foreign company' means any company or body corporate incorporated outside India whether having a place of business in India or not. Thus, where a company or body corporate has not established any place of business in India and does not conduct any business activity in India, it is not a foreign company within the meaning of Clause (42) of Section 2, but it shall be regarded as a foreign company for the purposes of section 234. Thus, a merger or amalgamation between an Indian company and a company incorporated outside India is possible as per the provisions of section 234 read with sections 230 and 232, whether or not the company incorporated outside India has a place of business in India, provided the legal requirements as discussed above are complied with.

Conclusion: The companies being amalgamated may or may not be companies registered in India.

5.6 Power to acquire shares of shareholders dissenting from scheme or contract approved by majority (Section 235)

An amalgamation or merger of two or more companies may be carried out by following the procedure prescribed under sections 230 to 232. However, such procedure is very cumbersome and time consuming. Instead of following this procedure, section 235 enables a company (i.e. the transferee company) to acquire the shares of another company (i.e. the transferor company). The acquisition of shares in the transferor company enables the transferee company to

exercise control over the former company. This process is commonly called as a 'takeover'. It does not involve the intervention of the Tribunal unless the dissenting shareholders approach the Tribunal. The company taken over remains in existence.

1. The offer to acquire shares

A company (hereinafter referred to as 'the transferee company') may prepare a scheme or contract by which an offer is made to the shareholders of another company (hereinafter referred to as 'the transferor company') to acquire their shares.

Time limit during which the offer shall remain open

The offer shall remain open for a period of 4 months, *i.e.* any shareholder of the transferor company may agree to transfer his shares to the transferee company within a period of 4 months from the date of the offer.

2. Approval of the offer, and notice to acquire the shares of dissenting shareholders

(a) If the offer made by the transferee company is approved by the shareholders holding not less than 9/10th in value of the shares, then, the transferee company may give notice to any dissenting shareholder that it desires to acquire his shares.

Time limit for giving notice

Notice to any dissenting shareholder may be given by the transferee company at anytime, but within 2 months of expiry of the period of 4 months during which the offer was open.

(b) For this purpose, any shares already held by the transferee company or any of its nominees or subsidiaries shall be excluded.

(c) Dissenting shareholder means –

(i) a shareholder who has not assented to the scheme or contract;

(ii) a shareholder who has failed or refused to transfer his shares to the transferee company.

3. Right of the dissenting shareholder(s) to make an application to the Tribunal

A dissenting shareholder to whom notice of acquisition is given by the transferee company, may make an application to the Tribunal praying that acquisition of his shares should not be permitted.

Time limit for making application

The application may be made to the Tribunal by any dissenting shareholder within 1 month of receipt of notice of acquisition of shares by him.

4. Acquisition of shares by the transferee company

The transferee company shall be entitled as well as bound to acquire the shares of the dissenting shareholders on the same terms on which the shares of the approving shareholders were transferred to the transferee company, in the following two cases:

(a) Where no application is made by any dissenting shareholder to the Tribunal within 1 month of receipt of notice of acquisition of shares.

(b) Where an application is made by any dissenting shareholder, but such application is dismissed by the Tribunal.

The transferee company shall acquire the shares of the dissenting shareholder in the following manner:

(a) The transferee company shall send to the transferor company –

(i) a copy of the notice of acquisition of shares earlier sent to the dissenting shareholders;

(ii) an instrument of transfer of shares (*i.e.* Transfer deed).

(b) The instrument of transfer shall be executed –

(i) on behalf of the dissenting shareholder, by some person appointed by the transferor company; and

(ii) on behalf of the transferee company, by a person authorised by the transferee company.

(c) The transferee company shall pay to the transferor company the consideration payable by it in respect of the shares of the dissenting shareholders acquired by it.

(d) The transferor company shall register the shares in the name of the transferee company.

(e) The transferor company shall, within 1 month of registration of shares in the name of the transferee company, inform the dissenting shareholder of the fact of –

(i) registration of shares in the name of the transferee company; and

(ii) receipt of consideration paid by the transferee company to which the dissenting shareholder is entitled to.

(f) The transferor company shall –

(i) deposit into a separate bank account the consideration paid by the transferee company;

(ii) hold such consideration as a trustee for the dissenting shareholders; and

(iii) within 60 days, pay such consideration to the dissenting shareholders.

5. **No acquisition of shares by the transferee company**

The transferee company shall not be entitled to acquire the shareholders of the dissenting shareholders if the Tribunal allows the application of dissenting shareholders, *i.e.* where the Tribunal makes an order that the transferee company shall not be allowed to acquire the shares of the dissenting shareholders.

Theoretical Questions from CA Examinations

Q 5.6A. M/s FMCG Ltd. proposes to acquire the majority shares of M/s Slow Industries Ltd. by way of amalgamation. Briefly enumerate the steps that should be taken by the Transferee Company to achieve the objective under the Companies Act, 2013.

[CA (Final) Nov. 2002]

Q 5.6B. DEJYAS Ltd. has made an offer to acquire all the equity shares of ABC Ltd. at certain price. Members of the company who hold 90% of the shares of ABC Ltd. have accepted the offer. The remaining shares are held by 2 NRIs who do not agree to the deal. Explaining the procedure to finalise the deal, state the steps to be taken by the offeror company to acquire share of dissenting shareholders. Decide also whether DEJYAS Ltd. can acquire all the shares in ABC Ltd. under the provisions of the Companies Act, 2013.

[CA (Final) Nov. 1997]

Q 5.6C. M/s Premier Cements Ltd. proposes to take over M/s Excellent Clinker Ltd. by making an offer to members of Excellent Clinker Ltd. to purchase all the shares. Explain the provisions of Companies Act, 2013 regulating such takeover. [CA (Final) May 1996]

Q 5.6D. Explain the provisions of law with regard to the acquisition of shares of one company by another company by purchase of shares.

[CA (Final) Nov. 1993]

Q 5.6E. Who is a dissenting shareholder in case of amalgamation of companies? Explain the provisions of the Companies Act, 2013 with regard to the acquisition of shares of dissenting shareholders. [CA (Final) May 1992]

Q 5.6F. What is take-over bid? What is the procedure to be followed, under the Company Act, 2013 in such a case? Can take-over be challenged by anyone and if so, on what grounds? [CA (Final) Nov. 1990]

Q 5.6G. Premier Technologies Limited proposes to takeover Modern Solutions Limited, an unlisted company, by making an offer to the members of Modern Solutions Limited to purchase all their shares. At present, Premier Technologies Limited are not holding any shares in Modern Solutions Limited. Explain briefly the steps to be taken under the Companies Act, 2013 to give effect to the proposed takeover.

[CA (Final) Nov. 2013]

5.7 Purchase of minority shareholding (Section 236)

1. **Applicability of section 236**

Section 236 applies where –

(a) an acquirer, or a person acting in concert with such acquirer, becomes registered holder of 90% or more of the issued equity share capital of a company; or

(b) any person or group of persons becomes 90% majority or holds 90% of the issued equity share capital of a company, by virtue of an amalgamation, share exchange, conversion of securities or for any other reason.

2. **Duty of acquirer, person etc. to notify the company**

The acquirer, person or group of persons to whom section 236 applies (hereinafter referred to as the majority shareholders), shall notify the company of his / their intention to buy the remaining equity shares.

3. **Duty of acquirer, person etc. to make an offer to minority shareholders for acquisition of their shares**

The majority shareholders shall make an offer to the minority shareholders of the company to buy the equity shares held by such minority shareholders at a price determined on the basis of valuation by a registered valuer in accordance with the prescribed rules.

4. **Option of minority shareholders to sell their shares**

The minority shareholders of the company may agree to sell the minority shareholding to the majority shareholders at the price determined in accordance with the prescribed rules.

5. **Deposit of money by the majority shareholders, and disbursement of money to the entitled shareholders**

(a) The majority shareholders shall deposit in a separate bank account an amount equal to the value of shares of the minority shareholding determined in accordance with the prescribed rules.

(b) The bank account shall be operated by the company whose shares are being transferred for at least 1 year.

(c) The amount deposited in the bank account shall be disbursed to the entitled shareholders within 60 days.

(d) The disbursement shall continue to be made to the entitled shareholders for a period of 1 year, if –
   (i) for any reason such disbursement could not be made within the said period of 60 days; or
   (ii) the disbursement was made within the said period of 60 days, but the shareholder entitled to such payment failed to receive or claim such payment.

6. Company whose shares are being transferred to act as transfer agent

The company whose shares are being transferred shall act as a transfer agent for –
(a) receiving and paying the price to the minority shareholders; and
(b) taking delivery of the shares and delivering such shares to the majority shareholders.

7. Situation where any minority shareholder fails to deliver the shares

In case any minority shareholder fails to make physical delivery of shares within the time specified by the company whose shares are being transferred,–
(a) his share certificates shall be deemed to be cancelled;
(b) the company whose shares are being transferred shall be authorised to issue shares in lieu of the cancelled shares and complete the transfer in accordance with law.

8. Situation where a shareholder has died or ceased to exist etc.

If –
(a) the majority shareholders require a full purchase and deposits with the company the amount in respect of full purchase; and
(b) any shareholder who has died or ceased to exist, or whose heirs, successors, administrators or assignees have not been brought on record by transmission,

then, the right of such shareholder to sell his shareholding shall continue for a period of 3 years from the date acquisition of majority shareholding.

9. Situation where shareholders holding 75% or more shareholding reach an understanding for transfer at a higher price

Where the shares of minority shareholders have been acquired in pursuance of this section and as on or prior to the date of transfer following such acquisition, the shareholders holding 75% or more minority equity shareholding negotiate or reach an understanding on a higher price for any transfer, proposed or agreed upon, of the shares held by them without disclosing the fact or likelihood of transfer taking place on the basis of such negotiation, understanding or agreement, the majority shareholders shall share the additional compensation so received by them with such minority shareholders on a pro rata basis.

10. Situation where majority shareholders fail to acquire the full purchase of shares of the minority shareholders

If the majority shareholders fail to acquire the full purchase of shares of the minority shareholders, then, the provisions of this section shall continue to apply to the residual minority shareholders, even though, –
(a) the shares of the company of the residual minority equity shareholder had been delisted; and
(b) the period of 1 year or the period specified in the regulations made by SEBI under the Securities and Exchange Board of India Act, 1992, had elapsed.

Practical Problems from CA Examinations

Can the minority shareholders be compelled to sell their shares?

P 5.7A. In a scheme of reconstruction by a multinational company listed in India, the company wanted the minority shareholders to get out of the company by selling their shares back to the promoters at a price determined by the promoters. The minority shareholders were not given a choice whether they wanted to tender their shares or not. In the meeting, there were six non-promoter shareholders who voted against the scheme, but Chairman declared that the motion was carried with an overwhelming majority of more than 90% shareholding. However, minority shareholders contended that they had a right to reject the offer. Will they succeed? **[CA (Final) Nov. 2019]**

Ans. The given problem relates to section 236 of the Companies Act, 2013, as discussed below:

The legal position

1. Section 236 applies where –
   (a) an acquirer, or a person acting in concert with such acquirer, becomes registered holder of 90% or more of the issued equity share capital of a company; or
   (b) any person or group of persons becomes 90% majority or holds 90% of the issued equity share capital of a company, by virtue of an amalgamation, share exchange, conversion of securities or for any other reason.

2. The acquirer, person or group of persons to whom section 236 applies (hereinafter referred to as the majority shareholders), shall notify the company of his / their intention to buy the remaining equity shares.
3. The majority shareholders shall make an offer to the minority shareholders of the company to buy the equity shares held by such minority shareholders at a price determined on the basis of valuation by a registered valuer in accordance with the prescribed rules.
4. The minority shareholders of the company may agree to sell the minority shareholding to the majority shareholders at the price determined in accordance with the prescribed rules.

The given case

5. The promoters of a listed multinational company intended to buy the shares held by the minority shareholders at a price determined by the promoters. The minority shareholders were not given a choice whether they wanted to tender their shares or not. The minority shareholders contended that they had a right to reject the offer given by the promoters.

Analysis of the case

6. The promoters of a multinational company intended to acquire the equity shares held by the minority shareholders in accordance with the provisions of section 236. Such acquisition of equity shares is possible only if an offer is made to the minority shareholders and the price at which the equity shares shall be acquired by the promoters is the price determined on the basis of valuation by a registered valuer. However, in the given case, the price has been determined by the promoters, and no valuation has been done by the registered valuer.
7. Section 236 does not bind the minority shareholders to sell their shares to the promoters / majority shareholders. It is the discretion of the minority shareholders to sell or not to sell their shares to the promoters / majority shareholders. However, in the given case, the promoters intend to acquire the shares held by the minority shareholders even though some of the minority shareholders didn't intend to sell their shares.

Conclusion

8. The minority shareholders cannot be compelled to sell their shares to the promoters. Therefore, the contention of the minority shareholders that they have a right to reject the offer made by the promoters, is correct.

5.8 Power of Central Government to provide for amalgamation of companies in public interest. (Section 237)

1. **Situation where the Central Government is empowered to order amalgamation**

   The Central Government is empowered to order the amalgamation of 2 or more companies, if it is satisfied that such amalgamation is essential in the public interest.

2. **Order of amalgamation by the Central Government**

   The Central Government may, by an order notified in the Official Gazette, provide for the amalgamation of 2 or more companies into a single company with such constitution, property, powers, rights, interests, authorities and privileges, and such liabilities, duties and obligations, as may be specified in the order.

3. **Contents of the order**

   The order of the Central Government may also provide for –

   (a) the continuation by the transferee company of any legal proceedings pending by any transferor company;

   (b) the continuation against the transferee company of any legal proceedings pending against any transferor company; and

   (c) such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

4. **Rights of the members and creditors, and assessment of compensation**

   (a) Every member and creditor (including a debenture holder) of each of the transferor companies before the amalgamation shall have, as nearly as may be, the same interests and rights against the transferee company as he had in the transferor company.

   (b) In case the interests or rights of any member or creditor against the transferee company are less than his interests or rights against the transferor company, he shall be entitled to receive compensation from the transferee company.

   (c) The compensation shall be assessed by such authority as may be prescribed.

   (d) Every assessment of compensation shall be published in the Official Gazette.

   (e) Any person aggrieved by any assessment of compensation made by the prescribed authority may, within a period of 30 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.

5. Conditions for making an order of amalgamation

The Central Government shall not make an order of amalgamation unless –

(a) a copy of the proposed order of amalgamation has been sent in draft to each of the companies concerned;

(b) (i) the time for preferring an appeal to the Tribunal has expired; or

(ii) if an appeal has been preferred to the Tribunal, the appeal has been finally disposed off; and

(c) (i) the Central Government has sent a copy of the draft order of the proposed amalgamation to each of the companies;

(ii) the Central Government has fixed the time within which the objections and suggestions may be made by the companies concerned or any shareholder or creditor of such companies, which shall not be less than 2 months;

(iii) the Central Government has considered and made such modifications in the draft order as it may deem fit, in the light of suggestions and modifications made by any of the companies concerned or any shareholder or creditor of such companies.

6. Laying of a copy of order in the Parliament

A copy of every order of amalgamation made under this section shall be laid before each House of Parliament.

Theoretical Questions from CA Examinations

Q 5.8A. With a view to boost the share values, the Central Government wants to amalgamate two public limited companies into a single company. The Government and Public Financial Institutions have substantial interest in both the companies. The two companies are in the business of tourism and running several hotels which are not making good profits and consequently the share prices are depressed. Examine the powers of the Central Government to amalgamate the two companies in public interest. [CA (Final) May 2002]

Q 5.8B. X Ltd. and Y Ltd. are two listed companies engaged in the business of telecommunication. The companies are not making profits and as such their share's market prices have gone down. A substantial portion of their share capital is held by Central Government as well as some Public Financial Corporations. In order to increase the share value, the Central Government wants to amalgamate the aforesaid two companies into a single company. Examine the powers of Central Government to amalgamate the two companies in public interest as per the provisions of the Companies Act, 2013. [CA (Final) May 2007]

Q 5.8C. Cotton Yarn Ltd., and Country Cotton Blossom Ltd., are two listed companies engaged in the business of textiles. The companies are not making profits and as such their shares' market price have gone down. A substantial portion of their share capital is held by Central Government as well as some Public Financial Corporations. In order to increase the share value, the Central Government wants to amalgamate the aforesaid two companies into a single company. Examine the powers of Central Government to amalgamate the two companies in public interest as per the provisions of the Companies Act, 2013. [CA (Final) RTP, Nov. 2018]

Practical Problems from CA Examinations

Whether an appeal can be filed against the order of amalgamation passed by the Central Government?

P 5.8A. The Central Government in the public interest ordered for the amalgamation of ABC Limited and DEF Limited into a single company named KPN Limited through a notification in the official gazette. In this connection the prescribed authority ordered that the equity shareholders of ABC Limited were to be provided with a cash compensation of Rs. 2,000/- and two equity shares in KPN Limited for every single equity share held in ABC Limited. Mr. Ganesh, an equity shareholder of ABC Limited was dissatisfied not only with the amalgamation but also with the compensation offered by the prescribed authority. Advise him whether he can challenge the above amalgamation order of the Central Government. Also advise him within how many days and before which authority he can prefer an appeal against the order of the prescribed authority. Advise him referring to the provisions of the Companies Act, 2013 in this regard. [CA (Final) Nov. 2016]

Ans. The given problem relates to section 237 of the Companies Act, 2013.

As per section 237, the Central Government is empowered to make an order of amalgamation of 2 or more companies if it is satisfied that such amalgamation is in public interest.

The provisions with respect to compensation, as contained in section 237, are as under:

(a) Every member and creditor of each of the transferor companies before the amalgamation shall have, as nearly as may be, the same interests and rights against the transferee company as he had in the transferor company.

(b) In case the interests or rights of any member or creditor against the transferee company are less than his interests or rights against the transferor company, he shall be entitled to receive compensation from the transferee company.

(c) The compensation shall be assessed by such authority as may be prescribed.

(d) Every assessment of compensation shall be published in the Official Gazette.

(e) Any person aggrieved by any assessment of compensation made by the prescribed authority may, within a period of 30 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.

In the given case, Mr. Ganesh, a shareholder of ABC Limited is not satisfied with the order of amalgamation passed by the Central Government, and also with the compensation determined by the prescribed authority. Mr. Ganesh intends to prefer an appeal against –

(a) the order of amalgamation passed by the Central Government; and

(b) the assessment of compensation by the prescribed authority.

Section 237 entitles any member of the transferor company to prefer an appeal to the Tribunal against the assessment of compensation by the prescribed authority. Thus, Mr. Ganesh is entitled to prefer an appeal to the Tribunal against the assessment of compensation by the prescribed authority. Such appeal may be preferred within 30 days from the date of publication of such assessment of compensation in the Official Gazette.

However, section 237 does not entitle any person to prefer any appeal against the order of amalgamation passed by the Central Government. Thus, Mr. Ganesh cannot prefer any appeal before any authority against the order of amalgamation passed by the Central Government. In other words, Mr. Ganesh cannot seek any order from any Court or Tribunal cancelling or nullifying the order of amalgamation passed by the Central Government. His only remedy is to prefer an appeal against the assessment of compensation, as discussed above.

5.9 Registration of offer of schemes involving transfer of shares (Section 238)

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, following provisions shall apply:

1. The directors of the transferor company shall prepare a circular. The circular shall be addressed to the members of the transferor company. The circular shall disclose the offer made by the transferee company to the members of the transferor company for the acquisition of their shares. The circular shall contain a recommendation to the members of the transferor company to accept such offer. The circular shall be accompanied by such information as may be prescribed.
2. Every such offer shall contain a statement by the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available.
3. Every such circular shall be presented to the Registrar for registration.
4. No circular shall be issued until it is registered by the Registrar.
5. The Registrar may refuse, for reasons to be recorded in writing, to register the circular if such circular –
   (a) does not contain the prescribed information;
   (b) contains the information in a manner which is likely to give a false impression.
6. In case the Registrar refuses to register the circular, he shall communicate such refusal to the parties within 30 days of the application.
7. An appeal shall lie to the Tribunal against an order of the Registrar refusing to register any circular.
8. If any circular is issued before it is presented to the Registrar for registration and is registered by the Registrar, any director who has issued such a circular shall be liable to a penalty of Rs. 1 lakh.

5.10 Preservation of books and papers of amalgamated companies (Section 239)

1. **Conditions for disposal of books**

   Prior permission of the Central Government shall be required for disposal of the books and papers of a company –
   (a) which has been amalgamated with another company; or
   (b) whose shares have been acquired by another company.

2. **Appointment of a person to examine the books**

   The Central Government may, before granting the permission for disposal of books and papers, appoint a person to examine the books and papers of the company for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with –
   (a) the promotion of the transferor company; or
   (b) the management of the affairs of the transferor company; or
   (c) the amalgamation of the transferor company; or
   (d) the acquisition of its shares.

To whom an application is to be made where amalgamation of 2 companies is in public interest, and provisions with respect to preservation of books and records

P 5.10A. CPR Ltd. and TJC Ltd. are wholly owned by Government of Tamil Nadu. As a policy matter, the Government issued administrative orders for merging TJC Ltd. with CPR Ltd. in the public interest. State the authority with whom the application for merger is required to be filed under the provisions of the Companies Act, 2013. Also state the provisions governing the preservation of Books and Records of TJC Ltd. after merger under the said Act. [CA (Final) May 2018]

Ans. The given problem relates to section 237 and 239 of the Companies Act, 2013.

As per section 237, the Central Government is empowered to make an order of amalgamation of 2 or more companies if it is satisfied that such amalgamation is in public interest. The Central Government may, by an order notified in the Official Gazette, provide for the amalgamation of 2 or more companies into a single company with such constitution, property, powers, rights, interests, authorities and privileges, and such liabilities, duties and obligations, as may be specified in the order.

In the given case, the Government of Tamil Nadu is of the opinion that the amalgamation of CPR Ltd. and TJC Ltd. is in public interest. For the purpose of such amalgamation, an application seeking an order of amalgamation under section 237 is required to be made to the Central Government, and if the Central Government is satisfied that such amalgamation is in public interest, it may make an order of amalgamation in accordance with the provisions of section 237.

Following provisions as contained in section 239 shall apply with respect to preservation of books and records of TJC Ltd. after its merger with CPR Ltd.:

1. Prior permission of the Central Government shall be required for disposal of its books and papers.
2. Before granting such permission, the Central Government may appoint a person to examine the books and papers for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with –
   (a) the promotion of the transferor company; or
   (b) the management of the affairs of the transferor company; or
   (c) the amalgamation of the transferor company; or
   (d) the acquisition of its shares.

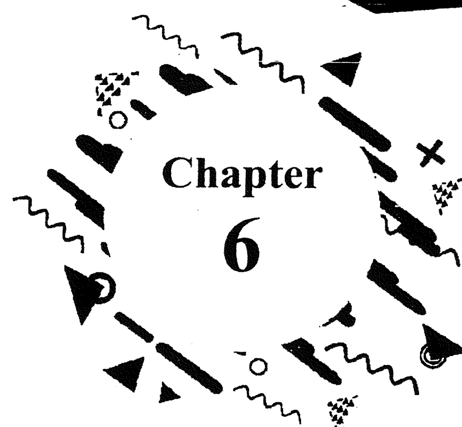
5.11 Liability of officers in respect of offences committed prior to merger, amalgamation, etc. (Section 240)

In respect of any offence punishable under this Act, all the officers in default of the transferor company shall continue to be liable for any offence committed prior to its merger, amalgamation or acquisition.

The provisions of section 240 shall apply notwithstanding anything contained in any other law for the time being in force.

Prevention of Oppression and Mismanagement

(Chapter XVI of the Companies Act, 2013 consisting of Sections 241 to 246)



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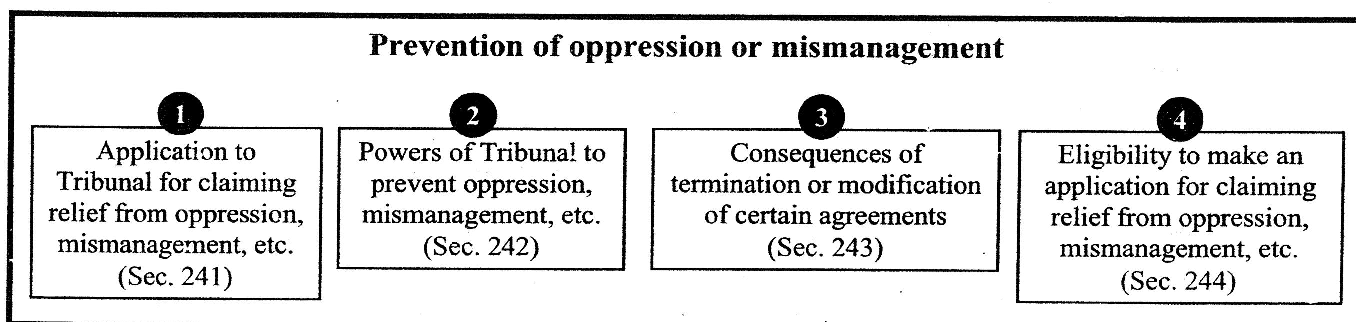
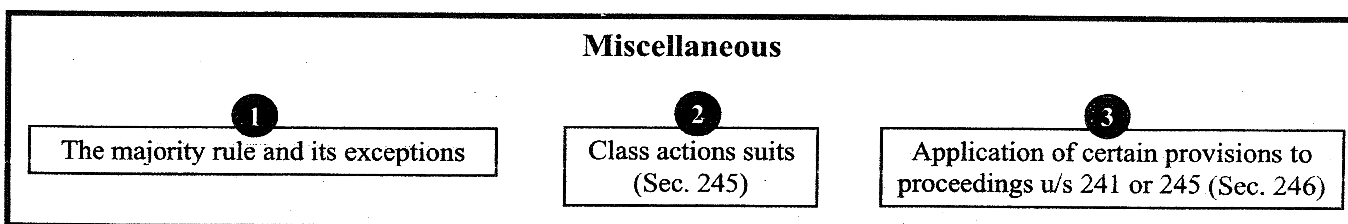




Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, any reference to any section means reference to the sections of the Companies Act, 2013.

6.1 The 'Majority Rule'

The management of the company is based on the Majority Rule. The affairs of a company are conducted by the majority of members. The resolution passed by the majority of members is binding on the company and consequently on the minority. In case of differences among the members, the issue is resolved by a vote of majority. The Courts do not usually intervene in the matters of internal management of the company. This basic principle of 'Majority Rule' was laid down in ***Foss*** v ***Harbottle (1843) 2 Hare 461***.

Rule in *Foss* v *Harbottle* – Supremacy of majority

Two shareholders brought an action against the directors charging them with 'concerting and effecting various fraudulent and illegal transactions, whereby the property of the company was misapplied, alienated and wasted'. They claimed damages from the defendants. The Court dismissed the action on the following two grounds (These two grounds constitute the very basis of Majority Rule):

1. **Proper plaintiff is the company**

   Only the company is aggrieved. The Court held that the damage was caused to the company and thus only the company was the aggrieved party. As such, the suit could be brought only by the company and not by any individual shareholder.

   Mere injury is not enough. Where a damage or injury is caused to the company, it also affects its members. Yet, they are not entitled to maintain a suit because mere injury is not enough. A person would be aggrieved only if he is able to further establish that injury was caused due to a breach of duty towards him. Since the directors owe no duty to an individual member but to the company as a whole, one or more individual members cannot be proper plaintiff.

2. **Unproductive litigation**

   The wrong done to the company could be ratified by the company (acting through the majority of members). As such, the award of damages by the Court would have been futile as the majority had the powers to ratify the alleged breach of duty and it could decide not to recover the damages. Thus, litigation would have proved worthless.

Justification and advantages of the rule in Foss v Harbottle

It is a cardinal principle of company law that 'Will of the majority must prevail'. The main advantages of Majority Rule are as follows:

1. **Proper plaintiff**

   Where an injury is caused to the company and not to the individual members, the company alone is aggrieved. As such, action can be brought only by the company. Thus, the Majority Rule recognises and supports the concept of separate legal entity of the company, *i.e.* a company is an entity separate from its owners.

2. **Unproductive litigation**

   If the wrong done to the company can be ratified by the company, it would be futile to have litigation except with the consent of the majority.

3. **Multiplicity of suits avoided**

   If every individual member is allowed to institute a suit for a wrong done to the company, it would result in countless number of suits on the same subject resulting in chaos and wastage of money and time.

4. **Recognition of 'will of majority'**

   The well accepted rule that will of majority must prevail has been followed and reaffirmed by the principle laid down in ***Foss* v *Harbottle***.

Exceptions to the rule in *Foss* v *Harbottle*

Ordinarily, a company acts through the majority of members and the resolutions passed by a majority of members bind the company as well as the minority. Since, the majority of members is in an advantageous position to run the company as per their wishes, they may cause serious damage or injury to the company. Where the directors, who also control the majority shareholding, misuse their powers for their personal gains, the minority has no right to sue them as per the 'Majority Rule'. Thus, to protect the minority interest, certain exceptions to the 'Majority Rule' have been developed.

1. ***Ultra vires* and illegal acts**

   The Majority Rule applies only where an act has been done irregularly and ratification is possible. However, illegal acts cannot be ratified even with the consent of all the members and thus no majority vote can be effective if the action is *ultra vires* the company. Where the company proposes to enter into an illegal transaction, any member can restrain the company by obtaining an injunction. An individual member has a right to restrain the company from making excessive payments to its employees ***[Parke* v *Daily News Ltd. (1962) Ch. 927]***.

2. **Fraud on minority**

   Where the majority misuses its powers to defraud or oppress the minority, an action can be brought by an individual member. For example, if majority divides the whole assets of the company, and passes a resolution that everything must be given to them and that minority should have nothing to do with it, any member can take action against it. Few illustrative cases are discussed hereunder:

- ***Majority diverting the profits of the company to another company in which they are majority shareholders.*** Majority of members of 'Company A', who were also members of 'Company B', passed a resolution compromising an action against 'Company B'. The facts showed that the compromise was detrimental to the interests of 'Company A' but was favourable to 'Company B'. Held, the majority tried to put something in their pockets at the cost of the minority and thus minority was empowered to take an action ***[Menier*** v ***Hooper's Telegraph Works Ltd. (1874) L.R. 9 Ch. 350].***
- ***Compulsory acquisition of shares of a minority shareholder.*** A large majority of 98% wished to buy the shares held by the minority shareholders. When minority shareholders refused to sell their shares, the majority shareholders passed a resolution altering the articles so as to enable 9/10th of the shareholders to buy the shares of any other shareholder. Held, the minority could not be compelled to sell its shares to the majority ***[Brown*** v ***British Abrasive Wheel Co. (1919) 1 Ch. 290].***

3. **Wrongdoers in control**

   Where wrongdoers are in control, the minority will have a right of action since otherwise the grievance would never reach the Court, for the wrongdoers would never allow the company to institute a suit.

4. **Breach of fiduciary duties**

   The directors and promoters owe fiduciary duties to the company. If they make a secret profit, there is a breach of duty (although it may not amount to fraud) and they can be compelled to account for the profits made by them.

   - ***Utilising a contract belonging to the company for personal gains.*** Three directors holding 75% of the share capital of the company used their positions as directors and obtained a contract in their own names. As it amounted to breach of duty towards the company, they called a general meeting in which a resolution was passed to the effect that the company had no interest in the contract. It was held that the company could claim profits realised by the directors ***[Cook*** v ***Deeks (1916) 1 AC 554].***
   - ***Sale at gross undervalue.*** A husband and wife were the only two directors in a company. They held majority shares of the company. The land of the company was sold to one of the directors at gross undervalue. Held, the minority shareholders had a valid cause to bring an action against the directors ***[Daniels*** v ***Daniels (1978) Ch. 406].***

5. **Requirement of special resolution**

   As per the Majority Rule, the affairs of a company are conducted by the majority of members. However, where an act requires a special majority, *i.e.* where the business can be transacted only by passing a special resolution, simple majority is not sufficient.

6. **Infringement of rights of a member**

   Where wrong is done to a company, the company shall be the aggrieved person. Similarly, where the personal rights of an individual member are infringed, he becomes the aggrieved person and so he can take action for the enforcement of such rights. He can insist on the strict compliance with the legal provisions of the Act, memorandum and articles of the company ***[Nagappa Chettiar*** v ***Madras Race Club (1949) – VKJ].***

II. Exceptions under the Companies Act, 2013

1. **Variation of class rights (Section 48)**

   The rights attached to any class of shares may be varied with the consent of the members holding 3/4th of issued shares of that class or if a special resolution is passed at a separate meeting of the holders of the issued shares of that class. Such variation can be made only if provision for variation is contained in the memorandum or articles of the company or such variation is not prohibited by the terms of issue of shares of that class. However, holders of not less than 10% of the shares of that class who had not consented to the variation may apply to the Tribunal for the cancellation of the variation.

2. **Reconstruction and amalgamation (Section 235)**

   Where in the course of acquisition of shares of one company (*i.e.* transferor company) by another company (*i.e.* transferee company), the transferee company intends to acquire the shares of the dissenting shareholders of the transferor company, the dissenting shareholders may make an application to the Tribunal praying that the acquisition of their shares should not be permitted even though shareholders holding 90% or more of the share capital of the transferor company have accepted the offer.

3. **Investigation into affairs of the company (Section 213)**

Requisite number of members is empowered to make an application to the Tribunal to make a declaration that the affairs of the company ought to be investigated. Thereupon, the Central Government shall order investigation of affairs of the company.

Requisite number of members.

- In the case of a company having a share capital, not less than 100 members, or members holding not less than 1/10th of the total voting power.
- In the case of a company having no share capital, not less than 1/5th of the total number of members.

4. **Prevention of oppression and mismanagement (Section 241)**

The most important provisions relating to minority protection are contained in section 241.

Requisite number of members is empowered to make an application to the Tribunal if the affairs of the company are being mismanaged or are conducted in a manner prejudicial to public interest or in a manner oppressive to any member. The Tribunal may make such orders as is necessary to do justice in the facts of the case.

Requisite number of members.

- In the case of a company having a share capital, 'requisite number of members' means the lower of the following:
  (a) 100 members; or
  (b) 1/10th of total number of members; or
  (c) 1/10th of issued share capital of the company.
- In the case of a company not having a share capital, 'requisite number of members' means 1/5th of the total number of members.

5. **Other statutory rights**

- Requisite number of members have a right to call an extraordinary general meeting (Section 100).
- Requisite number of members have the right to propose a resolution at an annual general meeting (Section 111).
- Requisite number of members can demand a poll (Section 179).
- Any member can apply to the Tribunal to call an annual general meeting if default is made in holding an annual general meeting (Section 97).
- Any member can apply to the Tribunal to call an extraordinary general meeting if default is made in holding an extraordinary general meeting (Section 98).
- Any member can present a petition for compulsory winding up of the company on just and equitable ground (Section 270 read with section 272).

In ***Foss v Harbottle*** the wrongdoers to the company were its directors. But, it is immaterial as to who are the wrongdoers. Even where a wrong is done by a third party, the 'Majority Rule' shall apply and the company alone can bring an action against the third party.

Theoretical Questions from CA and CS Examinations

Q 6.1A. The majority of shareholders of Voyage Travellers Limited passed a special resolution to alter its articles of association and give the directors a power to transfer the shares of any shareholder who compete with the company's business. Mr. KPS, who is a shareholder of Voyage Travellers Limited also carried on a competing business, challenged the validity of the alteration. Decide, based on the rule of majority, whether the contention of Mr. KPS is valid case of oppression against minority. [CA (Final) Nov. 2019]

Q 6.1B. "Majority will have its way but the minority must be allowed to have its say." Explain this statement in detail with remedies available to the minority shareholders. [CA (Final) Nov. 1992; CS (Final) Dec. 1997]

Q 6.1C. "Even though the shareholders' democracy is supreme, the Companies Act, 2013 and the decided cases afford sufficient protection to the minority shareholders." Examine the statement. [CS (Final) Dec. 1996 (Modified)]

Q 6.1D. "The cardinal principle of corporate management is the rule by the majority of shareholders." Elucidate this statement by citing the relevant case law. Also mention the exceptions, if any, to this rule with the support of case law. [CS (Final) Dec. 1990]

Practical Problems from CS Examinations

Misuse of corporate opportunity by the directors – Can minority sue the directors?

P 6.1A. The directors of a company held more than 75% shares in the company. The company was carrying on business of construction of projects. The directors acquired certain contracts in their own name in breach of trust and made profits for themselves. In the annual general meeting, they passed a resolution that the company had no interest in the contract. The minority shareholders filed a case against directors asking them to account for the profits. Discuss. [CS (Final) Dec. 1995]

OR

Sky-High Ltd. is engaged in the business of construction. A, B and C, directors of the Sky-High Ltd. are holding 75% of the capital of this company. The company passed a resolution at its general meeting that it would not be interested in a particular contract for construction of a bridge. Subsequently, the same contract was obtained by A, B and C in their own names.

[CS (Final) Dec. 2001]

Ans. The Majority Rule governs the internal management of the company. As such if any wrong is done to the company, the proper plaintiff to institute a suit is the company itself and the Court would not interfere at the instance of the individual shareholders ***[Foss v Harbottle (1843) 2 Hare 461]***. However, if the majority misuses its powers to defraud or oppress the minority, an action can be brought by an individual member.

Three directors holding 75% of the share capital of the company used their positions as directors and obtained a contract in their own names. As it amounted to breach of duty towards the company, they called a general meeting in which a resolution was passed to the effect that the company had no interest in the contract. It was held that directors utilised the contract belonging to the company for their personal gain and it amounted to a fraud on the minority. The company could claim profits realised by the directors ***[Cook v Deeks (1916) 1 AC 554]***.

The facts of the given case are identical to the facts specified in ***Cook v Deeks*** and so it can be said that the minority shareholders will succeed.

6.2 Application to Tribunal for relief in cases of oppression, etc. (Section 241)

1. Application by member(s) to the Tribunal for claiming relief from oppression etc. [Section 241(1)]

In order to claim relief from oppression etc., one or more members who are eligible as per section 244, may complain to the Tribunal that –

(a) the affairs of the company have been or are being conducted in a manner –

(i) prejudicial to public interest;

(ii) prejudicial or oppressive to the member(s) making such application or any other member(s); or

(iii) prejudicial to the interests of the company.

(b) a material change has taken place in the management or control of the company 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.

What is not a material change?

A change brought about by, or in the interests of –

(a) creditors; or

(b) debentureholders; or

(c) any class of shareholders of the company.

What is a material change?

The 'material change' may take place by –

(a) an alteration in the Board of directors; or

(b) an alteration in the manager; or

(c) an alteration in the ownership of the company's shares; or

(d) an alteration in the membership of the company, if the company has no share capital; or

(e) in any other manner whatsoever

2. Application by the Central Government to the Tribunal [Section 241(2)]

If the Central Government 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 Chapter XVI of the Companies Act, 2013.

The applications under sub-section (2) of section 241, in respect of such company or class of companies, as may be prescribed, shall be made before the Principal Bench of the Tribunal which shall be dealt with by such Bench.

3. **Reference by the Central Government to the Tribunal to inquire into and decide as to whether a person is a fit and proper person [Section 241(3)]**

Where in the opinion of the Central Government there exist circumstances suggesting that –

(a) any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law or of breach of trust;

(b) the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices;

(c) a company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or

(d) the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest,

the Central Government may initiate a case against such person and refer the same to the Tribunal with a request that the Tribunal may inquire into the case and record a decision as to whether or not such person is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.

1. **Person concerned to be joined as a respondent [Section 241(4)]**
   The person against whom a case is referred to the Tribunal under sub-section (3) of section 241, shall be joined as a respondent to the application.
2. **Requirements of application made by the Central Government to the Tribunal [Section 241(5)]**
   (a) Every application under sub-section (3) shall contain a concise statement of such circumstances and materials as the Central Government may consider necessary for the purposes of the inquiry.
   (b) Every application under sub-section (3) shall be signed and verified in the manner laid down in the Code of Civil Procedure, 1908.

Theoretical Questions from CA and CS Examinations

Q 6.2A. State the conditions which must be satisfied before filing an application for the prevention of oppression.
[CA (Final) June 2009 (New Course), CS (Final) June 1999]

Q 6.2B. "Section 241 is intended to avoid winding up, if possible, and keep the company going while at the same time saving the minority shareholders from oppression." Critically examine this statement. [CS (Final) June 2001]

Q 6.2C. "Law intends relieving minority shareholders from oppression without resorting to winding up of the company." Discuss.
[CA (Final) May 1993]

Q 6.2D. A group of shareholders are approaching you for an advice in relation to the fact that the affairs of the company are being conducted in a manner oppressive to the shareholders. Advise them as to the relevant provision of the Companies Act, 2013 under which their complaint would fall into? What would be your advice, if they complain that the affairs are prejudicial to the interest of the company?
[CA (Final) RTP May 2008 (Modified)]

Q 6.2E. Who can apply to the Company Law Board for relief in case of oppression and mismanagement? [CA (Final) May 1986]

6.3 Right to apply under section 241 (Section 244)

The provisions of section 244 have been enacted so as to discourage the presentation of frivolous applications by one or more disgruntled shareholders. These provisions are explained hereunder:

1. **Eligibility to make an application**

   An application under section 241 may be made as follows:

   (a) Members. Members eligible to make the application are as follows:

   (i) Company having a share capital. Members eligible to apply shall be the lowest of the following:
   - 100 members; *or*
   - 1/10th of the total number of members; *or*
   - One or more members holding not less than 1/10th of the issued share capital of the company.

(ii) ***Company having no share capital.*** Application shall be valid only if it is made by at least 1/5th of total number of members.

Application by lesser number of members

The Tribunal has the discretion to waive the requirements as to eligibility (in the case of a company having a share capital and also in the case of a company having no share capital). Thus, the Tribunal may permit a lesser number of members to make an application.

(b) ***The Central Government.*** The Central Government may itself make an application to the Tribunal if it is of the opinion that the affairs of a company are being conducted in a manner prejudicial to public interest [Section 241(2)].

2. Validity of an application – Conditions to be fulfilled

(a) The applicants must have paid all the calls and other sums due on their shares. However, the Tribunal has the discretion to waive this requirement, *i.e.* the Tribunal may permit filing of an application even where the calls or other sums due on shares have not been paid.

(b) The applicants must hold the requisite number of shares at the time of filing the application.

(c) Joint holders of shares are counted as one member only.

(d) Section 244 requires that the application should be made by requisite number of members. It does not require that the member must be a holder of equity shares only. Thus, a preference shareholder, being a member, is also entitled to make an application to the Tribunal.

3. Application by members – Certain issues

Following points need to be noted:

(a) ***Definition of member [Section 2(55)].*** A person shall be a member of the company if –

(i) he agrees in writing to become a member; *and*

(ii) his name is entered in its register of members.

Following provisions are important in this regard:

- Where shares are held in depository system, the beneficial owner is treated as a member. So, application under section 241 can be made by the beneficial owner, and not by the depository.
- A person entitled to shares but whose name has not been entered in the register of members cannot apply.
- Where a person has obtained a decree for rectification of register of members of the company to have his name entered in it, he may make an application although his name is not entered in the register of members [***Stadmed Pvt. Ltd.*** **v** ***Kshetra Mohan Saha*** **(1969) 39 Comp Cas 741**].
- A person in whose favour share certificates have been issued can exercise the rights as a member notwithstanding the omission of his name from the register of members [***N. Satyaprasad Rao*** **v** ***L.N. Sastry*** **(1988) 64 Comp Cas 492, 496**].

(b) ***Members ceasing to be members – Consequences.*** The requirement as to minimum shareholding is to be satisfied only at the time of filing of the application. If some of the members who consented to the application ceased to be members by selling their shares, the application is still maintainable [***Jagdish Chandra Mehra*** **v** ***New India Embroidery Mills*** **(1964) 1 Comp LJ 291**].

Where after making of the application, the applicant's name was struck off the register of members on the ground that the transfer was unstamped or because of any other reason, the application continues to remain valid [***Sayedabad Tea Company Ltd.*** **v** ***Samarendra Nath Ghattak*** **(1995) 83 Comp Cas 504**].

(c) ***Consent to make an application.*** Any one or more members may make an application to the Tribunal on behalf of all the members by obtaining the consent of other members in writing. All the consenting members need not join in the application.

Consent must be prior to making of application

The consent to make the application must be obtained before making the application. As such, consent obtained subsequent to the making of the application is ineffective [***Makhanlal Jain*** **v** ***Amrit Banaspati Company Ltd.*** **(1953) 23 Comp Cas 100**].

Members must consent to subject matter of application

Consenting members have to apply their mind both to the allegations and relief sought. Mere consenting to an application is not enough if the style of consent shows non-application of mind. Consent letter must show that the members exercised an intelligent mind [***Shanker*** **v** ***South Indian Concerns Ltd.*** **(1997) 1 Comp LJ**].

(d) ***Withdrawal of consent – Consequences.*** The consent to be given by members is reckoned at the beginning of the proceedings. The withdrawal of consent by a shareholder during the course of the proceedings does not affect the maintainability of the application [***Rajahmundri Electric Supply Corporation*** v ***Nageshwara Rao*** **AIR 1956 SC 213**].

(e) ***Can majority claim relief under section 241?*** Section 241 nowhere requires that application for claiming relief from oppression or mismanagement shall be made only by the minority shareholders.

In other words, section 241 neither disentitles a majority of members to make an application, nor requires that application shall be made by minority members only.

Since section 241 is of remedial nature (*i.e.* object of section 241 is to prevent a mischief), its proper construction should be to give the words used their widest amplitude. Therefore, no upper limit should be implied in section 241.

An application made by majority shareholders alleging oppression or mismanagement is not *prima facie* invalid. The facts and circumstances may justify intervention of the Tribunal on an application made by majority of members. The Tribunal intervenes if the majority proves that there are sufficient grounds to constitute oppression on the majority. Thus, where the facts proved harassment of management by forming parallel Board of directors, parallel Board meetings, parallel AGMs, parallel registered offices etc., it amounted to oppression, and majority was entitled to make an application claiming relief from oppression [***Re, Sindri Iron Foundry Pvt. Ltd; Radhey Shyam Gupta*** v ***Kamal Oil***].

Where minority shareholders took advantage of absence of majority shareholders and passed a resolution wrongly depriving the majority of its right to further shares in order to achieve a majority, the action of minority was held to be oppressive. A single or isolated act which has permanent effect which is harsh or burdensome, constitutes oppression [***T M Paul*** v ***City Hospital***].

Some examples of oppression on majority are given below:

(i) Where the minority, by physical force or other wrongful act, oust the majority, so as to prevent the lawful exercise of their rights as shareholders.

(ii) Where there are serious disputes between two group of shareholders, and consequently two registered offices are set up, two separate Boards are elected, separate Board meetings are held and separate general meetings are held, company's business, property and assets are passed to unauthorised persons.

(iii) Where the minority shareholders take advantage of absence of members holding majority share capital, and pass a resolution wrongly depriving a member of his shares in order to achieve a majority.

Practical Problems from CA Examinations

Whether application made to the Tribunal satisfies the eligibility requirements?

P 6.3A. ABC Private Limited is a company in which there are eight shareholders. Can a member holding less than one-tenth of the share capital of the company apply to the Tribunal for the relief against oppression and mismanagement?

[CA (Final) May 2000 (Modified)]

OR

There are eight shareholders in M/s Supra Private Ltd. Mr. Shyam who is holding less than one-tenth of the share capital of the company seeks your advice whether he can apply to the Tribunal for relief against oppression and mismanagement. Advise.

[CA (Final) Nov. 2002 (Modified)]

Ans. As per section 244 of the Companies Act, 2013, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be the lowest of the following:

(a) 100 members; *or*

(b) 1/10th of the total number of members; *or*

(c) Members holding not less than 1/10th of the issued share capital of the company.

In the given case, there are only eight shareholders. Not less than '1/10th of total number of members' means 'not less than 1 member'. Accordingly, a single member satisfies the eligibility requirement of '1/10th of total number of members'. Therefore, a single member can present a petition to the Tribunal, regardless of the fact that he holds less than 1/10th of the issued share capital of the company, provided he must have paid all the calls and other sums due on his shares.

Right to apply, and whether application is maintainable if the company is incurring losses and not declaring dividend

P 6.3B.

Case I. A group of shareholders consisting of 25 members decide to file a petition before the Tribunal for relief against oppression and mismanagement by the Board of directors of M/s. Fly By Night Operators Ltd. The company has a total of 300 members and the group of 25 members holds one tenth of the total paid up share capital accounting for one-fifteenth of the issued share capital. The main grievance of the group is that due to mismanagement by the Board of directors, the company is incurring losses and the company has not declared any dividends even when profits were available in the past years for declaration of dividend. Advise the group of shareholders regarding the success of –

(i) getting the petition admitted; and

(ii) obtaining relief from the Tribunal. [CA (Final) May 1999]

Case II. A group of shareholders consisting of 30 members decide to file a petition before the Tribunal for relief against oppression and mismanagement by the Board of directors of M/s. Aravalli Manufacturing Company Limited having a paid up share capital of Rs. 1 crore. The company has a total of 500 members and the group of 30 members holds one-tenth of the total paid-up share capital accounting for one-fifteenth of the issued share capital. The grievance of the group is that due to the mismanagement by the Board of directors, the company is incurring losses and has not declared any dividend for the past five years. In the light of the provisions of the Companies Act, 2013, please advise the group of shareholders regarding the admission of the petition and the relief thereof. [CA (Final) May 2019]

Case III. The Board of directors of a company *bonafide* decides not to declare any dividend for the year ended 31st March, 2015. A group of shareholders complain to the Tribunal against the above decision of the Board of directors on the ground of mismanagement and wants the company to declare dividend. Examine with reference to the provisions of the Companies Act, 2013 whether the act of the company is valid. [CA (Final) May 1997 (Modified)]

Case IV. The profits of ABC Limited for the financial year 2014-2015 fell considerably due to recession. The Board of directors of the company, therefore, bonafide did not recommend any dividend for the year. At the Annual General Meeting of the company, a group of members objected to the Board's decision and wanted the Board to make recommendation for dividend. On refusal by the Board, the members, who feel oppressed by the Board's decision to skip the dividend, move to the Tribunal and complain against the Board on the ground of oppression and mismanagement. Examining the provisions of the Companies Act, 2013, decide:

(i) Whether the members' contention shall be tenable?

(ii) Whether the act of Board of directors not to recommend any dividend shall amount to oppression and mismanagement? [CA (Final) RTP May 2016 (Modified)]

Ans. The given problems relate to section 241 read with section 244 of the Companies Act, 2013, as discussed below:

The legal position

As per section 244 of the Companies Act, 2013, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be the lowest of the following:

(a) 100 members; *or*

(b) 1/10th of the total number of members; *or*

(c) Members holding not less than 1/10th of the issued share capital of the company.

So as to decide as to whether there is oppression or mismanagement or not, following points are worth noting:

(a) The conduct can be said to be oppression only when it is burdensome, harsh and wrongful. Oppression involves an element of lack of probity and fair dealings to a member.

(b) The relief is available only when the acts complained of are shown to be continued acts of oppression.

(c) The relief is available only if it is established that the degree of oppression or mismanagement is so severe that there is just and equitable ground for winding up of the company.

(d) Where a company is continuously incurring losses, it cannot be regarded as an act of oppression ***[Ashoka Betelnut Co. P. Ltd. v M.K. Chandrakantha]***. Also, incurring of losses by a company does not in itself amount to mismanagement. However, if it is proved that due to mismanagement by the Board of directors, the company has been incurring losses, it may amount to mismanagement if the Tribunal is of the opinion that the facts would justify making of a winding up order.

(e) Non-declaration of dividend is not an act of oppression ***[Chander Krishna Gupta* v *Pannalal Girdharilal P. Ltd.]***.

(f) A *bonafide* decision of the Board not to recommend dividend and to accumulate profits does not amount to mismanagement ***[Thomas Vettom (VJ)* v *Kuttanad Rubber Co. Ltd.]***.

(g) Mere dissatisfaction of minority does not result in oppression or mismanagement ***[Thomas Vettom (VJ)* v *Kuttanad Rubber Co. Ltd.]***.

Case I.

The given case and analysis of the case

Applying the provisions of section 244 to the given case, the eligibility shall be as follows:

(i) 30 members (irrespective of amount or percentage of share capital held by them); or

(ii) One or more members holding 1/10th of issued share capital of the company.

whichever is lower.

2. In the instant case, a group of 25 members has made an application to the Tribunal. The applicants are less than 30 in number, and also the applicants hold (in aggregate) less than 1/10th of the issued share capital of the company. Thus, the said group of shareholders does not meet any of the above eligibility criteria. However, the Tribunal has a discretionary power to waive the eligibility requirements, *i.e.* the Tribunal may permit a lesser number of members to make an application. Thus, members may approach the Tribunal to permit them to make an application.
3. In the present case, the only grievance of members is that the company is incurring losses and the company had not declared any dividend in the past during the years when the profits were available for distribution of dividend. No other material has been produced before the Tribunal to prove the oppression or mismanagement.

Conclusions

(i) The application made by the members does not meet the eligibility requirements contained in section 244, and is therefore, liable to be rejected, unless the Tribunal waives the eligibility requirements.

(ii) The members are not likely to succeed in getting relief from the Tribunal, since –

(a) the allegation that the company is incurring losses, does not amount to oppression or mismanagement as was held in ***Ashoka Betelnut Co. P. Ltd. v M.K. Chandrakantha.***

(b) the allegation that the company had not declared any dividend in the past during the years when the profits were available for distribution of dividend, does not amount to oppression or mismanagement as was held in ***Chander Krishna Gupta v Pannalal Girdharilal P. Ltd.*** and ***Thomas Vettom (VJ) v Kuttanad Rubber Co. Ltd.***

Case II.

The given case and analysis of the case

1. Applying the provisions of section 244 to the given case, the eligibility shall be as follows:
   (i) 50 members (irrespective of amount or percentage of share capital held by them); or
   (ii) One or more members holding 1/10th of issued share capital of the company.
   whichever is lower.
2. In the instant case, a group of 30 members has made an application to the Tribunal. The applicants are less than 50 in number, and also the applicants hold (in aggregate) less than 1/10th of the issued share capital of the company. Thus, the said group of shareholders does not meet any of the above eligibility criteria. However, the Tribunal has a discretionary power to waive the eligibility requirements, *i.e.* the Tribunal may permit a lesser number of members to make an application. Thus, members may approach the Tribunal to permit them to make an application.
3. In the present case, the only grievance of members is that the company is incurring losses and the company had not declared any dividend for the past 5 years. No other material has been produced before the Tribunal to prove oppression or mismanagement.

Conclusions

(i) The application made by the members does not meet the eligibility requirements contained in section 244, and is therefore, liable to be rejected, unless the Tribunal waives the eligibility requirements.

(ii) The members are not likely to succeed in getting relief from the Tribunal, since –

(a) the allegation that the company is incurring losses, does not amount to oppression or mismanagement as was held in ***Ashoka Betelnut Co. P. Ltd. v M.K. Chandrakantha.***

(b) the allegation that the company had not declared any dividend in the past during the years when the profits were available for distribution of dividend, does not amount to oppression or mismanagement as was held in ***Chander Krishna Gupta v Pannalal Girdharilal P. Ltd.*** and ***Thomas Vettom (VJ) v Kuttanad Rubber Co. Ltd.***

Case III.

The given case, analysis of the case and conclusion

The only grievance of members is that the company has not declared any dividend for the year ended 31st March, 2015. No other material has been produced before the Tribunal to prove the oppression or mismanagement.

Non-declaration of dividend does not result in oppression or mismanagement as was held in ***Chander Krishna Gupta v Pannalal Girdharilal P. Ltd.*** and ***Thomas Vettom (VJ) v Kuttanad Rubber Co. Ltd.***

Case IV.

The given case and analysis of the case

1. A group of members has made a complaint to the Tribunal alleging oppression and mismanagement on the ground that the Board has not recommended any dividend for the financial year 2014-2015 due to fall in profits.
2. No other material has been produced before the Tribunal to prove the oppression or mismanagement.

Conclusions

(i) The contention of the members is not tenable since there is no oppression or mismanagement.

(ii) The decision of the Board not to recommend any dividend does not amount to oppression or mismanagement as was held in ***Chander Krishna Gupta v Pannalal Girdharilal P. Ltd.*** and ***Thomas Vettom (VJ) v Kuttanad Rubber Co. Ltd.***

Various cases w.r.t. eligibility requirements and subsequent withdrawal of consent

P 6.3C. Answer the following cases:

Case I. **A group of shareholders of M/s. High Profile Engineering Company Ltd. has filed a petition before the Tribunal alleging various acts of oppression and mismanagement by the majority shareholders. The petitioner group holds 15% of the issued share capital of the company. During the course of hearing before the Tribunal, some of the petitioner group of shareholders holding about 6% of the issued share capital of the company have withdrawn their consent by stating that they are misled by the group to sign the petition and after coming to know of the true facts they have disassociated themselves with the petition and they, along with the other majority shareholders have submitted that the petition should be dismissed on the ground of non-maintainability. Examine their contention having regard to the provisions of the Companies Act, 2013.**

[CA (Final) Nov. 1999, Nov. 2009 (Modified)]

Case II. **The issued, subscribed and paid-up share capital of ABC Company Limited is Rs. 10 lakhs consisting of 90,000 equity shares of Rs. 10 each fully paid up and 10,000 preference shares of Rs. 10 each fully paid up. Out of members of company, 400 members holding one preference share each and 50 members holding 500 equity shares applied for relief under section 241 of the Companies Act, 2013. As on the 'date of petition', the company had 600 equity shareholders and 5,000 preference shareholders.**

Examine whether the above petition under section 241 is maintainable. Will your answer be different, if preference shareholders have subsequently withdrawn their consent? **[CA (Final) June 2009, May 2004 (Modified)]**

Case III. **The issued, subscribed and paid up capital of OPM Limited is Rs. 5 crores consisting of 50,00,000 equity shares of Rs. 10 each. The company has 700 members. A petition was made to the appropriate authority duly signed by 80 members holding 2,50,000 equity shares of the company seeking relief against oppression and mismanagement. Subsequently 20 of them withdrew their consent. Examine with reference to the relevant provisions of the Companies Act, 2013 and decided case law whether the petition is maintainable.** **[CA (Final) Nov. 2008, May 2013, May 2015 (Modified)]**

Case IV. **The issued and paid up capital of Crown Jewels Limited is Rs. 5 crore consisting of 5,00,000 equity shares of Rs. 100 each. The said company has 500 members. A petition was submitted before the Tribunal signed by 80 members holding 10,000 equity shares of the company for the purpose of relief against oppression and mismanagement by the majority shareholders. Examining the provisions of the Companies Act, 2013, decide whether the said petition is maintainable. Also explain the impact on the maintainability of the above petition, if subsequently 40 members, who had signed the petition, withdrew their consents.**

[ICAI, RTP, May 2018; ICAI, Mock Test Paper, April 2018]

Ans. As per section 244 of the Companies Act, 2013, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be the lowest of the following:

(a) 100 members; *or*

(b) 1/10th of the total number of members; *or*

(c) Members holding not less than 1/10th of the issued share capital of the company.

It must be noted that the term 'member' includes an equity shareholder as well as a preference shareholder.

The validity of an application is to be judged as per the facts at the time of its presentation to the Tribunal. An application which is valid when presented to the Tribunal does not cease to be maintainable by reason of any event subsequent to its presentation to the Tribunal. After an application is presented to the Tribunal, the withdrawal of consent by one or more members does not anyway affect the maintainability of the application. Accordingly, the right of the applicant to proceed with the application or the jurisdiction of the Tribunal to dispose of the application on its own merits is not affected by reason of withdrawal of consent by any member **[*Rajahmundri Electric Supply Corporation* v *Nageshwara Rao* AIR 1956 SC 213]**.

Answer to Case I. In the present case, the petition has been made by the shareholders holding 15% of the issued share capital of the company and therefore, the petition meets the eligibility criterion laid down under section 244.

However, after the petition is made, some members holding 6% of the issued share capital of the company have withdrawn their consents. The issue raised in the question is whether the petition has become non-maintainable by reason of withdrawal of such consents.

Applying the judgment given in ***Rajahmundri Electric Supply Corporation* v *Nageshwara Rao*** to the given case, the petition made by the shareholders shall remain valid despite the fact that some of the petitioners holding about 6% of the issued share capital have withdrawn their consents.

Answer to Case II.

In the present case, the shareholding pattern of the company is as follows:

- Equity share capital is Rs. 9,00,000, which is held by 600 members.
- Preference share capital is Rs. 1,00,000, which is held by 5,000 members.
- Total share capital is Rs. 10,00,000, which is held by 5,600 members.

The application alleging oppression and mismanagement has been made by the members as follows:

(a) Number of members making the application:

■ Preference shareholders	400
■ Equity shareholders	50
■ Total members	450

(b) Amount of share capital held by the members making the application:

- Preference share capital Rs. 4,000 (400 preference shares of Rs. 10 each)
- Equity share capital Rs. 5,000 (500 equity shares of Rs. 10 each)
- Total share capital Rs. 9,000

The application shall be valid if it has been made by the lowest of the following:

(a) 100 members

(b) 560 members (being 1/10th of 5,600)

(c) Members holding issued share capital of Rs. 1,00,000 (being 1/10th of Rs. 10,00,000)

As is evident, the application made by 450 members meets the eligibility criteria specified under section 244, and therefore, the application is maintainable in terms of section 244.

Applying the judgment given in ***Rajahmundri Electric Supply Corporation* v *Nageshwara Rao*** to the given case, the petition made by the shareholders shall remain valid despite the fact that some of the petitioners have withdrawn their consents.

Comment: It has been assumed that the members making the application have paid all the calls due on their shares.

Answer to Case III.

In the given case, the number of members is 700. Not less than '1/10th of total number of members' means 'not less than 70 members'. Accordingly, the application made by 80 members satisfies the eligibility requirement of '1/10th of total number of members'. Therefore, the application made by 80 members is valid regardless of the fact that these 80 members hold in aggregate less than 1/10th of the issued share capital of the company.

Such application shall remain valid despite the fact that 20 applicants have subsequently withdrawn their consents **[*Rajahmundri Electric Supply Corporation* v *Nageshwara Rao* AIR 1956 SC 213]**.

Comment: It has been assumed that the members making the application have paid all the calls due on their shares.

Answer to Case IV.

In the given case, the number of members is 500. Not less than '1/10th of total number of members' means 'not less than 50 members'. Accordingly, the application made by 80 members satisfies the eligibility requirement of '1/10th of total number of members'. Therefore, the application made by 80 members is valid regardless of the fact that these 80 members hold in aggregate less than 1/10th of the issued share capital of the company.

Such application shall remain valid despite the fact that 40 applicants have subsequently withdrawn their consents **[*Rajahmundri Electric Supply Corporation* v *Nageshwara Rao* AIR 1956 SC 213]**.

Comment: It has been assumed that the members making the application have paid all the calls due on their shares.

Whether Tribunal can grant relief on an application made by majority of members?

P 6.3D. M/s City Hospital Private Ltd. has two groups of directors. A dispute arose between the two groups out of which one group controlled the majority of shares. A very serious situation arose in the administration of the company's affairs when the minority group ousted the lawful Board of Directors from the possession and control of the management of the company's factory and workshop. Books of account and statutory records were held by the minority group and consequently the annual accounts could not be prepared for two years. The majority group applied to the Tribunal under section 241 of the Companies Act, 2013. You are required to decide with reference to the provisions of the said Act, the following issues:

(i) Can majority of shareholders apply to the Tribunal for relief against the oppression by the minority shareholders?

(ii) Whether Tribunal can grant relief in such circumstances. [CA (Final) Nov. 2007]

OR

Examine the merits of the following petitions made under sections 241 of the Companies Act, 2013:

Speciality Chemicals Private Limited is controlled by two groups of members. The group holding majority of shares made an application to Tribunal alleging oppression by the minority group. [CA (Final) Nov. 2013 (Modified)]

OR

State whether a petition by majority shareholders complaining oppression by minority shareholders will succeed? [CA (Final) Nov. 1995]

OR

Can there be a situation when majority of members may take recourse to a petition under section 241 of the Companies Act, 2013? [CS (Final) June 1999]

Ans. The right to make an application is given under section 244 of the Companies Act, 2013. As per section 244, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be the lowest of the following:

(a) 100 members; *or*

(b) 1/10th of the total number of members; *or*

(c) Members holding not less than 1/10th of the issued share capital of the company.

However, in case of a company not having a share capital, the application shall be valid only if it is made by at least 1/5th of total number of members.

Section 244 specifies the minimum number of members who are eligible to make an application. It nowhere prohibits a majority of members from making the application. In other words, section 244 does not expressly or impliedly stipulate that an application shall be maintainable only if it is made by the minority.

Where the application is made by a majority of members, relief may be granted if the Tribunal is satisfied that the majority is oppressed and has been rendered completely ineffective by the wrongful acts of a minority group.

There may be oppression where a minority by physical force or other wrongful act oust the majority, so as to prevent the lawful exercise of their rights as shareholders. As such, where two different registered offices at two different addresses had been set up, that two rival Boards were holding meetings, that the company's business, property and assets had passed on to the unauthorized persons, that unauthorized persons claimed to be the shareholders and directors, it was held that majority was oppressed, and accordingly the application made by majority was held to be maintainable **[*Re, Sindri Iron Foundry Pvt. Ltd.* (1964) 34 Comp Cas 510]**.

The issues raised in the given problem are answered as below:

(i) Application to the Tribunal by majority of shareholders is valid since the right to apply to the Tribunal is not confined to minority shareholders alone; majority may also apply **[*Re, Sindri Iron Foundry Pvt. Ltd.*]**. Since, in the given case, the majority is oppressed, the majority of shareholders may apply to the Tribunal for relief against the oppression by minority shareholders.

    Whether the application made by the majority shareholders would succeed or not would depend upon the satisfaction of the Tribunal with respect to fulfilment of conditions laid down under section 241 read with section 242, *i.e.* –

    (a) the affairs of the company have been or are being conducted in a manner –

        (i) prejudicial to public interest;

        (ii) prejudicial or oppressive to the member(s) making such application or any other member(s); or

        (iii) prejudicial to the interests of the company; and

    (b) 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.

(ii) The Tribunal may grant such relief as it may deem fit in the light of facts and circumstances of the case, in accordance with the provisions of Sections 242 and 243, if the Tribunal is of the opinion that the conditions laid down under section 241 and 242 are satisfied.

Can a legal representative of a deceased member who holds less than one-tenth of the issued share capital, apply for relief?

P 6.3E. MNC Private Ltd. is a company in which there are six shareholders. Mr. Srinath, who is a director and also the legal representative of a deceased shareholder holding less than one tenth of the share capital of the company made a petition to the Tribunal for relief against oppression and mismanagement. Examine under the provisions of the Companies Act, 2013 whether the petition made by Mr. Srinath is valid and maintainable? [CA (Final) Nov. 2018]

Ans. The given problem relates to section 244 of the Companies Act, 2013.

The legal position

1. As per section 244, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be the lowest of the following:

    (a) 100 members; *or*

    (b) 1/10th of the total number of members; *or*

    (c) Members holding not less than 1/10th of the issued share capital of the company.

The given case and analysis of the case

2. There are only 6 shareholders. Not less than '1/10th of total number of members' means 'not less than 1 member'. Accordingly, a single member satisfies the eligibility requirement of '1/10th of total number of members'. Therefore, a single member can present a petition to the Tribunal, regardless of the fact that he holds less than 1/10th of the issued share capital of the company, provided he must have paid all the calls and other sums due on his shares.

3. The petition to the Tribunal has been made by Mr. Srinath who is a director and a legal representative of a deceased member. However, the transmission of shares of the deceased member has not been effected in the name of Mr. Srinath, and so Mr. Srinath is not himself a member of MNC Private Limited as on the date of making petition to the Tribunal.

4. The legal representative of a deceased member is entitled to file a petition under section 241 of the Act for relief against oppression and mismanagement, even though the name of the deceased member is still recorded in the register of members **[*Worldwide Agencies Pvt. Ltd. and another v Margaret T. Desor and others*]**. It would be wrong to insist that the name of the legal representative be first put on the register before he can move an application under section 241.

Conclusion

5. The petition made by Mr. Srinath fulfils the requirements of section 244, and is therefore, valid and maintainable.

A person who is a director as well as a member holding less than 10% of the share capital of the company is removed from directorship – Whether application made by him alleging oppression is maintainable?

P 6.3F. M/s DJ Limited, a listed company, as per the audited financial statements as at March 31, 2018 is having issued and paid-up equity share capital comprising of 10 lakhs shares of Rs. 10 each and issued and paid-up preference share capital of 5 lakhs shares of Rs. 10 each respectively. The members of the company after complying with the provisions of section 169 of the Companies Act, 2013 removed one Mr. Satish from the directorship of the company on 1st August 2018 before the completion of his term of office. Mr. Satish is also one of the members of the company holding 110000 fully paid-up equity shares. Mr. Satish has alleged oppression on his removal and has moved the jurisdictional Honourable National Company Law Tribunal (NCLT) under section 241 read with section 244 of the Companies Act, 2013. The Board of directors of the company is of the opinion that the application is not maintainable as per the provisions of section 244 of the Companies Act, 2013. Decide.

Also, state if any other recourse that is available with Mr. Satish under the provisions of the Companies Act, 2013.

[CA (Final) Nov. 2018]

Ans. The given problem relates to section 244 read with sections 241 and 242 of the Companies Act, 2013.

1. As per section 244, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be the lowest of the following:
   (a) 100 members; or
   (b) 1/10th of the total number of members; or
   (c) Members holding not less than 1/10th of the issued share capital of the company.
2. It must be noted that the term 'member' includes an equity shareholder as well as a preference shareholder.
3. In the present case, the shareholding pattern of the company is as follows:
   - Equity share capital is Rs. 1 crore divided into 10 lakh shares of Rs. 10 each.
   - Preference share capital is Rs. 50 lakh divided into 5 lakh shares of Rs. 10 each.
   - Total share capital is Rs. 1.5 crore divided into 15 lakh shares of Rs. 10 each.
4. An application alleging oppression or mismanagement shall be valid if it has been made by the lowest of the following:
   (a) 100 members
   (b) 1/10th of the total number of members
   (c) Members holding issued share capital of Rs. 15 lakh (being 1/10th of Rs. 1.5 crore)
5. In the given case, the application has been made by Mr. Satish, who holds issued share capital of Rs. 11 lakh only. The application made by Mr. Satish does not meet the eligibility criteria specified under section 244, and therefore, his application is not maintainable in terms of section 244. However, the Tribunal has the discretion to waive the requirements with respect to eligibility, and thus, the Tribunal may permit Mr. Satish to make the application.
6. As per section 241 read with section 242, for obtaining relief from oppression or mismanagement, an application is required to be made to the Tribunal. After due inquiry, the Tribunal may make such order as it may deem fit, if it is of the opinion –
   (a) that the affairs of the company have been or are being conducted in a manner –
      (i) prejudicial to public interest;
      (ii) prejudicial or oppressive to the member(s) making such application or any other member(s); or
      (iii) prejudicial to the interests of the company; and
   (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up.
7. As is evident from the language used in sections 241 and 242, the acts complained of shall amount to oppression only if such acts have adversely affected a person in his capacity as a member of the company. Such acts which adversely affect a person who is not a member of the company do not amount to oppression. Further, where the affairs of a company are conducted in a manner which are prejudicial to a member, but not in his capacity of a member but in any other capacity, it does not amount to oppression.

8. Where a person who is a member as well as a director is removed from directorship, there is no oppression, since no wrong is done to any person in his capacity of a member.
9. In the present case, Mr. Satish, who is a director as well as a member, is removed from directorship. This does not amount to oppression in terms of section 241 because of the following reasons:
   (a) No harm or prejudice is caused to any person in his capacity of a member. To constitute oppression, the conduct complained of must affect a person in his capacity as a member of the company. Oppression in any other capacity, *i.e.* as a director of a company is outside the purview of section 241.
   (b) The election and removal of directors is the prerogative of the members and such an act cannot *ipso facto* be treated as oppression on minority, unless the conduct of the majority is based on malafide considerations.
   (c) The conduct can be said to be oppression only when it is burdensome, harsh and wrongful. Oppression involves an element of lack of probity and fair dealings to a member. Mere removal of a director does not amount to oppression.
   (d) The relief is available only when the acts complained of are shown to be continued acts of oppression or mismanagement.
   (e) The relief is available only if it is established that degree of oppression of mismanagement is so severe that there is just and equitable ground for winding up of the company.

   Since the conditions specified in section 241 have not been fulfilled, there is no oppression or mismanagement and therefore, relief from the Tribunal under section 242 cannot be claimed.
10. Mr. Satish may explore recourse to the following measures:
   (a) He may, along with other members, make an application to the Tribunal under section 213 seeking an order of investigation into the affairs of the company. For this purpose, the application shall have to be made to the Tribunal by the eligible members (*i.e.* lower of 100 members or one or more members holding 10% of total voting power).
   (b) He may transfer the shares held by him to any person at such price as may be agreed between the parties.
   (c) As per section 169, he shall be entitled to claim compensation for loss of office of director in accordance with the terms of his appointment or contract. However, the right to compensation is subject to the restrictions imposed under section 202 of the Companies Act, 2013.

Practical Problems from CS Examinations

Can a legal representative of a deceased member apply for relief?

P 6.3G. Legal representative of a deceased member of a company alleged oppression and mismanagement. He made a complaint to the Tribunal for relief. The management of the company is of the opinion that the petitioner has no *locus standi* since he is not a member. The register still shows the name of the deceased as member. Will the representation be entertained by the Tribunal?

Ans. The legal representative of a deceased member is entitled to file a petition under section 241 of the Act for relief against oppression and mismanagement, even though the name of the deceased member is still recorded in the register of members **[*Worldwide Agencies Pvt. Ltd. and another* v *Margaret T. Desor and others*]**. It would be wrong to insist that the name of the legal representative be first put on the register before he can move an application under section 241. Therefore, the Tribunal may entertain the complaint in the given case.

Whether consent given by GPA holder is a valid consent?

P 6.3H. Three shareholders X, Y and Z intend to file a petition before the Tribunal under section 241 of the Companies Act, 2013. To comply with requirement of one-tenth shareholding, the shareholder X gave consent in writing for and on behalf of his daughter, also a shareholder, who had authorised her father to act on her behalf as her general power of attorney (GPA) holder. Is the consent given by her GPA holder for and on her behalf a valid consent? Will it affect the petition in any manner if, during the course of proceedings, one of the shareholders withdraws the consent? [CS (Final) Dec. 1996]

OR

A petition was made to the Tribunal under section 244 duly signed by 120 members of the company seeking relief against oppression and mismanagement. Subsequently, 40 of the members withdrew their signatures from the petition. Explain the legal position. [CS (Final) June 1997]

Ans. Consent given by a duly authorised power of attorney has been held to be a valid consent. This is an application of the normal rule of agency that excepting matters of personal nature, whatever a person can do by himself, he can get it done through another **[*P. Punnaiah* v *Jeypore Sugar Co. Ltd.*]**. Thus, consent given by a shareholder on behalf of her daughter in terms of GPA is valid.

The validity of an application is to be judged as per the facts at the time of its presentation to the Tribunal. An application which is valid when presented to the Tribunal does not cease to be maintainable by reason of any event subsequent to its presentation to the Tribunal. After an application is presented to the Tribunal, the withdrawal of consent by one or more members does not anyway affect the maintainability of the application. Accordingly, the right of the applicant to proceed with the application or the jurisdiction of the Tribunal to dispose of the application on its own merits is not affected by reason of withdrawal of consent by any member **[*Rajahmundri Electric Supply Corporation* v *Nageshwara Rao* AIR 1956 SC 213]**.

Thus, even if one of the shareholders withdraws his consent after the application is made to the Tribunal, it would not affect the validity of the application, and the application shall still be maintainable.

6.4 Powers of the Tribunal and consequence of termination or modification of certain agreements (Sections 242 and 243)

As per section 241, requisite number of members (as specified under section 244) may apply to the Tribunal for claiming relief from oppression or mismanagement. After due inquiry, the Tribunal may make such orders as are necessary to bring an end to the matters complained of. The Tribunal has been vested with the powers of wide amplitude to grant relief from oppression and mismanagement. These powers, and conditions to be fulfilled subject to which the Tribunal shall exercise such powers, are explained as follows:

1. **Conditions to be fulfilled for exercise of powers by the Tribunal**

   Upon receiving an application under section 241, the Tribunal may exercise the powers vested in it, if it is of the opinion –

   (a) that the company's affairs have been or are being conducted in a manner –

   (i) prejudicial to public interest; or

   (ii) prejudicial or oppressive to any member or members; or

   (iii) prejudicial to the interests of the company; and

   (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up.

1. **Definition of the term 'oppression'**

   The term 'oppression' has not been defined under the Companies Act, 2013. Whether the conduct of the affairs of a company are oppressive or not will depend upon the facts and circumstances of a particular case. The conduct can be said to be oppression only when it is burdensome, harsh and wrongful. Oppression involves an element of lack of probity and fair dealings to a member. Mere cornering of shares, non-declaration of dividend and building up reserves do not amount to oppression.

   Exercise of statutory power cannot result in oppression. A *bonafide* exercise of any power given under the Companies Act, 2013 or any other law for the time being in force, cannot amount to oppression, *e.g.* if a director is removed under section 169, there is no oppression, because the shareholders have a statutory right to remove a director by using the provisions of section 169.

2. **No oppression except in the capacity of a member**

   The conduct complained of shall amount to oppression only if such conduct affects a person in his capacity as a member of the company. Oppression in any other capacity, *e.g.* as a director or a creditor is outside the purview of this section. Thus, where the majority of directors override the minority directors, it does not amount to oppression.

   In order to prove oppression, the complaining member(s) must prove oppression in his/their capacity of 'member'. A person removed from directorship under section 169 cannot claim relief from oppression since no wrong has been done to him in the capacity of a member. This will be so, even if he happens to be a member of the company.

   Rights and interests as a member of a company can alone be agitated and not in relation to any commercial relation that a member has with the company as was held in ***Anil Gupta* v *Mirai Auto Industries Pvt. Ltd.***

3. **Continuity of oppression**

   In order to prove oppression, it is necessary that the acts complained of must be continued acts of oppression. The conduct of affairs of the company must indicate a continuous wrong.

4. **Justification of winding up**

   In order to prove oppression, the application must make out a *prima facie* case that the degree of oppression is so severe that there is just and equitable ground for winding up of the company.

   In ***Re, Bellador Silk Ltd.***, the application failed on the following grounds:

   (i) The application was made for the collateral purpose of forcing the repayment of loans to other companies in which the applicant was interested and was therefore, an abuse of power.

(ii) The applicant had filed the application complaining wrongs done to him in the capacity of a director and not in the capacity of a member.

(iii) The circumstances were not such as to justify the winding up.

5. **Winding up prejudicial to applicants**

In order to prove oppression, the applicants must satisfy the Tribunal that though it is justified to wind up the company, but winding up would unfairly prejudice the applicants.

6. **Articles restricting the rights of members to be void**

Where any provision contained in the articles or any agreement restrains any person from brining the proceedings for claiming relief from oppression or mismanagement, such provision shall be void since the provisions contained in section 241 cannot be barred or defeated by any provision contained in the articles or any agreement, as was held in ***O.P. Gupta* v *Shiv General Finance (P) Ltd.***

7. **Relief from oppression or mismanagement – A remedy alternate to winding up**

Relief from oppression or mismanagement is available only in those cases where the Tribunal regards it just and equitable to wind up the company. Therefore, the relief under section 241 is also known as an alternate remedy, *i.e.* a remedy alternative to winding up. *In other words,* the provisions of section 241 are intended to avoid recourse to the extreme step of winding up of a company and at the same time protect the minority shareholders from oppression.

8. **Oppression must be continuous; conduct must be burdensome, harsh and wrongful; lack of probity or fair dealings must be shown**

A private company had three groups of shareholders. The two groups of shareholders passed a special resolution (as per section 62 of the Companies Act, 2013) for making further issue of capital to the public. The other group contended that this was an act of oppression by the majority group. The Supreme Court expressed the position as: "It is not enough to show that there is just and equitable cause for winding up of the company though that must be shown as a preliminary to the application of section 241. It must further be shown that the conduct of the majority shareholders was oppressive to the minority as members and this requires that events have to be considered not in isolation but as part of a consecutive story. There must be continuous acts on the part of the majority shareholders, continuing upto the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some of the members. The conduct must be burdensome, harsh and wrongful, and mere lack of confidence between the majority shareholders and the minority shareholders would not be enough unless the lack of confidence springs from oppression of a minority by a majority in the management of the company's affairs and such oppression must involve at least an element of lack of probity or fair dealings to a member in the matter of his propriety rights as a shareholder." ***[Shanti Prasad Jain* v *Kalinga Tubes Ltd.]***. The complaining shareholder must be under a burden which is unjust or harsh or tyrannical ***[Scottish Co-operative Wholesale Society* v *Meyer]***.

9. **There must be visible departure from the standards of fair dealing**

The word 'oppressive' would include 'intent to defraud', 'fraud', misfeasance', or 'other misconduct'. The conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and of violation of the conditions of fair play on which every shareholder who entrusts his money to the company is entitled to rely. There must be an element of lack of probity or fair dealing to a member in the matter of his propriety rights as a shareholder ***[Elder* v *Elder and Watson Ltd.]***.

10. **A persistent and persisting course of unjust conduct must be shown**

One of the shareholders who was also a director of the company disregarded the resolutions of the Board and conducted the business of the company as if it were his own business. Held, it amounted to oppression ***[Re, Harmer (H.R.) Ltd.]***.

11. **Forcing risky objects amounts to oppression**

Where, after the life insurance business of a company was nationalised, the majority attempted to force new and more risky objects upon an unwilling minority, it was held that this amounted to oppression on the minority ***[Re, Hindustan Co-op. Insurance Society Ltd.]***.

12. **Isolated acts do not amount to oppression**

An isolated act, which is contrary to law, may not necessarily and by itself support the inference that the law was violated with a malafide intention or that such violation was burdensome, harsh and wrongful ***[Needle Industries (India) Ltd.* v *Needle Industries Newey (India) Holdings Ltd.]***.

An isolated act cannot be said to be continuing upto the date of application, and so it does not amount to oppression.

13. **Unwise acts do not imply oppression**

Where the managing director was unwise, inefficient and careless and although the majority shareholders had failed to exercise their control to restrain the activities of the managing director, it was held that there was no oppression as the managing director did not act unscrupulously, unfairly or with any lack of probity and such acts or omissions of the majority shareholders were not designed to achieve some unfair advantage ***[Re, Five Minutes Car Wash Services Ltd.]***. An unwise, inefficient or careless conduct of a director does not amount to oppression, though it may amount to mismanagement. For claiming relief from oppression, a conduct which lacks probity, which is unfair and which causes prejudice to the applicant in the exercise of his legal and propriety rights as a shareholder must be shown to exist ***[Needle Industries (India) Ltd.* v *Needle Industries Newey (India) Holdings Ltd.]***.

14. Oppression in case of a family company

A company which is incorporated with mutual trust and confidence with a view to run it in the form of *quasi* partnership is generally termed as a family company.

- Although members have full right to remove a director, yet such right is not unrestricted in a family company, and an aggrieved member may always complain of oppression, even if removal of a director is in accordance with the provisions of section 169. Thus, removal of a director of one group, even if as per section 169, amounts to oppression if the company was formed with a view to run it as a quasi partnership ***[Naresh Trehan* v *Hymatic Agro Equipments]***.
- Appointing additional directors in a family concern to marginalise the authority of the other group amounts to oppression ***[S James Fredrick* v *Mrs. Minnie R Fredrick]***.
- Increasing the number of directors and upsetting balance in the Board, when two groups were equally represented in the Board, will amount to oppression if one group is reduced to minority in Board ***[Ravi Shankar Taneja* v *Motherson Triplex]***.
- In a family company, any change in shareholding without mutual agreement is an act of oppression. Issue of shares to one group to the detriment of other group and appointing additional directors from one group is oppression ***[Pushpa Prabhudas Vora* v *Voras Exclusive Tools Pvt. Ltd.]***.
- Increase in capital to secure increase in voting strength by increasing the holding of one group, when there was no need of any funds, amounts to oppression ***[Smt. Namita Gupta* v *Cachar Native Joint Stock Co. Ltd.]***.
- Issuing shares on right basis when company is in dire need of funds is not oppression even if incidentally it creates a new majority ***[Harikumar Rajah* v *Sovereign Dairy Ltd.]***.
- Issuing shares for requirement of company is not oppression merely because minority shareholders were required to make substantial payments ***[Jeetu Lalvani* v *JBA Printing Ink]***.
- Even in a family company, a director can be removed for just and proper reasons ***[Vinod Kumar Mittal* v *Kaveri Lime Industries]***.

2. Powers of the Tribunal (Nature of orders of Tribunal)

The Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, including the following orders:

(a) The regulation of conduct of affairs of the company in future.

(b) The purchase of shares of any member of the company by any other member or by the company.

(c) In the case of a purchase of its shares by the company, the consequent reduction of its share capital.

For effecting the reduction of capital, compliance with the provisions of section 66 is not required.

(d) Restrictions on the transfer or allotment of shares of the company.

(e) The termination, setting aside or modification, of any agreement between the company and the managing director, any other director or manager, upon such terms and conditions as the Tribunal may deem fit.

Consequences of termination of certain agreements (Section 243)

Where any such agreement is terminated, set aside or is modified, the following consequences shall follow:

(i) ***Vacation of office.*** Such managing director or director or manager shall vacate his office as from the date of the order of the Tribunal. The Tribunal is not bound to follow the procedure prescribed under section 169 for making such an order. As such, the Tribunal has unlimited powers to remove the existing directors and manager.

(ii) ***No compensation for loss of office.*** The managing director, director or manager whose agreement is terminated, set aside or modified shall not be entitled to claim any damages or compensation for loss of office.

(iii) ***No similar appointment for 5 years in the company.*** The managing director, director or manager whose agreement is so terminated or set aside, shall not act as the managing director, director or manager of such company for a period of 5 years except with the permission of the Tribunal. The Tribunal may grant such permission only after giving an opportunity of being heard to the Central Government.

(iv) ***Punishment for contravention.*** Any person who knowingly acts as a managing director, director or manager of a company in contravention of the provisions of this section, and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to 6 months or with fine which may extend to Rs. 5 lakh, or with both.

(f) The termination, setting aside or modification, of any agreement between the company and any other person.

1. No such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned.
2. A person whose agreement is terminated, set aside or modified shall not be entitled to claim any damages or compensation.

(g) 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 3 months before the date of the application made to the Tribunal, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference.

(h) Removal of the managing director, manager or any of the directors of the company.

(i) Recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery, including transfer to Investor Education and Protection Fund or repayment to identifiable victims.

(j) 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.

(k) Appointment of such number of persons as directors, who may be required to report to the Tribunal on such matters as the Tribunal may direct.

(l) Imposition of costs as may be deemed fit by the Tribunal.

(m) Any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made, *i.e.* in addition to the above powers, the Tribunal may make such orders as it may think fit for giving relief in respect of the matters complained of.

Powers of the Tribunal are illustrative only

It can be seen that powers enumerated under section 242 are illustrative only. The Tribunal may make any other order to end the oppression or mismanagement. Thus, wide and ample powers have been conferred on the Tribunal for regulating the conduct of the company's affairs and to provide for any other matter which the Tribunal thinks just and equitable to provide for.

3. Filing of copy of order of the Tribunal

The company shall, within 30 days, file a certified copy of order of the Tribunal with the Registrar.

4. Power of the Tribunal to make an interim order

Pending the final order, the Tribunal may make an interim order for regulating the company's affairs. The Tribunal may make the interim order only if an application is made to the Tribunal by any party to the proceedings. The interim order may stipulate such terms and conditions as may appear to the Tribunal to be just and equitable.

5. Order of the Tribunal to indicate as to whether the respondent is a fit and proper person [Section 242(4A)]

At the conclusion of the hearing of the case referred to in section 241(3), the Tribunal shall record its decision stating therein specifically as to whether or not the respondent is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.

Consequences, where the Tribunal makes an order that the respondent is not a fit and proper person (Section 243)

1. Where the Tribunal records its decision stating that a person is not a fit and proper person pursuant to sub-section (4A) of section 242, such person shall not hold the office of a director or any other office connected with the conduct and management of the affairs of any company for a period of 5 years from the date of the said decision.
2. However, the Central Government may, with the leave of the Tribunal, permit such person to hold any such office before the expiry of the said period of 5 years.
3. 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.
4. Any person who knowingly acts as a director or manager of a company in contravention of these provisions, and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to 6 months or with fine which may extend to Rs. 5 lakh, or with both.

6. Power of the Tribunal to alter the memorandum or articles

(a) Alteration by the Tribunal to be effective. The Tribunal is empowered to make any alteration in the memorandum or articles of a company, and such alteration shall have the same effect as if such alteration were duly made by a resolution passed by the company.

Where a particular regulation in the articles of the company was capable of being misused to prevent the members from exercising their ordinary right to demand a poll, the Tribunal ordered the amendment of such article **[*Dr. V. Sebastian* v *City Hospital Pvt. Ltd.* (1985) 57 Comp Cas 453]**.

The Tribunal is empowered to reframe or insert a new article, which may be against the company's memorandum or other articles and even against the Companies Act, 2013 provided that such an order is necessary to put an end to the matters complained of **[*Bennet Coleman & Co. Ltd.* v *Union of India*, (1977) 47 Comp Cas 92]**.

(b) ***Further alterations to require permission of the Tribunal.*** Any further alteration by the company would have to be consistent with the alterations made by the Tribunal and can be effective only if the permission of the Tribunal is obtained. Thus, once the Tribunal has altered an article contained in the articles of the company, the company cannot make an alteration which is calculated to reduce the effect of the alteration made by the Tribunal.

(c) ***Filing of copy of order of the Tribunal.*** The company shall file with the registrar a certified copy of every order of the Tribunal, which has the effect of altering the company's memorandum or articles, or which grants permission to the company to alter its memorandum or articles in future. The certified copy shall be filed with the registrar within 30 days of order of the Tribunal.

7. Punishment for contravention

If a company, without obtaining the permission of the Tribunal, makes any alteration in the memorandum or articles which is inconsistent with the alterations made by the Tribunal, the punishment shall be as follows:

(a) The company shall be punishable with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 25 lakh.

(b) Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh, or with both.

Theoretical Questions from CA Examinations

Q 6.4A. Discuss the powers of the Tribunal to pass the following orders on applications seeking relief from oppression and mismanagement: (i) Termination or modification of any agreement between the company on the one hand, and the managing director or director or any other person. (ii) Alteration in the memorandum or articles of the company. [CA (Final) Nov. 1997]

Practical Problems from CA Examinations

Illegal and invalid transactions, losses, non-declaration of dividend – Whether relief available?

P 6.4A. A group of shareholders holding 20% of the issued share capital of DEF Limited have filed a petition before the Tribunal alleging the following:

(i) Various acts of illegal, invalid and irregular transactions entered into in the name of the company.

(ii) Losses incurred due to mismanagement by the Board of directors.

(iii) Non-declaration of dividend despite having sufficient profits in the past years.

Examine the merits of the above petitions made under section 241 of the Companies Act, 2013 in the light of the judicial pronouncements made in this regard. [CA (Final) May 2017]

OR

A group of shareholders holding 12% of the issued share capital of Unique Products Limited have filed a petition before the Tribunal alleging various acts of illegal, invalid and irregular transactions entered into in the name of the Company. Examine the merits of the petition in the light of judicial pronouncements made in this regard. [CA (Final) Nov. 2013 (Modified)]

OR

A group of shareholders holding more than 15% of the issued capital of M/s Defraud Ltd. have filed a petition before the Tribunal alleging various acts of illegal, invalid and irregular transactions entered into in the name of the company. Examine the merits of the petition in the light of the judicial pronouncements made in this regard. [CA (Final) Nov. 2009, Nov. 2001 (Modified)]

Ans. Section 244 specifies the eligibility criteria to make an application to the Tribunal for claiming relief from oppression or mismanagement. As per section 244 of the Companies Act, 2013, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be the lowest of the following:

(a) 100 members; or

(b) 1/10th of the total number of members; or

(c) Members holding not less than 1/10th of the issued share capital of the company.

In the given case, the application has been made by members holding 20% of the issued share capital of the company. This application satisfies the requirement of 'members holding not less than 1/10th of the issued share capital of the company'. Therefore, such application satisfies the eligibility requirements of section 244, even if the members making the application are less than 100 and even if their number is less than 1/10th of the total number of members of the company.

The given cases are discussed as under:

(i) The shareholders have alleged that the company has entered into various illegal, invalid and irregular transactions. This in itself would not constitute a ground for invoking the provisions of section 241 unless it is proved that these acts are oppressive to the shareholders or prejudicial to the interest of the company or public interest **[*Sheth Mohanlal Ganpatram* v *Shri Sayaji Jubilee Cotton and Jute Mills Co. Ltd.* (1964) 34 Comp Cas 777]**. Therefore, the petition of the shareholders will fail unless they prove to the satisfaction of the Tribunal that the acts complained of constitute oppression or are prejudicial to the interest of the company or public interest.

(ii) Where a company is continuously incurring losses, it cannot be regarded as an act of oppression **[*Ashoka Betelnut Co. P. Ltd.* v *M.K. Chandrakantha* (1997) 88 Comp Cas 274]**. Also, incurring of losses by a company does not in itself amount to mismanagement. However, if it is proved that due to mismanagement by the Board of directors, the company has been incurring losses, it would amount to mismanagement.

(iii) Non-declaration of dividend is not an act of oppression **[*Chander Krishna Gupta* v *Pannalal Girdharilal P. Ltd.* (1984) 55 Comp Cas 702]**. A bonafide decision of the Board not to recommend dividend and to accumulate profits does not amount to mismanagement **[*Thomas Vettom (VJ)* v *Kuttanad Rubber Co. Ltd.* (1984) 56 Comp Cas 284]**.

Whether relief is available where majority of directors override the wishes of the minority directors?

P 6.4B. State whether the aggrieved party would succeed in obtaining relief from the Tribunal on the ground of oppression where the majority of the Board of directors override the minority directors and the minority directors apply to the Tribunal complaining oppression by majority directors. **[CA (Final) Nov. 1995]**

Ans. As per section 241 read with section 242, for obtaining relief from oppression or mismanagement, an application is required to be made to the Tribunal. After due inquiry, the Tribunal may make such order as it may deem fit, if it is of the opinion –

(a) that the affairs of the company have been or are being conducted in a manner –
   (i) prejudicial to public interest;
   (ii) prejudicial or oppressive to the member(s) making such application or any other member(s); or
   (iii) prejudicial to the interests of the company; and

(b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up.

As is evident from the language used in sections 241 and 242, the acts complained of shall amount to oppression only if such acts have adversely affected a person in his capacity as a member of the company. Such acts which adversely affect a person who is not a member of the company do not amount to oppression. Further, where the affairs of a company are conducted in a manner which are prejudicial to a member, but not in his capacity of a member but in any other capacity, it does not amount to oppression. For example, where a person who is a member as well as a director is removed from directorship, there is no oppression, since no wrong is done to any person in his capacity of a member.

Where the majority directors override the minority directors, it does not amount to oppression since there was no wrong done to any person in his capacity as a member **[*Re, Bellador Silk Ltd.* (1956) 1 All ER 667]**.

In the present case, the majority directors override the minority directors. This does not amount to oppression in terms of section 241 since no harm or prejudice is caused to any person in his capacity of a member. Accordingly, in the given case, relief under section 241 is not available. The same decision on the same facts was given in ***Re, Bellador Silk Ltd.***

Whether relief is available where it is alleged that deposits are against the interests of the company?

P 6.4C. In an application made to the Tribunal claiming relief against oppression and mismanagement, it is alleged that the directors of the company have misused their position in making certain inter-corporate deposits which are against the interests of the company. Will the Tribunal entertain application containing such allegation in the case of private company?

[CA (Final) May 2000]

Ans. As per section 241 read with section 242, for obtaining relief from oppression or mismanagement, an application is required to be made to the Tribunal. After due inquiry, the Tribunal may make such order as it may deem fit, if it is of the opinion –

(a) that the affairs of the company have been or are being conducted in a manner –
   (i) prejudicial to public interest;
   (ii) prejudicial or oppressive to the member(s) making such application or any other member(s); or
   (iii) prejudicial to the interests of the company; and

(b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up.

As is evident from the language used in sections 241 and 242, the acts complained of shall amount to oppression or mismanagement only if 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.

In the given case, the applicants have alleged that the inter-corporate deposits made by the company are against the interests of the company. This in itself cannot be termed as oppression or mismanagement, since –

(a) the applicants have alleged that the inter-corporate deposits are against the interests of the company, but there is no material on record to prove the same;

(b) even if it is proved that the inter-corporate deposits made by the company were against the interests of the company, there may be no illegality and no malafide intention, since to prove oppression or mismanagement, it must be shown that the conduct of affairs was burdensome, harsh and wrongful;

(c) there is no continuity of acts, since to prove oppression or mismanagement it must be shown that there were continuous acts oppressing the minority;

(d) the act complained of (*i.e.* the making of inter-corporate deposits which are against the interests of the company) does not justify the winding up of the company on just and equitable ground.

[*Sheth Mohanlal Ganpatram v Shri Sayaji Jubilee Cotton and Jute Mills Co. Ltd.* (1964) 34 Comp Cas 777].

Whether relief is available the directors continue in office after expiry of their tenure?

P 6.4D. Whether continuation of directors in office after expiry of their tenure and where infighting continues among them amounts to mismanagement? [CA (Final) RTP May 2009]

Ans. As per section 241 read with section 242, for obtaining relief from oppression or mismanagement, an application is required to be made to the Tribunal. After due inquiry, the Tribunal may make such order as it may deem fit, if it is of the opinion –

(a) that the affairs of the company have been or are being conducted in a manner –

 (i) prejudicial to public interest; or

 (ii) prejudicial or oppressive to the member(s) making such application or any other member(s); or

 (iii) prejudicial to the interests of the company; and

(b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up.

The four directors of the company continued to act after the expiry of their term of office. There was complete deadlock between the two groups of shareholders who held equal shares in the company. It was held that continuation of directors after the expiry of their term of office amounted to illegality and there was no valid Board. As a result of complete deadlock in the Board, there was just and equitable ground for winding up the company. Therefore, it amounted to mismanagement ***[Sishu Ranjan Dutta and Another v Bhola Nath Paper House Ltd.]***.

The facts of the given case are similar to the facts in ***Sishu Ranjan Dutta and Another v Bhola Nath Paper House Ltd.*** Therefore, it amounts to mismanagement.

Deadlock in management – Whether amounts to oppression?

P 6.4E. MRJ Company Limited, a closely held company comprised two groups of shareholders - one foreign and the other Indian. The foreign group holds 55% and the Indian 45% of the shares of the company. The articles of association of the company provided all the matters of the mutual understanding of both the groups. The articles also contained the provisions enabling the two groups to enjoy equal amount of managerial power. The relationship between the two groups could not last for a long time and differences arose between them. The two groups could not operate, leading to a deadlock. The Indian group, therefore, complained to the Tribunal for action against the foreign group for oppression. Referring to the provisions of the Companies Act, 2013, decide.

(i) Whether the contention of the Indian group that the foreign group is acting in a manner oppressive to the Indian group will sustain?

(ii) What relief can the Tribunal grant to the petitioners in this case? [CA (Final) May 1996]

OR

60% shares of Indo-French-Ltd. are held by French Group and balance by an Indian Group. As per Articles of Association of the company both groups had equal managerial powers. The relationship between the two groups soured and the operations of the company reached a deadlock. The Indian Group approached the Tribunal for action against the French Group for oppression. Based on these facts, you are required to decide, with reference to the provisions of the Companies Act, 2013 and/or the decided case laws, the following issues:

(i) Whether the contention of oppression against the French Group by the Indian Group is tenable?

(ii) What are the powers of the Tribunal in this regard? [CA (Final) May 2007, May 2005]

Ans. An application seeking relief from the Tribunal must make out a prima facie case that the degree of oppression or mismanagement is so severe that there is just and equitable ground for winding up of the company. The answer to the given problem is as follows:

(i) Both the Indian group and foreign groups are equally strong in terms of managerial powers, and one is unable to oppress the other. As such, there may be a deadlock, but not oppression. It is not a case for winding up of the company and so relief under section 242 is not available ***[Gnanasambandam (CP) v Tamilnad Transports (Coimbatore) Pvt. Ltd. (1971) 41 Comp Cas 26]***. Thus, the contention of the Indian group that the foreign group is acting in a manner oppressive to the Indian group is not tenable.

(ii) The powers of the Tribunal under section 242 are discretionary in character. The Tribunal may order the foreign group to buy out the minority group shareholding at the fair price with necessary permission as was held in ***Yashovardhan Saboo v Groz Beckert Saboo Ltd. (1993) 1 Comp LJ 20***. However, where there was deadlock in the management of private limited company and both the parties failed to buy the other group, the company was wound up under just and equitable ground ***[Kishan Lal Ahuja v Suresh Kumar Ahuja]***. Thus, in the given case, if both the groups fail to exercise the option to buy the other group, the Tribunal may order the company to be wound up.

Deadlock in management – Whether amounts to oppression?

P 6.4F. Mutual Distrust Private Limited has two shareholders namely A and B holding 51% and 49% respectively. Both are working as directors. Due to differences between them, A decides to hold a Board meeting on 30th April, 2014 but the same could not be held due to non-co-operation from B and lack of quorum. Advice A about the steps that can be taken under the Companies Act, 2013 to resolve the matter. [CA (Final) May 2014]

Ans. An application seeking relief from the Tribunal must make out a *prima facie* case that the degree of oppression or mismanagement is so severe that there is just and equitable ground for winding up of the company.

Both the directors are equally strong in terms of managerial powers. Both the directors hold almost equal shareholding. In the present circumstances, it appears that holding a Board meeting is an impossibility due to deadlock.

The Tribunal is empowered to make an order that either A or B shall buy the shareholding of the other at a fair price ***[Yashovardhan Saboo v Groz Beckert Saboo Ltd. (1993) 1 Comp LJ 20]***. In case both A and B fail to buy the shareholding of the other, the Tribunal may make an order of winding up of the company under just and equitable ground ***[Kishan Lal Ahuja v Suresh Kumar Ahuja]***. Thus, A is advised to make an application to the Tribunal seeking the abovementioned orders.

Allotment of further shares resulting in reduction of shareholding of a particular member – Consequences

P 6.4G. Messrs Ahimsa Private Limited was incorporated in the year 2016 under the Companies Act, 2013 by 3 brothers, namely, Amit, Anil and Akhlesh. All the three were Promoter-directors named in the Articles of Association and subscribed for 100 shares each in the company through Memorandum of Association. Thereafter, from time to time, further shares were allotted in proportion of one-third to each of them and in due course, the company started earning substantial profits. Due to greed of money, the two brothers, namely, Amit and Anil, joined hands together to assume complete control of the company, leaving their brother, Akhlesh in lurch. Both the brothers got further shares allotted to themselves, thereby their joint shareholding increased from 662/3% to 90%, while the shareholding of Akhlesh got reduced from the erstwhile 331/3% to 10%. No notice of any Board Meeting was sent to Akhlesh, who was sidelined and was also removed as a Director.

Aggrieved by the decisions taken by his two brothers at his back, Akhlesh seeks your advice for taking out appropriate proceedings before the court or judicial authority of competent jurisdiction. Also suggest the nature of reliefs he may claim while filing his case. [CA (Final) Nov. 2006 (Modified)]

OR

M/s. Zebra Private Limited was incorporated in the year 2016 under the Companies Act, 2013 by 3 brothers, namely A, B and C. All the three were Promoter-directors named in the Articles of Association and subscribed for 100 shares each in the company through Memorandum of Association. Thereafter, from time to time, further shares were allotted in proportion of one-third to each of them and in due course the company started earning substantial profits. Due to greed of money, the two brothers, namely A and B joined hands together and assumed complete control of the company leaving their brother C in lurch. Both the brothers got further shares allotted to themselves, thereby their joint shareholding increased from 66% to 90%, while the shareholding of C got reduced from the erstwhile 33% to 10%. No notice of any Board Meeting was sent to C, who was sidelined and was also removed as a Director.

Aggrieved by the decisions taken by his two brothers at his back, C seeks your advice for taking out appropriate proceedings before the Court or Judicial authority of competent jurisdiction. Also suggest the nature of reliefs he may claim while filing his case. [CA (Final) Nov. 2011, Nov. 2014 (Modified)]

Ans. Generally, relief under section 241 is available only if the acts complained of adversely affect a person in his capacity as a member of the company, and so no relief can be granted under section 241 where a person is removed from directorship. However, in case of a family company (*i.e.* a company which is incorporated with mutual trust and confidence with a view to run it in the form of quasi partnership), it has been held in a number of cases that relief under section 241 is available where –

(a) a change is made in the shareholding without mutual agreement ***[Pushpa Prabhudas Vora v Voras Exclusive Tools Pvt. Ltd.]***;

(b) new shares are issued for the purpose of secure increase in voting strength by increasing holding of one group, when there is no need of any funds ***[Smt. Namita Gupta v Cachar Native Joint Stock Co. Ltd.]***;

(c) a director of one group is removed by the other group, even though such removal is in accordance with the provisions of the Act, *i.e.* section 169 ***[Naresh Trehan v Hymatic Agro Equipments]***.

Issue of further shares amounts to oppression if it is proved that the idea of issuing further shares was to benefit one group to the detriment of the other ***[Piercy v Mill(s) & Co. (1920) 1 Ch. 77]***. Further issue of shares must be made for the benefit of the company. If the directors use their fiduciary power of issuing shares for an extraneous purpose like maintenance or acquisition of control over the affairs of the company, it would amount to oppression ***[Needle Industries Case]***. It is not open to the directors to issue and allot shares in a manner by which an existing majority of shareholders is reduced to a minority. If the issue of shares disturbs the existing majority of the shareholders and if it is not *bonafide*, it will amount to oppression ***[Re, Gluco Series (P) Ltd.]***.

The given problem is answered as under:

(a) Akhlesh is advised to make an application to the Tribunal under section 241. In such application, Akhlesh should allege oppression by his two brothers, *viz.* Amit and Anil. By the facts of the case (*i.e.* the three brothers were Promoter-directors named in the Articles of Association, all three brothers had subscribed for 100 shares each in the company, from time to time, further shares were allotted in equal proportion to all the three brothers), it is clear that Ahimsa Private Limited is a family company. Further Akhlesh should allege that there was no proper reason for his removal from directorship, and that purpose of issuing the further shares was to benefit the two brothers (*viz.* Amit and Anil) to the detriment of him (*viz.* Akhlesh), and so the decision to issue the further shares was not for the benefit of the company, but for some extraneous purpose, *i.e.* acquisition of control over the affairs of the company.

The single act of issue of further shares shall have a continuous effect, and so it amounts to oppression, especially if, the Board meeting at which the further shares were allotted was held without complying with the requirements of section 173, and the member who was not offered further shares was also removed from directorship.

In ***Bhagirath Agarwala v Tara properties P. Ltd.***, on the similar facts it was held to be oppression.

Therefore, Akhlesh should file an application with the Tribunal for claiming relief from oppression.

(b) Akhlesh may seek following reliefs from the Tribunal (as contained in section 242):

(i) That the allotment of further shares to Amit and Anil should be declared as null and void, and should be set aside.

(ii) The removal of Akhlesh from directorship should be declared as null and void, and should be set aside.

(iii) The Tribunal should make an order for reconstitution of the Board of directors in such manner as the Tribunal may deem fit, *e.g.* some independent person be appointed on the Board of Ahimsa Private Limited as a director or appointed as the Chairman of the Board.

(iv) Akhlesh should be appointed as the managing director of the company having such substantial powers of management as may be specified by the Tribunal.

Whether allotment of further shares converting majority into minority or minority into majority amounts to oppression?

P 6.4H. Referring to the provisions of the Companies Act, 2013, as contained in section 241 of the Act, examine whether the following acts of the company amount to oppression?

(i) Allotment of shares by the directors of the company by which the existing majority is reduced to minority.

(ii) Allotment of shares by the directors by which the existing minority shareholders are made to majority.

(iii) A share sale agreement was executed by VC, an NRI. The shares and transfer deed were handed over to an escrow agent. The sale was subject to RBI permission. The shares were not transferred for 6 years since RBI permission was not received. VC, after waiting for a long period of time raises the issue and complains of oppression in the capacity of a member. As per the agreement the sale was unconditional. During the above period VC did not exercise any right as shareholder nor did the company treat him as a member. **[CA (Final) May 2006]**

Ans.

(i) and (ii). Issue of further shares amounts to oppression if it is proved that the idea of issuing further shares was to benefit one group to the detriment of the other ***[Piercy v Mill(s) & Co. (1920) 1 Ch. 77]***. Further issue of shares must be made for the benefit of the company. If the directors use their fiduciary power of issuing shares for an extraneous purpose like maintenance or acquisition of control over the affairs of the company, it would amount to oppression ***[Needle Industries Case]***. It is not open to the directors to issue and allot shares in a manner by which an existing majority of shareholders is reduced to a minority. If the issue of shares disturbs the existing majority of the shareholders and if it is not bonafide, it will amount to oppression ***[Re, Gluco Series (P) Ltd.]***.

Thus, –

(i) allotment of shares by the directors of the company by which the existing majority is reduced to minority shall amount to oppression, if the directors have acted *malafide*.

(ii) allotment of shares by the directors by which the existing minority shareholders are made to majority shall amount to oppression, if the directors have acted *malafide*.

(iii) When a share sale agreement was executed by an NRI and the scrips and transfer deed were handed over to an escrow agent as such sale was subject to RBI permission and full consideration money was received, then such a person after lapse of about 5 years, cannot raise an issue of oppression in the capacity of a member, as the transfer remained in abeyance awaiting RBI permission. As per facts, the sale of shares was unconditional and unrestricted, and there was no clause to render the sale agreement infructuous after lapse of any stipulated time. Also, during the long intervening period neither the NRI exercised any right as shareholder nor the company treated him as a member ***[Rajiv Mehta v Group 4 Securities Hindustan (P.) Ltd. (1998), 18 SCL 89 CLB]***.

The facts in the given case are similar to the abovementioned case, and therefore, it can be said that there is no oppression.

Removal of directors of a family group – Whether oppression?

P 6.41. M/s Continuous Conflicts Ltd. is a company controlled by two family groups. The first family group has four directors, namely, Mr. A, Mr. B, Mr. C and Mr. D on the Board of directors. The second family group has two representatives Mr. X and Mr. Y on the Board. Because of internal family troubles, the first group, by virtue of its majority shareholding removed both Mr. X and Mr. Y as the directors of the company. Aggrieved by this action the second group is planning to move an application before the Tribunal. You have been approached for advice. Advise as to the eligibility restrictions regarding filing the application and the chances of getting the relief from the Tribunal, assuming that there is no other material on record in support of oppression on the minority group. [CA (Final) May 2002, Nov. 2008]

Ans. The management of the company is based on the Majority Rule. The Tribunal and the Courts do not usually intervene in the matters of internal management of the company. However, where the exercise of voting power by the majority results in oppression on the members or results in mismanagement or prejudice to public interest, the Tribunal may grant the relief to the minority.

As per section 244, the eligibility criterion to file an application with the Tribunal for claiming relief from oppression or mismanagement is as follows:

(i) ***In the case of a company having a share capital.*** Members eligible to apply shall be the lowest of the following:

(a) 100 members; or

(b) 1/10th of the total number of members; or

(c) Members holding not less than 1/10th of the issued share capital of the company.

(ii) ***In the case of a company having no share capital.*** The application shall be made by at least 1/5th of total number of members.

The applicants must have paid all the calls and other sums due on their shares. The applicants must hold the requisite number of shares at the time of filing the application.

In the present case the removal of two directors cannot, *ipso facto*, amount to an act of oppression or mismanagement or an act prejudicial to public interest because of the following reasons:

(i) The election and removal of directors is the prerogative of the members and such an act cannot ipso facto be treated as oppression on minority, unless the conduct of the majority is based on *malafide* considerations.

(ii) The conduct can be said to be oppression only when it is burdensome, harsh and wrongful. Oppression involves an element of lack of probity and fair dealings to a member. Mere removal of two directors does not amount to oppression.

(iii) To constitute oppression, the conduct complained of must affect a person in his capacity as a member of the company. Oppression in any other capacity, *i.e.* as a director of a company is outside the purview of section 241.

(iv) The relief is available only when the acts complained of are shown to be continued acts of oppression or mismanagement.

(v) The relief is available only if it is established that degree of oppression or mismanagement is so severe that there is just and equitable ground for winding up of the company.

In the given case, it has been made clear that there is no other material on record in support of oppression on the minority. Since the conditions specified in section 241 have not been fulfilled, there is no oppression on the second family group and therefore, relief from the Tribunal cannot be claimed.

Practical Problems from ICAI Material

Removal of managing director, pressurising him to sell his shares below the fair market value, etc. – Whether constitute oppression and what relief can be provided by the Tribunal?

P 6.4J. Mr. B. Dutt is the Managing Director of Food Plaza Restaurants Private Limited. FPRPL was incorporated in furtherance of a Joint Venture Agreement ("JVA") between Mr. B. Dutt and Jack India Pvt. Limited (JIPL) in 2017, both having 50% of equal share in the said company. FPRPL was to be governed by the terms and conditions set out in its Memorandum of Association and its Articles of Association.

JIPL held the Board meeting, without giving prior notice of such meeting to Mr. B. Dutt, took decision to remove Mr. B. Dutt with an allegation of mismanagement of funds in FPRPL. JIPL pressurised him to sell his shares at Rs. 5 crore, against Rs. 15 crore which was the fair market price of Mr. B. Dutt's shares.

Advise whether Mr. B. Dutt has right to claim any relief and would he succeed in obtaining relief from Tribunal on the ground of oppression by JIPL? [ICAI, Mock Test Paper, August, 2018]

Ans.

The legal position

Generally, relief under section 241 is available only if the acts complained of adversely affect a person in his capacity as a member of the company, and so no relief can be granted under section 241 where a person is removed from directorship or managing directorship. However, in case of a family company (*i.e.* a company which is incorporated with mutual trust and confidence with a view to run it in the form of quasi partnership), it has been held in a number of cases that relief under section 241 is available where –

(a) a change is made in the shareholding without mutual agreement ***[Pushpa Prabhudas Vora v Voras Exclusive Tools Pvt. Ltd.]***;

(b) a director of one group is removed by the other group, even though such removal is in accordance with the provisions of the Act, *i.e.* section 169 ***[Naresh Trehan v Hymatic Agro Equipments]***.

The given case

The facts of the given case are similar to the facts in ***Vikram Bakshi and Others v Connaught Plaza Restaurants Limited and Others***. The detailed facts of Vikram Bakshi and Others v Connaught Plaza Restaurants Limited and Others were as follows:

- Vikram Bakshi and McDonalds India Private Limited (hereinafter referred to as 'MIPL') entered into a Joint Venture Agreement (hereinafter referred to as 'JVA') by which they each held 50% of equity shares in Connaught Plaza Restaurants Private Limited (hereinafter referred to as 'CPRPL').
- CPRPL was appointed as the primary franchisee for McDonalds for a period of 25 years.
- The JVA specified that there shall be 4 directors on the Board of CPRPL, and each party (*viz.* Vikram Bakshi and MIPL) shall have a right to nominate 2 directors each on the Board of CPRPL.
- The JVA also contained a condition that if Mr. Vikram Bakshi is not continued as the managing director, then, MIPL shall purchase the shares held by Mr. Vikram Bakshi as per the fair market value determined by the formula specified in the JVA.
- In 2007-2008, MIPL offered to buy the shares held by Mr. Vikram Bakshi for $ 5 million. However, on the basis of fair market value, Mr. Bakshi demanded $ 100 million. This led to dispute between Mr. Vikram Bakshi and MIPL with the result that Mr. Vikram Bakshi was terminated from the post of managing director in 2013 as MIPL alleged diversion of funds and mismanagement by Mr. Vikram Bakshi.
- Mr. Vikram Bakshi made an application to the Tribunal seeking relief from oppression and mismanagement. He alleged that there was a history of prejudices and oppression shown against him by MIPL.
- It was submitted before the Tribunal that JVA provided for determination of disputes between Mr. Vikram Bakshi and MIPL by way of arbitration and so the Tribunal had no jurisdiction to entertain the application for oppression and mismanagement. The Tribunal held that it had the jurisdiction to entertain the application made to it under section 241, since the JVA was incorporated in the articles of association of CPRPL.
- The Tribunal noticed that the financial position of CPRPL was very healthy and there was no case of diversion of funds or mismanagement by Mr. Vikram Bakshi.
- The Tribunal held that the acts of the nominee directors of MIPL to block the reappointment of Mr. Vikram Bakshi as the managing director was an act of oppression and was done with the *malafide* and pre-meditated intention of availing the benefits of their right to purchase the shares held by Mr. Vikram Bakshi upon his termination.
- The Tribunal relied on the fact that the actions of MIPL were detrimental to public interest as several employees of the franchisee suffered due to the decision of MIPL to terminate the franchisee agreement.
- The Tribunal held that there was a continuing trend of MIPL's prejudice and oppression towards Mr. Vikram Bakshi. Therefore, the Tribunal held that this was a fit case of oppression and mismanagement.

- The Tribunal made an order reinstating Mr. Vikram Bakshi as the managing director of CPRPL.
- The order made by the Tribunal makes it evident that where a clear *malafide* intent is established, the relief from oppression must be provided.

Conclusions

1. The affairs of Food Plaza Restaurants Private Limited have been conducted in a manner oppressive to Mr. B Dutt, since –
   (a) Mr. B Dutt was removed from the position of managing director without giving to him prior notice of Board meeting;
   (b) Mr. B Dutt was not given an opportunity to disprove the false allegations levelled against him;
   (c) Mr. B Dutt was pressurised to sell his shares in Food Plaza Restaurants Private Limited at a price which was much below the fair market price;
   (d) there were continued acts constituting oppression against Mr. B Dutt.
2. The Tribunal may pass such orders as it may think fit so as to bring to an end the matters complained of, including –
   (a) reinstatement of Mr. B Dutt as the managing director of Food Plaza Restaurants Private Limited;
   (b) appointment of an Administrator with a right to vote in Board meetings so as to regulate in future the conduct of affairs of the company.

Nature of orders of the Tribunal where minority shareholders are completely excluded from the affairs of the company

P 6.4K. ABC limited used the business resources of the company in favour of the majority shareholders and completely excluded the minorities from the affairs of the company. As of consequences, minority members filed an application to Tribunal to look into the matter on the regulation of conduct of affairs of the company in future. State in the light of the Companies Act, 2013, the action to be taken by the Tribunal in the given situation.

Ans. If, it is established before the Tribunal that the affairs of the company have been or are being conducted in a manner prejudicial to public interest or prejudicial or oppressive to any member(s) or prejudicial to the interests of the company, there is just and equitable ground for winding up of the company, the conduct of affairs of the company is burdensome, harsh and wrongful and there is lack of probity and fair dealings towards the members, the Tribunal shall be empowered to make such orders as it may think fit, so as to bring to an end the matters complained of. The Tribunal shall also be empowered to make an interim order for regulating the company's affairs, if an application seeking such order is made to the Tribunal by any party to the application. Such interim may order may include the appointment of an administrator to supervise the conduct of affairs of the company.

6.5 Class action (Section 245)

1. Application by members or depositors on others' behalf, and remedies sought for

(a) Such number of member(s) or depositor(s) as are eligible under this section may make an application to the Tribunal for seeking such remedies as are provided under this section.

(b) The application may be made on the ground 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.

2. Remedies under section 245

The Tribunal is empowered to pass any of the following orders:

(a) To restrain the company from committing an act which is *ultra vires* the articles or memorandum of the company.

(b) To restrain the company from committing breach of any provision of the company's memorandum or articles.

(c) 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.

(d) To restrain the company and its directors from acting on such resolution.

(e) 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.

(f) To restrain the company from taking action contrary to any resolution passed by the members.

(g) To claim damages or compensation or demand any other suitable action from or against –

   (i) 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;

(ii) 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

(iii) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part.

(h) To seek any other remedy as the Tribunal may deem fit.

3. Liability of partners of audit firm

Where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.

4. Members and depositors eligible under section 245

As per section 245 read with Rule 84 of the National Company Law Tribunal Rules, 2016, the number of members and depositors eligible to make an application under section 245 are as follows:

(a) Members. Members eligible to make the application are as follows:

(i) Company having a share capital. Members eligible to apply shall be the lowest of the following:

- 100 members; *or*
- 5% of the total number of members; *or*
- member or members holding –
  (A) not less than 5% of the issued share capital of the company, in case of an unlisted company;
  (B) not less than 2% of the issued share capital of the company, in case of a listed company.

A member shall not be eligible unless he has paid all the calls and other sums due on his shares.

(ii) Company having no share capital. Application shall be valid only if it is made by at least 1/5th of total number of members.

(b) Depositors. Depositors eligible to make the application shall be the lowest of the following:

(i) 100 depositors; *or*

(ii) 5% of the total number of depositors; *or*

(iii) One or more depositors to whom the company owes 5% of total deposits of the company.

5. Factors considered by the Tribunal before making any order

In considering an application, the Tribunal shall take into account the following factors:

(a) Whether the member or depositor is acting in good faith in making the application for seeking an order under this section.

(b) Any evidence produced before the Tribunal with respect to the involvement of any person other than directors or officers of the company.

(c) Whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section.

(d) Any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section.

(e) Where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be –

(i) authorised by the company before it occurs; or

(ii) ratified by the company after it occurs;

(f) Where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.

6. Consequences where the application is admitted by the Tribunal

If an application is admitted, then the Tribunal shall have regard to the following:

(a) Public notice shall be served on admission of the application to all the members or depositors in such manner as may be prescribed.

(b) All similar applications prevalent in any jurisdiction should be consolidated into a single application and the members or depositors should be allowed to choose the lead applicant. However, if 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.

(c) Two class action applications for the same cause of action shall not be allowed.

(d) 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.

7. Order of the Tribunal to be binding on all concerned

Any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company.

8. Punishment for contravention

(a) 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 Rs. 5 lakh but which may extend to Rs. 25 lakh.

(b) 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 Rs. 25,000 but which may extend to Rs. 1 lakh.

9. Frivolous application to be rejected and costs to be paid by the applicant

Where any application filed before the Tribunal is found to be frivolous or vexatious, it shall –

(a) reject the application; and

(b) make an order that the applicant shall pay to the opposite party such cost, not exceeding Rs. 1 lakh, as the Tribunal may deem fit.

The Tribunal shall record in writing the reasons on the basis of which it found the application to be frivolous or vexatious.

10. Non-applicability

Nothing contained in this section shall apply to a banking company.

Practical Problems from CA Examinations

Maintainability of class action application made by 20 depositors out of total 200 depositors on the ground that the company is managed in a manner which is prejudicial to the interests of depositors

P 6.5A. M/s Sunshine Oils Limited, a listed company as at 31st March, 2018 as per the audited financial statements is having 200 depositors with Rs. 50 crores of deposit in the company. Out of the total 200 depositors, 20 depositors of the company have formed a group and have appointed Mr. Ram (a practicing advocate who is not one of the depositors) as their representative to file an application in the National Company Law Tribunal (NCLT) to bring a class action suit against the management of the company as they are of the opinion that the management and conduct of affairs of the company are being conducted in a manner which is prejudicial to the interest of the depositors being oppressive. Will the application of Mr. Ram be admitted by the Honourable Tribunal? Discuss with reference to the provisions of the Companies Act, 2013? [CA (Final) May 2018]

OR

A group of depositors in M/s. Bright Limited, a listed company, appointed Mr. Fair, an advocate as a representative to file an application in the National Company Law Tribunal (NCLT) on behalf of the depositors to bring a class action suit against the management of the company as they are of the opinion that the management and conduct of affairs of the company are being conducted in a manner which is prejudicial to the interest of the depositors being oppressive.

Examine in the given situation, whether the appointment of Mr. Fair is valid as regards to the filling of the application before the Tribunal in the light of the provisions of the Companies Act, 2013? [ICAI, RTP, Nov. 2018]

Ans. The given problem relates to section 245 of the Companies Act, 2013, as discussed below:

The legal position

1. Section 245 empowers the members or depositors (if such members or depositors are eligible as per section 245) to make a class action application to the Tribunal on the ground 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.
2. The number of depositors eligible to make the class action application shall be the lowest of the following:
   (i) 100 depositors; or
   (ii) 5% of the total number of depositors; or
   (iii) One or more depositors to whom the company owes 5% of total deposits of the company.

The given case and analysis of the case

3. M/s Sunshine Oils Limited is a listed company having 200 depositors and deposits of Rs. 50 crores. Out of total 200 depositors, 20 depositors of the company have filed a class action application against M/s Sunshine Oils Limited by appointing Mr. Ram as their representative to file an application to the Tribunal. Mr. Ram is a practicing advocate, but he is not a depositor of the company.
4. In the class action application, it has been alleged that the management and conduct of affairs of the company are being conducted in a manner which is prejudicial to the interest of the depositors being oppressive.
5. Section 245 does not require that the person authorised by the depositors to make a class action application to the Tribunal has to be a depositor himself. Instead, section 432 states that a party to any proceeding or appeal before the Tribunal may appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any other person.

Conclusion

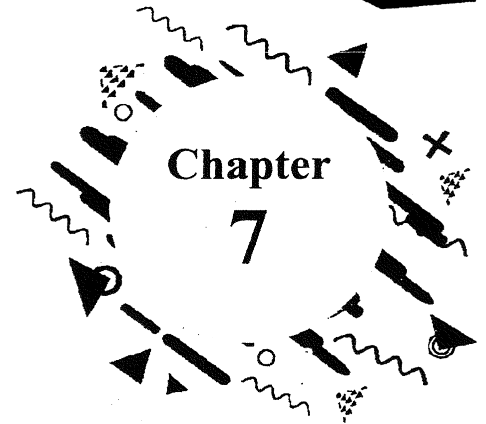
6. The application has been made by 20 depositors out of total 200 depositors. Thus, the application satisfies the eligibility criterion (*i.e.* the depositor making the application must not be less than 5% of total number of depositors). Accordingly, the class action application is valid and the authorisation given by the depositors to Mr. Ram to present the class action application before the Tribunal is also valid.

6.6 Application of certain provisions to proceedings under section 241 or 245 (Section 246)

The provisions of sections 337 to 341 (both inclusive) shall apply *mutatis mutandis*, in relation to an application made to the Tribunal under section 241 or 245.

Registered Valuers

(Chapter XVII of the Companies Act, 2013 consisting of Section 247)



Bird's eye-view of the Chapter

Registered Valuers (Sec. 247)

Bird's eye-view of the Companies (Registered Valuers and Valuation) Rules, 2017

Rule No.	Marginal Heading
Chapter I Preliminary	
1	Short title, commencement and application
2	Definitions
Chapter II Eligibility, Qualifications and Registration of Valuers	
3	Eligibility for registered valuers
4	Qualifications-and-exp
5	Valuation Examination
6	Application for certificate of registration
7	Conditions of Registration
8	Conduct of Valuation
9	Temporary surrender
10	Functions of a Valuer
11	Transitional Arrangement

Chapter III Recognition of Registered Valuers Organisations	
12	Eligibility for registered valuers organisations
13	Application for recognition
14	Conditions of Recognition
Chapter IV Cancellation or Suspension of Certificate of Registration or Recognition	
15	Cancellation or suspension of certificate of registration or recognition
16	Complaint against a registered valuer or registered valuers organisation
17	Procedure to be followed for cancellation or suspension of registration or recognition certificate
Chapter V Valuation Standards	
18	Valuation Standards
19	Committee to advise on valuation matters
Chapter VI Miscellaneous	
20	Punishment for contravention
21	Punishment for false statement

Bird's eye-view of the Forms used in this Chapter

Form No.	Description of E-Form (Purpose of E-Form)
Form A	Application for registration as a valuer by an individual
Form B	Application for registration as a valuer by a partnership entity / company
Form C	Certificate of registration
Form D	Application for recognition

Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, –
   (a) any reference to any section means reference to the sections of the Companies Act, 2013; and
   (b) any reference to any rule means reference to the Rules contained in the Companies (Registered Valuers and Valuation) Rules, 2017.

7.1 Registered Valuers (Section 247)

1. **Applicability of section 247**

   Section 247 applies where a valuation is required to be made in respect of –
   - (a) any property, stocks, shares, debentures, securities or goodwill or any other assets of a company (hereinafter referred to as the assets); or
   - (b) liabilities of a company; or
   - (c) net worth of a company.
2. **Valuation by whom?**
   - (a) Valuation under section 247 shall be made by a person having such qualifications and experience as may be prescribed.
   - (b) Such person must be registered as a valuer in such manner as may be prescribed.
   - (c) Such person must be a member of an organisation recognised in such manner and on such terms and conditions as may be prescribed.
3. **Appointment of registered valuer**

   The registered valuer shall be appointed by –
   - (a) the audit committee; or
   - (b) the Board, in case the audit committee is not constituted.
4. **Duties of the registered valuer**
   - (a) The registered valuer shall make an impartial, true and fair valuation of any assets which is required to be valued.
   - (b) The registered valuer shall exercise due diligence while performing the functions as valuer.
   - (c) The registered valuer shall make the valuation in accordance with such rules as may be prescribed.
   - (d) The registered valuer shall not undertake valuation of any assets in which he has a direct or indirect interest or becomes so interested at any time during a period of 3 years prior to his appointment as valuer or 3 years after the valuation of assets was conducted by him.
5. **Punishment for contravention**
   - (a) If a registered valuer contravenes the provisions of this section or the rules made thereunder, he shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh.
   - (b) However, if the registered valuer has contravened such provisions with the intention to defraud the company or its members, he shall be punishable with –
     - (i) imprisonment for a term which may extend to 1 year; and
     - (ii) fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 5 lakh.
   - (c) Where a registered valuer is convicted under sub-section (3), he shall be liable to
     - (i) refund to the company the remuneration received by him; and
     - (ii) pay damages to the company or to any other person for loss arising out of incorrect or misleading statements of particulars made in his report.

The Central Government has delegated its powers and functions under section 247 to the Insolvency and Bankruptcy Board of India, subject to the condition that the Central Government may revoke such delegation of powers or it may exercise the powers under the said section, if in its opinion such a course of action is necessary in the public interest.

Practical Problems from CA Examinations

Whether the Board of directors of a listed public company is empowered to appoint a registered valuer?

P 7.1A. The Board of directors of M/s APCO Limited, a listed public company, for carrying out the valuation of the immovable properties standing in the name of the company as required under the provisions of the Companies Act, 2013 proposes to appoint Mr. Mehta, an individual as the valuer. Referring to the provisions of the Companies Act, 2013 read with the companies (Registered Valuers and Valuation) Rules, 2017, the audit committee is of the opinion that the Board of directors does not have the right to appoint the valuer. Decide. [CA (Final) Nov. 2018 (modified)]

Ans. The given problem relates to section 247 read with section 177 of the Companies Act, 2013, as discussed below:

1. As per section 247, the registered valuer shall be appointed by –
   - (a) the audit committee; or
   - (b) the Board, in case the audit committee is not constituted.

2. As per section 177, constitution of an audit committee is mandatory for all listed public companies.
3. In the given case, M/s APCO Limited is a listed public company, and so it is mandatory for M/s APCO Limited to constitute the audit committee. Complying with the provisions of section 177, M/s APCO Limited has constituted the audit committee.
4. As per section 247, the Board is empowered to appoint the registered valuer only in a case where there is no audit committee. Since in the present case, M/s APCO Limited has constituted the audit committee, the appointment of the registered valuer shall be made by the audit committee, and not by the Board of directors.
5. Thus, the opinion of the audit committee that the Board does not have the right to appoint the registered valuer, is correct.

Whether appointment of a registered valuer is valid where such appointment is made by the managing director of the company and the person appointed as registered valuer had an indirect interest in the asset 48 months back?

P 7.1B. M/s KIL Limited, a listed company, proposed to acquire a plant for consideration other than cash from Mr. KK, a director. The Managing Director of the company identified Mr. JK a registered valuer under the provisions of the Companies Act, 2013 for the purpose of valuation of the plant. Mr. KK acquired the plant 48 months back from a partnership firm in which the spouse of Mr. JK is a partner. The Managing Director of the company issued an order appointing Mr. JK as a registered valuer. Examine and decide whether the decision of appointment and the mode of appointment is valid under the provisions of the Companies Act, 2013? [CA (Final) Nov. 2019]

Ans. The given problem relates to section 247 read with section 177 and section 192 of the Companies Act, 2013, as discussed below:

The legal position

1. As per section 192, if an asset is to be acquired for consideration other than cash, by a company from a director of the company, then, prior approval of members shall be required and the value of such asset shall be duly calculated by a registered valuer, and the value so calculated shall be disclosed to the members in the notice of the general meeting.
2. As per section 247, the registered valuer shall be appointed by –
   (a) the audit committee; or
   (b) the Board, in case the audit committee is not constituted.
3. As per section 177, constitution of an audit committee is mandatory for all listed public companies.
4. It is also a requirement of section 247 that a person can be appointed as a registered valuer only if he has no direct or indirect interest at any time during a period of 3 years prior to his appointment as registered valuer.

The given case and analysis of the case

5. M/s KIL Limited is a listed public company, and so it is mandatory for M/s KIL Limited to constitute the audit committee.
6. Assuming that M/s KIL Limited has constituted an audit committee in compliance with the provisions of section 177, the appointment of a registered valuer can be made only by the Audit Committee.
7. In the given case, Mr. JK was indirectly interested in the plant which M/s KIL Limited intends to acquire from Mr. KK, a director of the company. However, Mr. JK ceased to have such interest 48 months back, i.e. 4 years back. Accordingly, in the preceding 3 years, Mr. JK had no direct or indirect interest in the asset to be acquired by M/s KIL Limited. Therefore, Mr. JK is not disqualified for appointment as a registered valuer.

Conclusion

8. The decision to appoint Mr. JK as the registered valuer is valid since he is not disqualified for such appointment.
9. The mode of appointment of Mr. JK as registered valuer is not valid, since such appointment could be made only by the audit committee of M/s KIL Limited.

Appendix
The Companies (Registered Valuers and Valuation) Rules, 2017

MINISTRY OF CORPORATE AFFAIRS
NOTIFICATION
New Delhi, the 18th October, 2017

G.S.R 1316(E).– In exercise of the powers conferred by section 247 read with sections 458, 459 and 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the following rules, namely:-

CHAPTER I
PRELIMINARY

1. Short title, commencement and application.

(1) These rules may be called the Companies (Registered Valuers and Valuation) Rules, 2017.

(2) They shall come into force on the date of their publication in the Official Gazette.

(3) These rules shall apply for valuation in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets or net worth of a company or its liabilities under the provision of the Act or these rules.

Explanation.- It is hereby clarified that conduct of valuation under any other law other than the Act or these rules by any person shall not be affected by virtue of coming into effect of these rules.

2. Definitions.

(1) In these rules, unless the context otherwise requires —

(a) "Act" means the Companies Act, 2013 (18 of 2013);

(b) "authority" means an authority specified by the Central Government under section 458 of the Companies Act, 2013 to perform the functions under these rules;

(c) "asset class" means a distinct group of assets, such as land and building, machinery and equipment, displaying similar characteristics, that can be classified and requires separate set of valuers for valuation;

(d) "certificate of recognition" means the certificate of recognition granted to a registered valuers organisation under sub-rule (5) of rule 13 and the term "recognition" shall be construed accordingly;

(e) "certificate of registration" means the certificate of registration granted to a valuer under sub-rule (6) of rule 6 and the term "registration" shall be construed accordingly;

(f) "partnership entity" means a partnership firm registered under the Indian Partnership Act, 1932 (9 of 1932) or a limited liability partnership registered under the Limited Liability Partnership Act, 2008 (6 of 2009);

(g) "Annexure" means an annexure to these rules;

(h) "registered valuers organisation" means a registered valuers organisation recognised under sub-rule (5) of rule 13;

(i) "valuation standards" means the standards on valuation referred to in rule 18; and

(j) "valuer" means a person registered with the authority in accordance with these rules and the term "registered valuer" shall be construed accordingly.

(2) Words and expressions used but not defined in these rules, and defined in the Act or in the Companies (Specification of Definitions Details) Rules, 2014, shall have the same meanings respectively assigned to them in the Act or in the said rules.

CHAPTER II
ELIGIBILITY, QUALIFICATIONS AND REGISTRATION OF VALUERS

3. Eligibility for registered valuers.

(1) A person shall be eligible to be a registered valuer if he-

(a) is a valuer member of a registered valuers organisation;

Explanation.— For the purposes of this clause, "a valuer member" is a member of a registered valuers organisation who possesses the requisite educational qualifications and experience for being registered as a valuer;

(b) is recommended by the registered valuers organisation of which he is a valuer member for registration as a valuer;

(c) has passed the valuation examination under rule 5 within three years preceding the date of making an application for registration under rule 6;

(d) possesses the qualifications and experience as specified in rule 4;

(e) is not a minor;

(f) has not been declared to be of unsound mind;

(g) is not an undischarged bankrupt, or has not applied to be adjudicated as a bankrupt;

(h) is a person resident in India;

Explanation.— For the purposes of these rules 'person resident in India' shall have the same meaning as defined in clause (v) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999) as far as it is applicable to an individual;

(i) has not been convicted by any competent court for an offence punishable with imprisonment for a term exceeding six months or for an offence involving moral turpitude, and a period of five years has not elapsed from the date of expiry of the sentence:

Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be registered;

(j) has not been levied a penalty under section 271J of Income-tax Act, 1961 (43 of 1961) and time limit for filing appeal before Commissioner of Income-tax (Appeals) or Income-tax Appellate Tribunal, as the case may be has expired, or such penalty has been confirmed by Income-tax Appellate Tribunal, and five years have not elapsed after levy of such penalty; and

(k) is a fit and proper person:

Explanation.— For determining whether an individual is a fit and proper person under these rules, the authority may take account of any relevant consideration, including but not limited to the following criteria-

- (i) integrity, reputation and character,
- (ii) absence of convictions and restraint orders, and
- (iii) competence and financial solvency.

(2) No partnership entity or company shall be eligible to be a registered valuer if-

(a) it has been set up for objects other than for rendering professional or financial services, including valuation services and that in the case of a company, it is a subsidiary, joint venture or associate of another company or body corporate;

(b) it is undergoing an insolvency resolution or is an undischarged bankrupt;

(c) all the partners or directors, as the case may be, are not ineligible under clauses (c), (d), (e), (f), (g), (h), (i), (j) and (k) of sub-rule (1);

(d) three or all the partners or directors, whichever is lower, of the partnership entity or company, as the case may be, are not registered valuers; or

(e) none of its partners or directors, as the case may be, is a registered valuer for the asset class, for the valuation of which it seeks to be a registered valuer.

4. Qualifications and experience.

An individual shall have the following qualifications and experience to be eligible for registration under rule 3, namely:-

(a) post-graduate degree or post-graduate diploma, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least three years of experience in the specified discipline thereafter; or

(b) a Bachelor's degree or equivalent, in the specified discipline, from a University or Institute established, recognised or incorporated by law in India and at least five years of experience in the specified discipline thereafter; or

(c) membership of a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession with at least three years' experience after such membership.

Explanation I.— For the purposes of this clause the 'specified discipline' shall mean the specific discipline which is relevant for valuation of an asset class for which the registration as a valuer or recognition as a registered valuers organisation is sought under these rules.

Explanation II.— Qualifying education and experience for various asset classes, is given in an indicative manner in Annexure–IV of these rules.

Explanation III. For the purposes of this rule and Annexure IV, 'equivalent' shall mean professional and technical qualifications which are recognised by the Ministry of Human Resources and Development as equivalent to professional and technical degree.

5. Valuation Examination.

(1) The authority shall, either on its own or through a designated agency, conduct valuation examination for one or more asset classes, for individuals, who possess the qualifications and experience as specified in rule 4, and have completed their educational courses as member of a registered valuers organisation, to test their professional knowledge, skills, values and ethics in respect of valuation:

Provided that the authority may recognise an educational course conducted by a registered valuers organisation before its recognition as adequate for the purpose of appearing for valuation examination:

Provided also that the authority may recognise an examination conducted as part of a master's or post graduate degree course conducted by a University which is equivalent to the valuation examination.

(2) The authority shall determine the syllabus for various valuation specific subjects or assets classes for the valuation examination on the recommendation of one or more Committee of experts constituted by the authority in this regard.

(3) The syllabus, format and frequency of the valuation examination, including qualifying marks, shall be published on the website of the authority at least three months before the examination.

(4) An individual who passes the valuation examination, shall receive acknowledgement of passing the examination.

(5) An individual may appear for the valuation examination any number of times.

6. Application for certificate of registration.

(1) An individual eligible for registration as a registered valuer under rule 3 may make an application to the authority in Form-A of Annexure-II along with a non-refundable application fee of five thousand rupees in favour of the authority.

(2) A partnership entity or company eligible for registration as a registered valuer under rule 3 may make an application to the authority in Form-B of Annexure-II along with a non-refundable application fee of ten thousand rupees in favour of the authority .

(3) The authority shall examine the application, and may grant twenty one days to the applicant to remove the deficiencies, if any, in the application.

(4) The authority may require the applicant to submit additional documents or clarification within twenty- one days.

(5) The authority may require the applicant to appear, within twenty one days, before the authority in person, or through its authorised representative for explanation or clarifications required for processing the application.

(6) If the authority is satisfied, after such scrutiny, inspection or inquiry as it deems necessary, that the applicant is eligible under these rules, it may grant a certificate of registration to the applicant to carry on the activities of a registered valuer for the relevant asset class or classes in Form-C of the Annexure-II within sixty days of receipt of the application, excluding the time given by the authority for presenting additional documents, information or clarification, or appearing in person, as the case may be.

(7) If, after considering an application made under this rule, the authority is of the prima facie opinion that the registration ought not be granted, it shall communicate the reasons for forming such an opinion within forty-five days of receipt of the application, excluding the time given by it for removing the deficiencies, presenting additional documents or clarifications, or appearing in person, as the case may be.

(8) The applicant shall submit an explanation as to why his/its application should be accepted within fifteen days of the receipt of the communication under sub- rule (7), to enable the authority to form a final opinion.

(9) After considering the explanation, if any, given by the applicant under sub-rule (8), the authority shall either -

(a) accept the application and grant the certificate of registration; or

(b) reject the application by an order, giving reasons thereof.

(10) The authority shall communicate its decision to the applicant within thirty days of receipt of explanation.

7. Conditions of Registration.

The registration granted under rule 6 shall be subject to the conditions that the valuer shall –

(a) at all times possess the eligibility and qualification and experience criteria as specified under rule 3 and rule 4;

(b) at all times comply with the provisions of the Act , these rules and the Bye-laws or internal regulations, as the case may be, of the respective registered valuers organisation;

(c) in his capacity as a registered valuer, not conduct valuation of the assets or class(es) of assets other than for which he/it has been registered by the authority;

(d) take prior permission of the authority for shifting his/ its membership from one registered valuers organisation to another;
(e) take adequate steps for redressal of grievances;
(f) maintain records of each assignment undertaken by him for at least three years from the completion of such assignment;
(g) comply with the Code of Conduct (as per Annexure-I of these rules) of the registered valuers organisation of which he is a member;
(h) in case a partnership entity or company is the registered valuer, allow only the partner or director who is a registered valuer for the asset class(es) that is being valued to sign and act on behalf of it;
(i) in case a partnership entity or company is the registered valuer, it shall disclose to the company concerned, the extent of capital employed or contributed in the partnership entity or the company by the partner or director, as the case may be, who would sign and act in respect of relevant valuation assignment for the company;
(j) in case a partnership entity is the registered valuer, be liable jointly and severally along with the partner who signs and acts in respect of a valuation assignment on behalf of the partnership entity;
(k) in case a company is the registered valuer, be liable alongwith director who signs and acts in respect of a valuation assignment on behalf of the company;
(l) in case a partnership entity or company is the registered valuer, immediately inform the authority on the removal of a partner or director, as the case may be, who is a registered valuer along with detailed reasons for such removal; and
(m) comply with such other conditions as may be imposed by the authority.

8. Conduct of Valuation.

(1) The registered valuer shall, while conducting a valuation, comply with the valuation standards as notified or modified under rule 18:
Provided that until the valuation standards are notified or modified by the Central Government, a valuer shall make valuations as per-
  (a) internationally accepted valuation standards;
  (b) valuation standards adopted by any registered valuers organisation.
(2) The registered valuer may obtain inputs for his valuation report or get a separate valuation for an asset class conducted from another registered valuer, in which case he shall fully disclose the details of the inputs and the particulars etc. of the other registered valuer in his report and the liabilities against the resultant valuation, irrespective of the nature of inputs or valuation by the other registered valuer, shall remain of the first mentioned registered valuer.
(3) The valuer shall, in his report, state the following:-
  (a) background information of the asset being valued;
  (b) purpose of valuation and appointing authority;
  (c) identity of the valuer and any other experts involved in the valuation;
  (d) disclosure of valuer interest or conflict, if any;
  (e) date of appointment, valuation date and date of report;
  (f) inspections and/or investigations undertaken;
  (g) nature and sources of the information used or relied upon;
  (h) procedures adopted in carrying out the valuation and valuation standards followed;
  (i) restrictions on use of the report, if any;
  (j) major factors that were taken into account during the valuation;
  (k) conclusion; and
  (l) caveats, limitations and disclaimers to the extent they explain or elucidate the limitations faced by valuer, which shall not be for the purpose of limiting his responsibility for the valuation report.

9. Temporary surrender.

(1) A registered valuer may temporarily surrender his registration certificate in accordance with the bye-laws or regulations, as the case may be, of the registered valuers organisation and on such surrender, the valuer shall inform the authority for taking such information on record.

(2) A registered valuers organisation shall inform the authority if any valuer member has temporarily surrendered his/its membership or revived his/ its membership after temporary surrender, not later than seven days from approval of the application for temporary surrender or revival, as the case may be.

(3) Every registered valuers organisation shall place, on its website, in a searchable format, the names and other details of its valuers members who have surrendered or revived their memberships.

10. Functions of a Valuer.

A valuer shall conduct valuation required under the Act as per these rules.

11. Transitional Arrangement.

Any person who may be rendering valuation services under the Act, on the date of commencement of these rules, may continue to render valuation services without a certificate of registration under these rules upto 31st January, 2019:

Provided that if a company has appointed any valuer before such date and the valuation or any part of it has not been completed before 31st January, 2019, the valuer shall complete such valuation or such part within 3 months thereafter.

CHAPTER III
RECOGNITION OF REGISTERED VALUERS ORGANISATIONS

12. Eligibility for registered valuers organisations.

(1) An organisation that meets requirements under sub-rule (2) may be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes if—

(i) it has been registered under section 25 of the Companies Act, 1956 (1 of 1956) or section 8 of the Companies Act, 2013 (18 of 2013) with the sole object of dealing with matters relating to regulation of valuers of an asset class or asset classes and has in its bye laws the requirements specified in Annexure-III;

(ii) it is a professional institute established by an Act of Parliament enacted for the purpose of regulation of a profession;

Provided that, subject to sub-rule (3), the following organisations may also be recognised as a registered valuers organisation for valuation of a specific asset class or asset classes, namely:-

(a) an organisation registered as a society under the Societies Registration Act, 1860 (21 of 1860) or any relevant state law, or;

(b) an organisation set up as a trust governed by the Indian Trust Act, 1882 (2 of 1882).

(2) The organisation referred to in sub-rule (1) shall be recognised if it –

(a) conducts educational courses in valuation, in accordance with the syllabus determined by the authority, under rule 5, for individuals who may be its valuers members, and delivered in class room or through distance education modules and which includes practical training;

(b) grants membership or certificate of practice to individuals, who possess the qualifications and experience as specified in rule 4, in respect of valuation of asset class for which it is recognised as a registered valuers organisation ;

(c) conducts training for the individual members before a certificate of practice is issued to them;

(d) lays down and enforces a code of conduct for valuers who are its members, which includes all the provisions specified in Annexure-I;

(e) provides for continuing education of individuals who are its members;

(f) monitors and reviews the functioning, including quality of service, of valuers who are its members; and

(g) has a mechanism to address grievances and conduct disciplinary proceedings against valuers who are its members.

(3) A registered valuers organisation, being an entity under proviso to sub-rule (1), shall convert into or register itself as a company under section 8 of the Companies Act, 2013 (18 of 2013), and include in its bye laws the requirements specified in Annexure- III, within one year from the date of commencement of these rules.

13. Application for recognition.

(1) An eligible organisation which meets the conditions specified in rule 12 may make an application for recognition as a registered valuers organisation for asset class or classes to the authority in Form-D of the Annexure-II along with a non-refundable application fee of rupees one lakh in favour of the authority.

(2) The authority shall examine the application, and may grant twenty-one days to the applicant to remove the deficiencies, if any, in the application.

(3) The authority may require the applicant to submit additional documents or clarification within twenty-one days.

(4) The authority may require the applicant to appear, within twenty-one days, before the Authority through its authorised representative for explanation or clarifications required for processing the application.

(5) If the authority is satisfied, after such scrutiny, inspection or inquiry as it deems necessary that the applicant is eligible under these rules, it may grant a certificate of recognition as a registered valuers organisation in Form-E of Annexure-II.

(6) If, after considering an application made under sub-rule (1), the authority is of the prima facie opinion that recognition ought not to be granted, it shall communicate the reasons for forming such an opinion within forty-five days of receipt of the application, excluding the time given by it for removing the deficiencies, presenting additional documents or clarifications, or appearing through authorised representative, as the case may be.

(7) The applicant shall submit an explanation as to why its application should be accepted within fifteen days of the receipt of the communication under sub- rule (6), to enable the authority to form a final opinion.

(8) After considering the explanation, if any, given by the applicant under sub- rule (7), the authority shall either -

(a) accept the application and grant the certificate of recognition; or

(b) reject the application by an order, giving reasons thereof.

(9) The authority shall communicate its decision to the applicant within thirty days of receipt of explanation.

14. Conditions of Recognition.

The recognition granted under rule 13 shall be subject to the conditions that the registered valuers organisation shall-

(a) at all times continue to satisfy the eligibility requirements specified under rule 12;

(b) maintain a register of members who are registered valuers, which shall be publicly available;

(c) admits only individuals who possess the educational qualifications and experience requirements, in accordance with rule 4 and as specified in its recognition certificate, as members;

(d) make such reports to the authority as may be required by it;

(e) comply with any directions, including with regard to course to be conducted by valuation organisation under clause (a) of sub-rule (2) of rule 12, issued by the authority;

(f) be converted or registered as company under section 8 of the Act, with governance structure and bye laws specified in Annexure-III, within a period of 2 years from the date of commencement of these rules if it is an organisation referred to in proviso to sub-rule (1) of rule 12;

(g) shall have the governance structure and incorporate in its bye laws the requirements specified in Annexure-III within one year of commencement of these rules if it is an organisation referred to in clause (i) of sub-rule (1) of rule 12 and existing on the date of commencement of these rules;

(h) display on its website, the status and specified details of every registered valuer being its valuer members including action under rule 17 being taken against him; and

(i) comply with such other conditions as may be specified by authority.

CHAPTER IV
CANCELLATION OR SUSPENSION OF CERTIFICATE OF REGISTRATION OR RECOGNITION

15. Cancellation or suspension of certificate of registration or recognition.

The authority may cancel or suspend the registration of a valuer or recognition of a registered valuers organisation for violation of the provisions of the Act, any other law allowing him to perform valuation, these rules or any condition of registration or recognition, as the case may be in the manner specified in rule 17.

16. Complaint against a registered valuer or registered valuers organisation.

A complaint may be filed against a registered valuer or registered valuers organisation before the authority in person or by post or courier along with a non-refundable fees of rupees one thousand in favour of the authority and the authority shall examine the complaint and take such necessary action as it deems fit:

Provided that in case of a complaint against a registered valuer, who is a partner of a partnership entity or director of a company, the authority may refer the complaint to the relevant registered valuers organisation and such organisation shall handle the complaint in accordance with its bye laws.

17. Procedure to be followed for cancellation or suspension of registration or recognition certificate.

(1) Based on the findings of an inspection or investigation, or a complaint received or on material otherwise available on record, if the authorised officer is of the prima facie opinion that sufficient cause exists to cancel or suspend the registration of a valuer or cancel or suspend the recognition of a registered valuers organisation, it shall issue a show-cause notice to the valuer or registered valuers organisation,:

Provided that in case of an organisation referred to in clause (ii) of sub-rule (1) of rule 12 which has been granted recognition, the authorised officer shall, instead of carrying out inspection or investigation, seek the information required from the registered valuers organisation within the time specified therein and in the case of a default, give one more opportunity to provide the information within specified time failing which or in the absence of sufficient or satisfactory information provided, either initiate the process under this rule or refer the matter to the Central Government for appropriate directions.

(2) The show-cause notice shall be in writing and shall state-

(a) the provisions of the Act and rules under which it has been issued;

(b) the details of the alleged facts;

(c) the details of the evidence in support of the alleged facts;

(d) the provisions of the Act or rules or certificate of registration or recognition allegedly violated, or the manner in which the public interest has allegedly been affected;

(e) the actions or directions that the authority proposes to take or issue if the allegations are established;

(f) the manner in which the person is required to respond to the show-cause notice;

(g) consequences of failure to respond to the show-cause notice within the given time; and

(h) procedure to be followed for disposal of the show-cause notice.

(3) The show-cause notice shall be served in the following manner by-

(a) sending it to the valuer or registered valuers organisation at its registered address by registered post with acknowledgment due; or

(b) an appropriate electronic means to the email address provided by the valuer or registered valuers organisation to the authority.

(4) The authorised officer shall dispose of the show-cause notice by reasoned order in adherence to the principles of natural justice.

(5) The order in disposal of a show-cause notice may provide for-

(a) no action;

(b) warning; or

(c) suspension or cancellation of the registration or recognition; or

(d) change in any one or more partner or director or the governing board of the registered valuers organisation.

(6) An order passed under sub-rule (5) cancelling the recognition of a registered valuers organisation, shall specify the time within which its members may take membership of another registered valuers organisation recognised for valuation of relevant asset class without prejudice to their registration.

(7) The order passed under sub-rule (5) shall be issued to the concerned person immediately, and published on the website of the authority.

(8) The order passed under sub-rule (5) shall not become effective until thirty days have elapsed from the date of issue of the order unless stated otherwise.

(9) Any person aggrieved by an order of the authorised officer under sub-rule (5) may prefer an appeal before the authority.

Explanation.— For the purposes of this rule, the authorised officer shall be an officer as may be specified by the authority.

CHAPTER V
VALUATION STANDARDS

18. Valuation Standards.

The Central Government shall notify and may modify (from time to time) the valuation standards on the recommendations of the Committee set up under rule 19.

19. Committee to advise on valuation matters.

(1) The Central Government may constitute a Committee to be known as "Committee to advise on valuation matters" to make recommendations on formulation and laying down of valuation standards and policies for compliance by companies and registered valuers.

(2) The Committee shall comprise of-

(a) a Chairperson who shall be a person of eminence and well versed in valuation, accountancy, finance, business administration, business law, corporate law, economics;

(b) one member nominated by the Ministry of Corporate Affairs;

(c) one member nominated by the Insolvency and Bankruptcy Board of India;

(d) one member nominated by the Legislative Department;

(e) up to four members nominated by Central Government representing authorities which are allowing valuations by registered valuers;

(f) up to four members who are representatives of registered valuers organisations, nominated by Central Government;

(g) Up to two members to represent industry and other stakeholder nominated by the Central Government in consultation with the authority;

(h) Presidents of, the Institute of Chartered Accountants of India, the Institute of Company Secretaries of India, the Institute of Cost Accountants of India as *ex-officio* members.

(3) The Chairperson and Members of the Committee shall have a tenure of three years and they shall not have more than two tenures.

CHAPTER VI
MISCELLANEOUS

20. Punishment for contravention.

Without prejudice to any other liabilities where a person contravenes any of the provision of these rules he shall be punishable in accordance with sub-section (3) of section 469 of the Act.

21. Punishment for false statement.

If in any report, certificate or other document required by, or for, the purposes of any of the provisions of the Act or the rules made thereunder or these rules, any person makes a statement,—

(a) which is false in any material particulars, knowing it to be false; or

(b) which omits any material fact, knowing it to be material,

he shall be liable under section 448 of the Act.

ANNEXURE-I
MODEL CODE OF CONDUCT FOR REGISTERED VALUERS

[See clause (g) of rule 7 and clause (d) of sub-rule (2) of rule 12]

Integrity and Fairness

1. A valuer shall, in the conduct of his/its business, follow high standards of integrity and fairness in all his/its dealings with his/its clients and other valuers.
2. A valuer shall maintain integrity by being honest, straightforward, and forthright in all professional relationships.
3. A valuer shall endeavour to ensure that he/it provides true and adequate information and shall not misrepresent any facts or situations.
4. A valuer shall refrain from being involved in any action that would bring disrepute to the profession.
5. A valuer shall keep public interest foremost while delivering his services.

Professional Competence and Due Care

6. A valuer shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.
7. A valuer shall carry out professional services in accordance with the relevant technical and professional standards that may be specified from time to time
8. A valuer shall continuously maintain professional knowledge and skill to provide competent professional service based on up-to-date developments in practice, prevailing regulations/guidelines and techniques.
9. In the preparation of a valuation report, the valuer shall not disclaim liability for his/its expertise or deny his/its duty of care, except to the extent that the assumptions are based on statements of fact provided by the company or its auditors or consultants or information available in public domain and not generated by the valuer.
10. A valuer shall not carry out any instruction of the client insofar as they are incompatible with the requirements of integrity, objectivity and independence.
11. A valuer shall clearly state to his client the services that he would be competent to provide and the services for which he would be relying on other valuers or professionals or for which the client can have a separate arrangement with other valuers.

Independence and Disclosure of Interest

12. A valuer shall act with objectivity in his/its professional dealings by ensuring that his/its decisions are made without the presence of any bias, conflict of interest, coercion, or undue influence of any party, whether directly connected to the valuation assignment or not.
13. A valuer shall not take up an assignment if he/it or any of his/its relatives or associates is not independent in terms of association to the company.
14. A valuer shall maintain complete independence in his/its professional relationships and shall conduct the valuation independent of external influences.
15. A valuer shall wherever necessary disclose to the clients, possible sources of conflicts of duties and interests, while providing unbiased services.
16. A valuer shall not deal in securities of any subject company after any time when he/it first becomes aware of the possibility of his/its association with the valuation, and in accordance with the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 or till the time the valuation report becomes public, whichever is earlier.
17. A valuer shall not indulge in "mandate snatching" or offering "convenience valuations" in order to cater to a company or client's needs.
18. As an independent valuer, the valuer shall not charge success fee.
19. In any fairness opinion or independent expert opinion submitted by a valuer, if there has been a prior engagement in an unconnected transaction, the valuer shall declare the association with the company during the last five years.

Confidentiality

20. A valuer shall not use or divulge to other clients or any other party any confidential information about the subject company, which has come to his/its knowledge without proper and specific authority or unless there is a legal or professional right or duty to disclose.

Information Management

21. A valuer shall ensure that he/ it maintains written contemporaneous records for any decision taken, the reasons for taking the decision, and the information and evidence in support of such decision. This shall be maintained so as to sufficiently enable a reasonable person to take a view on the appropriateness of his/its decisions and actions.
22. A valuer shall appear, co-operate and be available for inspections and investigations carried out by the authority, any person authorised by the authority, the registered valuers organisation with which he/it is registered or any other statutory regulatory body.
23. A valuer shall provide all information and records as may be required by the authority, the Tribunal, Appellate Tribunal, the registered valuers organisation with which he/it is registered, or any other statutory regulatory body.
24. A valuer while respecting the confidentiality of information acquired during the course of performing professional services, shall maintain proper working papers for a period of three years or such longer period as required in its contract for a specific valuation, for production before a regulatory authority or for a peer review. In the event of a pending case before the Tribunal or Appellate Tribunal, the record shall be maintained till the disposal of the case.

Gifts and hospitality.

25. A valuer or his/its relative shall not accept gifts or hospitality which undermines or affects his independence as a valuer.

    Explanation.— For the purposes of this code the term 'relative' shall have the same meaning as defined in clause (77) of Section 2 of the Companies Act, 2013 (18 of 2013).

26. A valuer shall not offer gifts or hospitality or a financial or any other advantage to a public servant or any other person with a view to obtain or retain work for himself/ itself, or to obtain or retain an advantage in the conduct of profession for himself/ itself.

Remuneration and Costs.

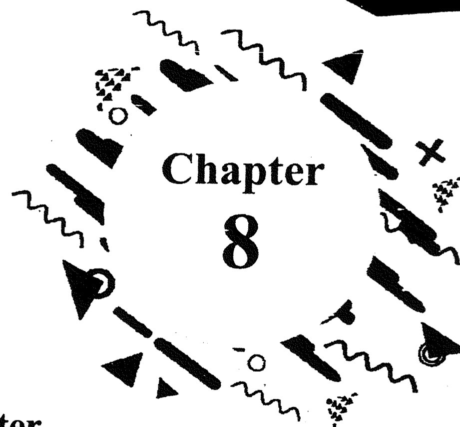
27. A valuer shall provide services for remuneration which is charged in a transparent manner, is a reasonable reflection of the work necessarily and properly undertaken, and is not inconsistent with the applicable rules.

28. A valuer shall not accept any fees or charges other than those which are disclosed in a written contract with the person to whom he would be rendering service.

Occupation, employability and restrictions.

29. A valuer shall refrain from accepting too many assignments, if he/it is unlikely to be able to devote adequate time to each of his/ its assignments.

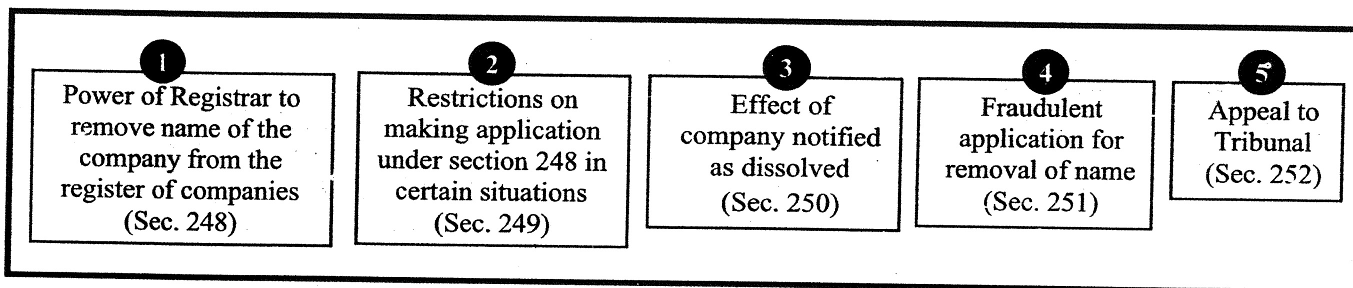
30. A valuer shall not conduct business which in the opinion of the authority or the registered valuer organisation discredits the profession.



Removal of Names of Companies from the Register of Companies

(Chapter XVIII of the Companies Act, 2013 consisting of Sections 248 to 252)

Bird's eye-view of the Chapter



Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, any reference to any section means reference to the sections of the Companies Act, 2013.
3. The Companies (Removal of Names of Companies from the Register of Companies) Rules, 2016 have not been included in the latest Study Material issued by ICAI. Accordingly, these Rules have not been incorporated in this Chapter.

8.1 Power of Registrar to remove name of the company from the register of companies (Section 248)

1. **Removal of name of the company from the register of companies by the Registrar *suo motu***
   (a) The Registrar is empowered to send a notice to the company and all its directors, of his intention to remove the name of the company from the register of companies, if the Registrar has reasonable cause to believe that –
      (i) a company has failed to commence its business within 1 year of its incorporation; or
      (ii) a company is not carrying on any business or operation for a period of 2 immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455; or
      (iii) the subscribers to the memorandum have not paid the subscription which they had undertaken to pay at the time of incorporation of a company and a declaration to this effect has not been filed within 180 days of its incorporation under section 10A; or
      (iv) the company is not carrying on any business or operations, as revealed after the physical verification carried out under section 12.

   (b) The notice sent by the Registrar shall require the company and its directors to send their representations along with copies of the relevant documents, if any, within a period of 30 days from the date of the notice.

2. **Removal of name of the company from the register of companies by the Registrar on an application by the company**
   (a) A company may file an application to the Registrar for removing its name from the register of companies on any of the following grounds:
      (i) It has not commenced its business within 1 year of its incorporation.
      (ii) It is not carrying on any business or operation for a period of 2 immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455.
   (b) Such an application may be filed only if before making such application, the company has extinguished all its liabilities.
   (c) Such an application may be filed only if the company is authorised by –
      (i) a special resolution; or
      (ii) consent of members holding 75% paid-up share capital.
   (d) In case the company is regulated under a special Act, approval of the regulatory body constituted or established under that Act shall also be obtained and enclosed with the application.
   (e) In case of a company registered under section 8, the provisions relating to removal of name of the company on an application made to the Registrar, shall not apply.
3. **Procedure for removal of name of the company from the register of companies**
   (a) The Registrar shall publish a notice in the prescribed manner and also in the Official Gazette for the information of the general public.
   (b) If upto the date mentioned in the notice, no cause is shown by the company, the Registrar may strike off the name of the company from the register of companies, and shall publish notice thereof in the Official Gazette, and on the publication in the Official Gazette of this notice, the company shall stand dissolved.
   (c) Before passing an order of striking off, the Registrar shall satisfy himself that sufficient provision has been made for –
      (i) the realisation of all amounts due to the company within a reasonable time; and
      (ii) for the payment or discharge of its liabilities and obligations by the company within a reasonable time.
   (d) The Registrar may, if he deems fit, obtain necessary undertakings from the managing director, director or other persons in charge of the management of the company with respect to realisation of amounts due and payment of liabilities.
4. **Consequences of removal of name of the company from the register of companies**
   Even where the name of a company is removed from the register of companies and the company stands dissolved,–
   (a) the assets of the company shall be made available for the payment or discharge of all its liabilities and obligations;
   (b) the liability, if any, of every director, manager or other officer who was exercising any power of management, shall continue and may be enforced against him;
   (c) the liability of every member of the company shall continue and may be enforced against him;
   (d) the Tribunal shall be empowered to wind up such a company.

Theoretical Questions from CA Examinations

Q 8.1A. Fine Electric Scooter Pvt. Ltd. incorporated in November, 2016 has not commenced or carried on any business since its inception. Promoters of the company being two subscribers have decided to dissolve the company and get the name of the company struck off the Registrar of Companies under the Fast Track Exit Mode. The promoters-directors seek your advice for dissolving the company. Advise.
[CA (Final) Nov. 2019]

Practical Problems from CA Examinations

Whether a company is liable to pay arrears of tax if its name has been struck off?

P 8.1A. Buina Limited has discontinued its business since 2015 and has not been filing annual returns. The Registrar of companies issued a notice for striking off the company. Since no reply was received within the time specified in the notice, the name of the company was struck off from the register of companies. There were tax arrears and a notice was sent to the company by the tax recovery officer. The directors contended that since the company's name has been struck off, the company does not exist and not liable to pay the tax. Referring to and analysing the relevant provisions of the companies Act, 2013 examine the validity of the company's claim. [CA (Final) May 2019]

Ans. The given problem relates to sections 248 of the Companies Act, 2013.

As per section 248, where the name of a company is removed from the register of companies and the company stands dissolved,–

(a) the assets of the company shall be made available for the payment or discharge of all its liabilities and obligations;

(b) the liability, if any, of every director, manager or other officer who was exercising any power of management, shall continue and may be enforced against him;

(c) the liability of every member of the company shall continue and may be enforced against him;

(d) the Tribunal shall be empowered to wind up such a company.

In the given case, the name of Buina Limited was struck off the register of companies. However, afterwards, it has become evident that there were certain tax arrears. It is contended by the directors of Buina Limited that the company is not liable to pay such arrears of tax as the name of the company has already been struck off the register of companies.

Section 248 expressly provides that even where the name of a company has been struck off the register of companies, its assets shall be made available for the payment or discharge of all its liabilities and also the liabilities of directors, manager, officers and members of the company can also be enforced against them.

Thus, the tax recovery officer is empowered to recover the arrears of tax payable by Buina Ltd.

8.2 Restrictions on making application under section 248 in certain situations (Section 249)

1. Cases in which no application can be made by the company for striking off the name of the company

A company shall not be eligible to file an application to the Registrar for removing its name from the register of companies if, at any time during the previous 3 months, the company –

(a) has changed its name or shifted its registered office from one State to another;

(b) has disposed of its property or rights, immediately before cesser of trade or otherwise carrying on of business, for the purpose of disposal for gain in the normal course of trading or otherwise carrying on of business;

(c) has engaged in any other activity except the one which is necessary or expedient for –

 (i) the purpose of making an application under section 248; or

 (ii) concluding the affairs of the company; or

 (iii) complying with any statutory requirement;

(d) has made an application to the Tribunal for the sanctioning of a compromise or arrangement and the matter has not been finally concluded; or

(e) is being wound up under Chapter XX of this Act or under the Insolvency and Bankruptcy Code, 2016.

2. Punishment for making an application when the company is not so eligible

If a company files an application with the Registrar under section 248 for the purpose of removal of name of the company from the register of companies, but such application is in contravention of section 249, then –

(a) the company shall be punishable with fine which may extend to Rs. 1 lakh;

(b) such application shall be withdrawn by the company or rejected by the Registrar as soon as it is brought to the notice of the Registrar that the company is not eligible to make an application for such removal.

Practical Problems from CA Examinations

Application made by a company for removal of its name pending the application for obtaining status of dormant company – Whether tenable?

P 8.2A. Kojol Research Development Ltd. was registered to innovate unique business idea emerging from research and development in new area. It is a future project and the Company has no significant accounting transactions and business activities. Therefore the Company made an application to RoC for obtaining the status of a Dormant Company. The application is under process. In the meantime, the Company without extinguishing all its liabilities filed an application to RoC for removing the name of the Company, after passing a special resolution giving effect to this.

In the light of the provisions of the Companies Act, 2013, analyse the following:

(1) Whether the application is tenable under the Act?

(2) What are the restrictions imposed under the Act for making application by a Company to remove the name of the Company from the register of RoC?

(3) What are the penal consequences in case of violation of restrictions? **[CA (Final) May 2018]**

Ans. The given problem relates to sections 248 and 249 of the Companies Act, 2013.

Removal of name of company from the register of companies by the Registrar on an application by the company (Section 248)

(a) A company may file an application to the Registrar for removing its name from the register of companies on any of the following grounds:

  (i) It has not commenced its business within 1 year of its incorporation.

  (ii) It is not carrying on any business or operation for a period of 2 immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455.

(b) Such an application may be filed only if before making such application, the company has extinguished all its liabilities.

(c) Such an application may be filed only if the company is authorised by –

  (i) a special resolution; or

  (ii) consent of members holding 75% paid-up share capital.

The questions asked in the given problem are answered as follows:

(1) Whether application made by Kojol Research Development Ltd. is tenable? (Section 248)

The application made by Kojol Research Development Ltd. is not tenable because of the following reasons:

  (a) The application for removal of name may be made by a company only if it has not made any application for obtaining the status of a dormant company. But, Kojol Research Development Ltd. had made an application for obtaining the status of a dormant company, and so this condition is not satisfied.

  (b) The application for removal of name may be made by a company only if it has extinguished all its liabilities. But, Kojol Research Development Ltd. has not extinguished all its liabilities at the time of making application for removal of its name, and so this condition is not satisfied.

(2) Restrictions imposed under the Act for making application by a Company to remove the name of the Company from the register of RoC (Section 249)

A company shall not be eligible to file an application to the Registrar for removing its name from the register of companies if, at any time during the previous 3 months, the company –

  (a) has changed its name or shifted its registered office from one State to another;

  (b) has disposed of its property or rights, immediately before cesser of trade or otherwise carrying on of business, for the purpose of disposal for gain in the normal course of trading or otherwise carrying on of business;

  (c) has engaged in any other activity except the one which is necessary or expedient for –

    (i) the purpose of making an application under section 248; or

    (ii) deciding whether to do so; or

    (iii) concluding the affairs of the company; or

    (iv) complying with any statutory requirement;

  (d) has made an application to the Tribunal for the sanctioning of a compromise or arrangement and the matter has not been finally concluded; or

  (e) is being wound up under Chapter XX of this Act or under the Insolvency and Bankruptcy Code, 2016.

(3) Penal consequences in case of violation of restrictions (Section 249)

If a company files an application with the Registrar under section 248 for the purpose of removal of name of the company from the register of companies, but such application is in contravention of section 249, then –

(a) the company shall be punishable with fine which may extend to Rs. 1 lakh;

(b) such application shall be withdrawn by the company or rejected by the Registrar as soon as it is brought to the notice of the Registrar that the company is not eligible to make an application for such removal.

8.3 Effect of company notified as dissolved (Section 250)

With effect from such date a company stands dissolved under section 248, –

(a) it shall cease to operate as a company; and

(b) the Certificate of Incorporation issued to it shall be deemed to have been cancelled except for the purpose of realising the amount due to the company and for the payment or discharge of the liabilities or obligations of the company.

8.4 Fraudulent application for removal of name (Section 251)

1. **Applicability of section 251**

   Section 251 applies if it is found that an application by a company under section 248 has been made –

   (a) with the object of evading the liabilities of the company; or

   (b) with the intention to deceive the creditors or to defraud any other persons.

2. **Consequences as per section 251**

   (a) The persons in charge of the management of the company shall, notwithstanding that the company has been dissolved –

   (i) be jointly and severally liable to any person or persons who had incurred loss or damage as a result of the company being dissolved; and

   (ii) be punishable for fraud in the manner as provided in section 447.

   (b) The Registrar may also recommend prosecution of the persons responsible for the filing of application under section 248.

8.5 Appeal to Tribunal (Section 252)

1. **Appeal to the Tribunal against order of striking off by any person**

   If an order of dissolution of a company is passed under section 248 by the Registrar, any person aggrieved by such an order may file an appeal to the Tribunal within a period of 3 years from the date of such order.

2. **Application by the Registrar to the Tribunal seeking restoration of name**

   (a) The Registrar may file an application before the Tribunal seeking restoration of name of a company, if the Registrar is satisfied that the name of such company was struck off the register of companies –

   (i) inadvertently; or

   (ii) on the basis of incorrect information furnished by the company or its directors,

   and that restoration of name of the company in the register of companies is required.

   (b) The Registrar may file such an application within a period of 3 years from the date of passing of the order dissolving the company under section 248.

3. **Order of the Tribunal for restoration of name**

   (a) If the Tribunal is of the opinion that the removal of the name of the company from the register of companies was not justified in view of the absence of any of the grounds on which the order was passed by the Registrar, it may order restoration of the name of the company in the register of companies.

   (b) Before passing any order, the Tribunal shall give a reasonable opportunity of making representations and of being heard to the Registrar, the company and all the persons concerned.

   (c) A copy of the order passed by the Tribunal shall be filed by the company with the Registrar within 30 days.

   (d) On receipt of the order of the Tribunal, the Registrar shall –

   (i) restore the name of the company in the register of companies; and

   (ii) issue a fresh certificate of incorporation.

4. Application to the Tribunal seeking restoration of name

(a) An application may be made to the Tribunal by –

(i) the company; or

(ii) any member of the company; or

(iii) any creditor of the company; or

(iv) any workman of the company,

who is aggrieved by the fact of striking off the name of the company from the register of companies.

(b) Such an application may be made to the Tribunal at anytime, but before the expiry of 20 years from the publication in the Official Gazette of the notice under section 248.

(c) On receipt of such an application, the Tribunal may, if it is satisfied that the company was, at the time when its name was struck off, carrying on business or in operation or otherwise it is just that the name of the company be restored to the register of companies, order the name of the company to be restored on the register of companies.

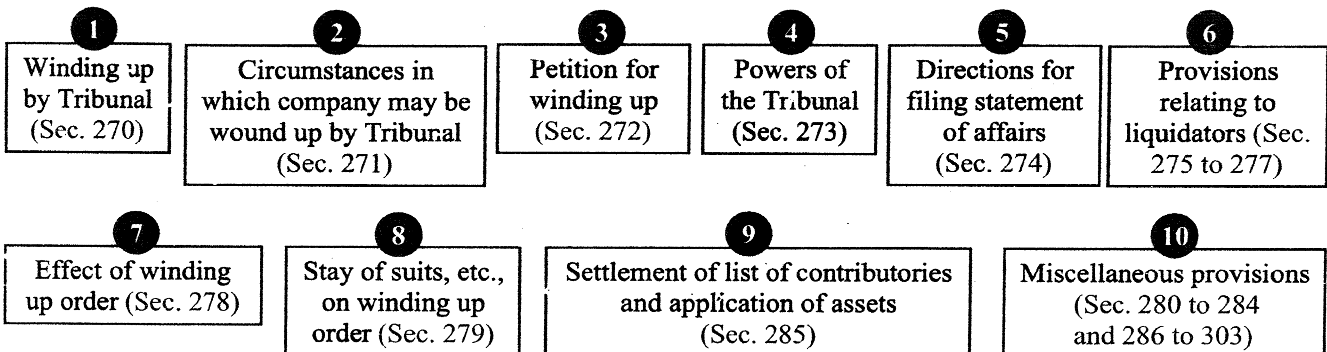
(d) The Tribunal may, by an order, give such other directions and make such provisions as it may deem fit for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off the register of companies.

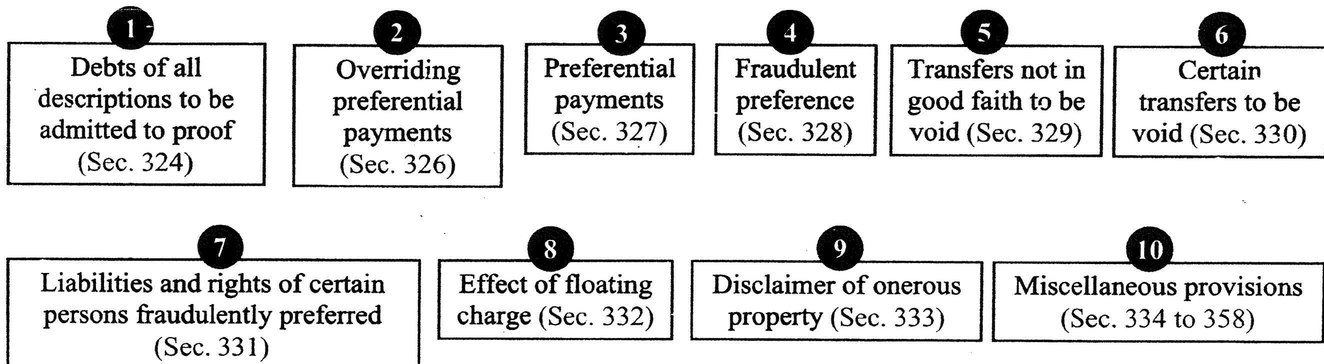
Winding Up

Chapter 9

(Chapter XX of the Companies Act, 2013 consisting of Sections 270 to 365)

Bird's eye-view of the Chapter





Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, any reference to any section means reference to the sections of the Companies Act, 2013.
3. The Companies (Winding Up) Rules, 2020 were notified in the Official Gazette by the Central Government on 24th January, 2020 and came into force with effect from 1st April, 2020. However, these Rules were not made applicable by ICAI for November, 2020 Exams. So, the Author of this Book has assumed that these Rules shall not be applicable for May, 2021 and onwards Exams. Accordingly, these Rules have not been included in this Book. In case, these Rules are made applicable by ICAI, the Author shall upload these Rules on www.bestword.in.
4. Sections 337 to 343, 348 to 351 and 359 to 365 have been excluded from the Syllabus vide ICAI Announcements dated 24th June 2019, 3rd July, 2019, 9th July 2019, 22nd July, 2019 and 15th July 2020, and therefore, these sections have not been included in this Book.

9.1 Introduction

1. Chapter XX of the Companies Act, 2013 consists of sections 270 to 365.
2. Chapter XX of the Companies Act, 2013 has been divided into 4 Parts, as follows:
   (i) Part I: Winding up by the Tribunal: Sections 270 to 303
   (ii) Part II: Voluntary winding up: Sections 304 to 323 (All these sections have been omitted by the Insolvency and Bankruptcy Code, 2016)
   (iii) Part III: Provisions applicable to every mode of winding up: Sections 324 to 358
   (iv) Part IV: Official Liquidators: Sections 359 to 365.

'Winding up' means winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable [Section 2(94A)].

9.2 Winding up by Tribunal (Section 270)

The provisions of Part I shall apply to the winding up of a company by the Tribunal under this Act.

9.3 Circumstances in which company may be wound up by Tribunal (Section 271)

A company may, on a petition under section 272, be wound up by the Tribunal on any of the following grounds:

Ground No. 1. Special resolution passed by the company

The company may, by passing a special resolution, resolve that the company be wound up by the Tribunal. On receipt of petition on this ground, the Tribunal may order the winding up of the company.

Ground No. 2. Company has acted against the security of the country etc.

The Tribunal may order the winding up of a company if the company has acted against the interests of –

(i) the sovereignty and integrity of India; or
(ii) the security of the State; or
(iii) friendly relations with foreign States; or
(iv) public order; or
(v) decency; or
(vi) morality.

Ground No. 3. Where the affairs of the company have been conducted fraudulently

The Tribunal may order the winding up of a company if the Tribunal is of the opinion that –

(i) the affairs of the company have been conducted in a fraudulent manner; or
(ii) the company was formed for fraudulent and unlawful purpose; or
(iii) the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith; and

that it is proper that the company be wound up.

The Tribunal may make an order under this ground on a petition made by –
(a) the Registrar; or
(b) any other person authorized by the Central Government by Notification under this Act.

Ground No. 4. Non-filing of financial statements or annual returns by the company

A company may be ordered to be wound up by the Tribunal if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding 5 consecutive financial years.

Ground No. 5. Just and equitable to wind up the company

When the Tribunal is of the opinion that it is just and equitable that the company should be wound up, it may order the winding up of the company.

- Winding up on this ground is in the nature of a remedy of the last resort and is allowed when other remedies are not efficacious enough to protect the general interests of the company and its claimants.
- The applicant must convince the Tribunal that –
  (i) there are just and equitable grounds for winding up the company; *and*
  (ii) there is no alternative remedy open to him **[*Re, Atul Drug House Ltd.* (1971) 41 Comp Cas 352]**.
- Where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal has the discretion to dismiss it, if –
  (i) an alternate remedy is available; *or*
  (ii) the applicant is acting unreasonably in asking for a winding up order.
- The Tribunal shall take into account not only the interests of the shareholders and creditors but also public interest and interest of employees.
- The words 'just and equitable' are not to be read *ejusdem generis* with the grounds mentioned under section 271.

Examples on just and equitable ground. The Tribunal may order the winding up of a company in the following cases:

(a) Loss of substratum. The substratum of the company may be said to have gone where the main purpose for which the company was formed becomes impossible, *i.e.* permanently impracticable. No general rule can be laid down as to the nature of circumstances in which it can be said that the substratum of the company has gone, and each case has to be decided on its own facts. Winding up order may be passed under the just and equitable ground in the following cases:
- Where it is established that the company was incorporated for a particular purpose which could no longer be achieved.
- Where it is impossible to carry on the business of the company except at a loss, *i.e.* there was no reasonable hope of trading at a profit.

(b) Deadlock in management. If there is total deadlock and there is no other practical remedy, the Tribunal would have little option but to order the winding up.

(c) Company is a bubble. Where the company is a mere bubble and does not carry on any business and does not have any property.

The power of the Tribunal to order winding up is discretionary

The use of the word '*may*' in the opening part of section 271 implies that the circumstances mentioned under section 271(1)(a) to (e) give to the Tribunal a discretionary power to order the winding up of a company, *i.e.* the Tribunal is not under an obligation to order the winding up of a company even if the conditions mentioned under any of the clauses of section 271 are fulfilled. The Tribunal may not order the winding up if it is opposed to the interest of the company or public interest.

Theoretical Questions from CA Examinations

Q 9.3A. Explain the cases in which a company may be wound up by the Tribunal. [CA (Final) May 1997]

Q 9.3B. Under what circumstances shall it be deemed that the substratum of a company has gone? A company has ceased to carry on two of the ten business stated as the main objects of the company. Examine whether the company can be wound up on the ground that substratum of the company is gone. [CA (Final) Nov. 2008]

9.4 Petition for winding up (Section 272)

The petition for winding up of a company shall be presented by any of the following persons:

1. The company

   A petition presented by the company for winding up before the Tribunal shall be admitted only if it is accompanied by a statement of affairs in such form and in such manner as may be prescribed.

2. Any contributory or contributories

Condition for presentation of petition by a contributory

A contributory shall be entitled to present the petition only if –

(i) the shares were originally allotted to him; or

(ii) he has held his shares for at least 6 months during the 18 months immediately preceding the commencement of winding up; or

(iii) the shares have been devolved on him by reason of the death of a member.

Certain clarifications with respect to presentation of petition by a contributory

A contributory shall be entitled to present a petition for the winding up of a company, notwithstanding that –

(i) he may be the holder of fully paid-up shares; or

(ii) the company may have no assets at all; or

(iii) the company may have no surplus assets left for distribution among the shareholders after the payment of its liabilities.

3. All or any of the persons specified in Points (1) and (2) above
4. The Registrar

The Registrar shall be entitled to present a petition for winding up only on the following grounds:

Ground No. 2. Company acting against the security of the country etc.

Ground No. 3. Where the affairs of the company have been conducted fraudulently

Ground No. 4. Non-filing of financial statements or annual returns by the company

Ground No. 5. Just and equitable to wind up the company

The Registrar shall obtain the previous approval of the Central Government before making a petition for winding up. Further, the Central Government shall not grant the approval to the Registrar unless the company has been given a reasonable opportunity of making representations.

5. Any person authorised by the Central Government in that behalf
6. The Central Government or a State Government, if the petition is made on the ground that the company has acted against the interests of -
   (a) the sovereignty and integrity of India; or
   (b) the security of the State; or
   (c) friendly relations with foreign States; or
   (d) public order; or
   (e) decency; or
   (f) morality.

A copy of every petition made to the Tribunal for winding up of a company shall also be filed with the Registrar. The Registrar shall submit his views to the Tribunal within 60 days of receipt of such petition.

Theoretical Questions from CA Examinations

Q 9.4A. *Who can file a petition for winding up by the Tribunal?* [CA (Final) Nov. 1994]

Q 9.4B. *When can a contributory of a company file a petition for winding up by the Tribunal?* [CA (Final) May 1996]

9.5 Powers of the Tribunal (Section 273)

1. Nature of orders of Tribunal

On receipt of a petition for winding up under section 272, the Tribunal may pass any of the following orders:

(a) Dismiss it, with or without costs.

(b) Make any interim order as it thinks fit.

(c) Appoint a provisional liquidator of the company till the making of a winding up order.

(d) Make an order for the winding up of the company with or without costs.

The Tribunal shall not refuse to make a winding up order merely because of the reason that –

(a) the assets of the company have been mortgaged for an amount equal to or in excess of those assets; or

(b) the company has no assets.

(e) Any other order as it thinks fit.

2. **Time limit for passing the order**

   The Tribunal shall pass its order within 90 days from the date of presentation of the petition.

3. **Condition for appointment of provisional liquidator**

   Before appointing a provisional liquidator, the Tribunal shall –

   (a) give notice to the company;

   (b) grant to the company a reasonable opportunity to make its representations, if any.

   However, the Tribunal may dispense with such notice if it is of the opinion that there is some special reason because of which notice need not be given to the company. The Tribunal shall record in writing such special reasons.

4. **Situation where petition of winding up is made on just and equitable ground**

   Where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make an order of winding up, if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably by seeking an order of winding up.

Practical Problems from CA Examinations

Whether failure to file financial statements and annual returns can be a ground form making a petition for winding up of the company?

P 9.5A. LED Bulb Ltd. has made default in filing financial statements and annual returns for a continuous period of 4 financial years ending on 31st March, 2017. The Registrar of Companies having jurisdiction approached the Central Government to accord sanction to present a petition to Tribunal (NCLT) for the winding up of the company on the above ground under Section 272 of the Companies Act, 2013. Examine the validity of the RoC move, explaining the relevant provisions of the Companies Act, 2013. State the time limit for passing an order by the Tribunal under Section 273 of the Companies Act, 2013?

[CA (Final) May 2018]

Ans. The given problem relates to sections 270, 272 and 273 of the Companies Act, 2013.

As per section 270, a company may be ordered to be wound up by the Tribunal on any of the 5 grounds mentioned therein. One of such grounds is as follows:

Where a company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding 5 consecutive financial years.

Section 272 contains the provisions as to who can make a petition for winding up of a company. As per section 272, the Registrar is one of the persons who is empowered to make a petition for winding up on the ground that the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding 5 consecutive financial years. However, before making the petition for winding up, the Registrar shall obtain the previous approval of the Central Government, and the Central Government shall not grant the approval to the Registrar unless the company has been given a reasonable opportunity of making representations.

As per section 273, where a petition for winding up of a company has been made to the Tribunal, the Tribunal shall pass its order within 90 days from the date of presentation of the petition.

The issues raised in the given question are answered as under:

Validity of Registrar's move

The default by LED Bulbs Ltd. has been in existence only for 4 financial years, and so the condition mentioned in section 272 that the default has to be for immediately preceding 5 consecutive years is not satisfied. Since none of the grounds mentioned in section 270 is attracted to LED Bulbs Ltd., the application made to the Central Government by the Registrar is not valid.

Time limit for passing order by the Tribunal under section 273

As per section 273, the Tribunal shall pass its order within 90 days from the date of presentation of the petition.

9.6 Directions for filing statement of affairs (Section 274)

1. **Duty to file the statement of affairs**

   (a) Where a petition for winding up is filed before the Tribunal by any person other than the company, the Tribunal shall, if it is satisfied that a *prima facie* case for winding up of the company is made out, by an order direct the company to file its objections along with a statement of its affairs within 30 days of the order in such form and in such manner as may be prescribed.

   (b) However, the Tribunal may allow a further period of 30 days in a situation of contingency or special circumstances.

(c) The Tribunal may direct the petitioner to deposit such security for costs as it may consider reasonable as a precondition to issue directions to the company.

(d) If a company fails to file the statement of affairs, then –

(i) the company shall not have a right to oppose the petition; and

(ii) a complaint may be filed in this behalf before the Special Court by Registrar, provisional liquidator, Company Liquidator or any person authorised by the Tribunal, and thereupon the directors and officers of the company liable for such non-compliance, shall be liable for imprisonment upto 6 months or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh, or with both.

2. **Duty to submit books of account**

Where an order of winding up of a company is passed by the Tribunal, the directors and officers of the company shall, within 30 days, submit to the liquidator, the books of account of the company duly completed and audited upto the date of the order of the Tribunal.

As per section 272, a petition for winding up presented by the company before the Tribunal shall be admitted only if it is accompanied by a statement of affairs in such form and in such manner as may be prescribed.

Theoretical Questions from CA Examinations

Q 9.6A. Explain the provisions of the Companies Act, 2013 relating to preparation and filing of Statement of Affairs (SA) in case of winding of a company by the Tribunal, with regard to the following aspects:

(i) Who is required to prepare and file SA and whether cost and expenses incurred in preparing SA are recoverable?

(ii) Contents of SA and the period within which the same is required to be submitted and to whom? Also state about delay in filing SA and upto what period the same is allowed. [CA (Final) May 2016 (Modified)]

9.7 Company Liquidators and their appointments (Section 275)

1. **Appointment of Company Liquidator**

Where the Tribunal makes an order for winding up of a company, the Tribunal shall appoint the Company Liquidator for the purpose of winding up of the company.

'Company Liquidator' means a person appointed by the Tribunal as the Company Liquidator in accordance with the provisions of section 275 for the winding up of a company under this Act [Section 2(23)].

2. **Who can be the Company Liquidator?**

The Company Liquidator shall be either –

(a) the Official Liquidator; or

(b) a person who is registered as an insolvency professional under the Insolvency and Bankruptcy Code, 2016.

3. **Terms and conditions of the appointment of the liquidator**

The terms and conditions of appointment of a provisional liquidator or Company Liquidator and the fee payable to him or it shall be specified by the Tribunal on the basis of task required to be performed, experience, qualification of such liquidator and size of the company.

4. **Restrictions on the powers of the provisional liquidator**

Where a provisional liquidator is appointed by the Tribunal, the Tribunal may limit and restrict his powers by the order appointing him or by a subsequent order, but otherwise he shall have the same powers as a liquidator.

5. **Filing of declaration of independence by the liquidator**

Within 7 days of appointment as provisional liquidator or Company Liquidator, such liquidator shall file with the Tribunal a declaration disclosing conflict of interest or lack of independence in respect of his appointment, if any. Such obligation shall continue throughout the term of his appointment.

6. **Appointment of provisional liquidator as Company Liquidator**

While passing a winding up order, the Tribunal may appoint a provisional liquidator, if any, as the Company Liquidator for the conduct of the proceedings for the winding up of the company.

9.8 Removal and replacement of liquidator (Section 276)

1. Removal of the liquidator

The Tribunal may, on a reasonable cause being shown and for reasons to be recorded in writing, remove the provisional liquidator or the Company Liquidator, as the case may be, as the liquidator of the company on any of the following grounds:

(a) Misconduct

(b) Fraud or misfeasance

(c) Professional incompetence or failure to exercise due care and diligence in performance of the powers and functions

(d) Inability to act as provisional liquidator or as the case may be, Company Liquidator

(e) Conflict of interest or lack of independence during the term of his appointment that would justify removal.

2. Transfer of work to another liquidator

In the event of death, resignation or removal of the provisional liquidator or as the case may be, Company Liquidator, the Tribunal may transfer the work assigned to him to another Company Liquidator for reasons to be recorded in writing.

3. Recovery of loss from liquidator

Where the Tribunal is of the opinion that any liquidator is responsible for causing any loss or damage to the company due to fraud or misfeasance or failure to exercise due care and diligence in the performance of his or its powers and functions, the Tribunal may recover or cause to be recovered such loss or damage from the liquidator and pass such other orders as it may think fit.

Before passing any order under this section, the Tribunal shall provide a reasonable opportunity of being heard to the provisional liquidator or, as the case may be, Company Liquidator.

9.9 Intimation to Company Liquidator, provisional liquidator and Registrar (Section 277)

1. Intimation of order by the Tribunal

Where the Tribunal makes an order for appointment of provisional liquidator or for the winding up of a company, it shall, within a period not exceeding 7 days from the date of passing of the order, cause intimation thereof to be sent to the Company Liquidator or provisional liquidator, as the case may be, and the Registrar.

2. Duty of the Registrar to update his records and intimate the stock exchange

On receipt of the copy of order of appointment of provisional liquidator or winding up order, the Registrar shall make an endorsement to that effect in his records relating to the company and notify in the Official Gazette that such an order has been made and in the case of a listed company, the Registrar shall intimate about such appointment or order, as the case may be, to the stock exchange or exchanges where the securities of the company are listed.

3. Discharge of officers and employees

The winding up order shall be deemed to be a notice of discharge to the officers, employees and workmen of the company, except when the business of the company is continued.

4. Constitution of winding up committee

Within 3 weeks from the date of passing of winding up order, the Company Liquidator shall make an application to the Tribunal for constitution of a winding up committee to assist and monitor the progress of liquidation proceedings by the Company Liquidator. Such winding up committee shall comprise of the following persons:

(i) Official Liquidator attached to the Tribunal

(ii) Nominee of secured creditors

(iii) A professional nominated by the Tribunal.

5. Functions of the winding up committee

The Company Liquidator shall be the convener of the meetings of the winding up committee which shall assist and monitor the liquidation proceedings in following areas of liquidation functions:

(i) Taking over assets

(ii) Examination of the statement of affairs
(iii) Recovery of property, cash or any other assets of the company including benefits derived therefrom
(iv) Review of audit reports and accounts of the company
(v) Sale of assets
(vi) Finalisation of list of creditors and contributories
(vii) Compromise, abandonment and settlement of claims
(viii) Payment of dividends, if any
(ix) Any other function, as the Tribunal may direct from time to time.

6. **Monthly reporting by the Company Liquidator to the Tribunal**
   The Company Liquidator shall place before the Tribunal a report along with minutes of the meetings of the committee on monthly basis duly signed by the members present in the meeting for consideration till the final report for dissolution of the company is submitted before the Tribunal.
7. **Submission of draft final report by the Company Liquidator to the winding up committee**
   The Company Liquidator shall prepare the draft final report for consideration and approval of the winding up committee.
8. **Submission of approved final report by the Company Liquidator to the Tribunal**
   The final report as approved by the winding up committee, shall be submitted by the Company Liquidator before the Tribunal for passing of a dissolution order in respect of the company.

Theoretical Questions from CA Examinations

Q 9.9A. Mr. X is appointed as a liquidator for PQR Ltd. Referring the provisions of the Companies Act, 2013 advise him about the period within which he is required to apply to the Tribunal for setting up a winding up committee and discuss the constitution and functions of the winding up committee. [CA (Final) Nov. 2019]

9.10 Effect of winding up order (Section 278)

The order for the winding up of a company shall operate in favour of all the creditors and all contributories of the company as if it had been made out on the joint petition of creditors and contributories.

9.11 Stay of suits, etc., on winding up order (Section 279)

1. **Stay of suits and legal proceedings**
   When a winding up order has been passed or a provisional liquidator has been appointed, no suit or other legal proceeding shall be commenced, or if pending at the date of the winding up order, shall be proceeded with, by or against the company, except with the leave of the Tribunal and subject to such terms as the Tribunal may impose.
2. **Disposal of application by the Tribunal**
   Any application to the Tribunal seeking leave for commencement or continuation of any suit or other legal proceedings shall be disposed of by the Tribunal within 60 days.
3. **Certain suits and proceedings not to be stayed**
   Any appeal pending before the Supreme Court or a High Court shall not be stayed.

Theoretical Questions from CA Examinations

Q 9.11A. How does the winding up order affect the pending suits or other legal proceedings against the company? [CA (Final) Nov. 1995]

9.12 Jurisdiction of Tribunal (Section 280)

The Tribunal shall have jurisdiction to entertain, or dispose of, –
(a) any suit or proceeding by or against the company;
(b) any claim made by or against the company, including claims by or against any of its branches in India;

(c) any application made under section 233 (*i.e.* merger or amalgamation of certain companies);

(d) any question of priorities or any other question whatsoever, whether of law or facts, including those relating to assets, business, actions, rights, entitlements, privileges, benefits, duties, responsibilities, obligations or in any matter arising out of, or in relation to winding up of the company, whether such suit or proceeding has been instituted, or is instituted, or such claim or question has arisen or arises or such application has been made or is made or such scheme has been submitted, or is submitted, before or after the order for the winding up of the company is made.

The provisions of section 280 shall apply notwithstanding anything to the contrary contained in any other law for the time being in force.

9.13 Submission of report by Company Liquidator (Section 281)

1. Submission of report by the Company Liquidator to the Tribunal

Where the Tribunal has made a winding up order or appointed a Company Liquidator, such liquidator shall, within 60 days from the order, submit to the Tribunal, a report containing the following particulars:

(a) The nature and details of the assets of the company including their location and value, stating separately the cash balance in hand and in the bank, if any, and the negotiable securities, if any, held by the company:

The valuation of the assets shall be obtained from registered valuers for this purpose.

(b) Amount of issued, subscribed and paid-up capital

(c) The existing and contingent liabilities of the company including names, addresses and occupations of its creditors, stating separately the amount of secured and unsecured debts, and in the case of secured debts, particulars of the securities given, whether by the company or an officer thereof, their value and the dates on which they were given

(d) The debts due to the company and the names, addresses and occupations of the persons from whom they are due and the amount likely to be realised on account thereof

(e) Guarantees, if any, extended by the company

(f) List of contributories and dues, if any, payable by them and details of any unpaid call

(g) Details of trade marks and intellectual properties, if any, owned by the company

(h) Details of subsisting contracts, joint ventures and collaborations, if any

(i) Details of holding and subsidiary companies, if any

(j) Details of legal cases filed by or against the company

(k) Any other information which the Tribunal may direct or the Company Liquidator may consider necessary to include.

2. Report to contain particulars regarding promotion of company and any frauds committed

The Company Liquidator shall include in his report the manner in which the company was promoted or formed and whether in his opinion any fraud has been committed by any person in its promotion or formation or by any officer of the company in relation to the company since the formation thereof and any other matters which, in his opinion, it is desirable to bring to the notice of the Tribunal.

3. Report to contain matters regarding viability of business

The Company Liquidator shall also make a report on the viability of the business of the company or the steps which, in his opinion, are necessary for maximising the value of the assets of the company.

4. Submission of further reports by the Company Liquidator

The Company Liquidator may also, if he thinks fit, make any further report or reports.

5. Inspection of report by creditors and contributories

Any person describing himself in writing to be a creditor or a contributory of the company shall be entitled by himself or by his agent at all reasonable times to inspect the report submitted in accordance with this section and take copies thereof or extracts therefrom on payment of the prescribed fees.

9.14 Directions of Tribunal on report of Company Liquidator (Section 282)

1. **Tribunal to fix time limit for completion of winding up proceedings and dissolution**
   The Tribunal shall, on consideration of the report of the Company Liquidator, fix a time limit within which the entire proceedings shall be completed and the company be dissolved.
2. **Revision of time limits for completion of winding up proceedings and dissolution**
   The Tribunal may, if it is of the opinion, at any stage of the proceedings, or on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, that it will not be advantageous or economical to continue the proceedings, revise the time limit within which the entire proceedings shall be completed and the company be dissolved.
3. **Order of Tribunal to sale the company as a going concern or its assets or part of assets**
   The Tribunal may, on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, order sale of the company as a going concern or its assets or part thereof.
4. **Constitution of sale committee by the Tribunal**
   The Tribunal may, where it considers fit, appoint a sale committee comprising such creditors, promoters and officers of the company as the Tribunal may decide to assist the Company Liquidator in sale.
5. **Order of investigation and filing of criminal complaint in case fraud is reported**
   Where a report is received from the Company Liquidator or the Central Government or any person that a fraud has been committed in respect of the company, the Tribunal shall, without prejudice to the process of winding up, order for investigation under section 210, and on consideration of the report of such investigation it may pass order and give directions under sections 339 to 342 or direct the Company Liquidator to file a criminal complaint against persons who were involved in the commission of fraud.
6. **Order of Tribunal for protection or preservation of assets**
   The Tribunal may order for taking such steps and measures, as may be necessary, to protect, preserve or enhance the value of the assets of the company.
7. **Other orders and directions by Tribunal**
   The Tribunal may pass such other order or give such other directions as it may consider fit.

9.15 Custody of company's properties (Section 283)

1. **Duty of the liquidator to take into his custody the property etc.**
   Where a winding up order has been made or where a provisional liquidator has been appointed, the Company Liquidator or the provisional liquidator, as the case may be, shall, on the order of the Tribunal, forthwith take into his or its custody or control all the property, effects and actionable claims to which the company is or appears to be entitled to and take such steps and measures, as may be necessary, to protect and preserve the properties of the company.
2. **Property of the company deemed to be in the custody of the Tribunal**
   Notwithstanding that it is the duty of the liquidator to take into his custody the property etc., all the property and effects of the company shall be deemed to be in the custody of the Tribunal from the date of the order of winding up of the company.
3. **Power of the Tribunal to order the officers, employees, etc. to deliver the property to the liquidator**
   On an application by the Company Liquidator or otherwise, the Tribunal may, at any time after the making of a winding up order, require any contributory for the time being on the list of contributories, and any trustee, receiver, banker, agent, officer or other employee of the company, to pay, deliver, surrender or transfer forthwith, or within such time as the Tribunal directs, to the Company Liquidator, any money, property or books and papers in his custody or under his control to which the company is or appears to be entitled.

9.16 Promoters, directors, etc., to cooperate with Company Liquidator (Section 284)

1. **Duty of promoters directors etc. to extend their cooperation to the liquidator**

   The promoters, directors, officers and employees, who are or have been in employment of the company or acting or associated with the company shall extend full cooperation to the Company Liquidator in discharge of his functions and duties.

2. **Punishment**

   Where any person, without reasonable cause, fails to discharge his obligations under this section, he shall be punishable with imprisonment which may extend to 6 months or with fine which may extend to Rs. 50,000, or with both.

9.17 Settlement of list of contributories and application of assets (Section 285)

1. **Duty of Tribunal to settle a list of contributories**

   As soon as may be after the passing of a winding up order by the Tribunal, the Tribunal shall –

   (a) settle a list of contributories;

   (b) cause rectification of register of members in all cases where rectification is required in pursuance of this Act; and

   (c) cause the assets of the company to be applied for the discharge of its liabilities.

   In settling the list of contributories, the Tribunal shall distinguish between those who are contributories in their own right and those who are contributories as being representatives of, or liable for the debts of, others.

2. **Power of Tribunal to dispense with the list of contributories**

   The Tribunal may dispense with the settlement of list of contributories if it appears to the Tribunal that it would not be necessary to –

   (a) make calls on contributories;

   (b) adjust the rights of contributories.

3. **Liability of contributories and conditions with respect to such liability**

   While settling the list of contributories, the Tribunal shall include every person, who is or has been a member, who shall be liable to contribute to the assets of the company an amount sufficient for payment of the debts and liabilities and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves, subject to the following conditions:

   (a) A person who has been a member shall not be liable to contribute if he has ceased to be a member for the preceding 1 year or more before the commencement of the winding up.

   (b) A person who has been a member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member.

   (c) A person who has been a member shall not be liable to contribute unless it appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them in pursuance of this Act.

   (d) In the case of a company limited by shares, no contribution shall be required from any person, who is or has been a member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as such member.

   (e) In the case of a company limited by guarantee, no contribution shall be required from any person, who is or has been a member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up but if the company has a share capital, such member shall be liable to contribute to the extent of any sum unpaid on any shares held by him as if the company were a company limited by shares.

Definition of contributory [Section 2(26)]

'Contributory' means a person liable to contribute towards the assets of the company in the event of its being wound up.

Explanation. For the purposes of this clause, it is hereby clarified that a person holding fully paid-up shares in a company shall be considered as a contributory but shall have no liabilities of a contributory under the Act whilst retaining rights of such a contributory.

Theoretical Questions from CA Examinations

Q 9.17A. Define 'contributory'. Who may be held liable as a contributory? [CA (Final) May 1996]

Q 9.17B. Explain the nature and extent of the liability of a contributory. [CA (Final) Nov. 1992]

Q 9.17C. X Ltd. had gone into liquidation and a liquidator was appointed to administer the assets and liabilities of the company. The liquidator of the company finds that the assets of the company are not sufficient to meet out the liabilities.

He therefore, calls on the contributories including the past members as per List B, to contribute towards the assets. The past members object to the liquidator's act on the ground that since they are no more members of the company, they are not liable to contribute. Referring to the provisions of the Companies Act, 2013 decide:

(i) Whether the contention of the past members is tenable and can they be exempted from the liability to contribute?

(ii) What would be your answer in case the members in question are the present members? [CA (Final) Nov. 2009]

Q 9.17D. Define "contributory" in a winding up. Explain the liabilities of contributories as present and past members. [CA (Final) May 2011]

Practical Problems from CA Examinations

Whether the subscribers to memorandum are liable as contributories if their suggestions are not included in the memorandum and articles?

P 9.17A. Some applicants consented to become shareholders of a company on the condition that their suggestions should be included in the memorandum and articles of association. Their suggestions, however, were not carried out by the promoters but the applicants signed usual applications for shares allotted to them and thereby become shareholders of the company. The company went into liquidation. What shall be the fate of the applicants who had consented to become shareholders on certain conditions? [CA (Final) May 2017 (Modified)]

Ans. The given problem relates to section 285 of the Companies Act, 2013. As per section 285, a person who is a member of the company shall be included in the list of contributories, and he shall be liable to pay the unpaid calls on the shares held by him.

A person who signs the memorandum and articles of a company which is proposed to be incorporated, is termed as subscriber, and on incorporation of the company, he becomes a member of the company. The fact that a person is a subscriber to memorandum is sufficient to constitute such person a member of the company. The subscribers to memorandum of association become members by the fact of subscription (i.e. signing on the memorandum). A subscriber cannot deny his obligation to take shares or to pay the money on the shares allotted to him on the ground that he was induced to sign the memorandum by fraud or misrepresentation.

In ***Re, East Bengal Sugar Mills Ltd.*** the names of two persons had been included in the list of contributories by the liquidator. These two persons were the subscribers to the memorandum and articles. The question before the Court was whether these two subscribers were liable to pay calls as contributories or not. Following two issues were raised before the Court:

Issue No. 1: The two subscribers alleged that prior to the incorporation of the company, draft memorandum and articles were shown to them, to which they had objected and had made certain suggestions. They had consented to become subscribers on the condition that their suggestions would be incorporated in the draft memorandum and articles. However, the promoters filed the memorandum and articles without incorporating their suggestions.

Issue No. 2: It was submitted before the Court that prior to winding up of the company, calls had been made on these two subscribers-members which remained unpaid, and the liability to pay calls had become barred by limitation, and accordingly, these two subscribers-members were not liable for the payment of these calls.

Decision of the Court: The Court held that it was the duty of the subscribers to satisfy themselves that their suggestions had been incorporated in the memorandum and articles. It was a failure on their part to check that their suggestions were incorporated or not, and so, this cannot be a reason for these two subscribers to escape from their liability to pay calls. The Court further held that when winding up of a company commences, then, as per section 285 a new liability is created irrespective of the fact that previously calls had been made by the company and had become time barred. Accordingly, it was held that inclusion of the names of two subscribers in the list of contributors was valid, and these two subscribers were liable for the payment of the calls.

Conclusion: Applying the provisions contained in section 285 and the decision in ***Re, East Bengal Sugar Mills Ltd.***, the applicants in the given case are liable for the payment of the calls remaining unpaid on the shares held by them.

Whether a past member is a contributory, whether he can be held liable for unpaid calls on shares previously held by him, and limitation on his liability?

P 9.17B. M/s IJK Limited was wound up with effect from 15th March 2018 by an order of the Court. Mr. A, who ceased to be a member of the company from 1st June 2017, has received a notice from the liquidator that he should deposit a sum of Rs. 5,000 as his contribution towards the liability on the shares previously held by him. In this context explain whether Mr. A can be called as a contributory, whether he can be made liable and whether there is any limitation on his liability. [CA (Final) Nov. 2018]

OR

M/s. XYZ Limited was wound up with effect from 15.3.2000 by an order of the Tribunal. Mr. A, who ceased to be a member of the company from 1.6.1999, has received a notice from the liquidator that he should deposit a sum of Rs. 5,000 as his contribution towards the liability on the shares previously held by him. In this context explain whether Mr. A can be called a contributory and whether he can be made liable and whether there is any limitation on his liability. **[CA (Final) May 2000]**

OR

By an order of the Tribunal M/s ABC Limited was wound up with effect from 15.3.2002. Mr. Gupta, who ceased to be a member of the company from 1.6.2001 received a notice from the liquidator to deposit a sum of Rs. 15,000 as his contribution towards the liability on the shares previously held by him. Mr. Gupta seeks your opinion about his liability. **[CA (Final) Nov. 2002]**

Ans. The given problem relates to clause (26) of section 2 and section 285 of the Companies Act, 2013.

The legal position

1. The term 'contributory' has been defined under clause (26) of section 2, as follows:

   'Contributory' means a person liable to contribute towards the assets of the company in the event of its being wound up.

   A person holding fully paid-up shares in a company shall be considered as a contributory but shall have no liabilities of a contributory under the Act whilst retaining rights of such a contributory.
2. As per section 285, a person, who is not a member, but has been a member in the past (*i.e.* a past member), shall also be liable to contribute to the assets of the company, subject to the following conditions:
   (a) A past member shall not be liable to contribute if he has ceased to be a member for 1 year or more before the commencement of the winding up.
   (b) A past member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member.
   (c) A past member shall not be liable to contribute unless it appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them. Thus, the liability of a past member is secondary.
   (d) In the case of a company limited by shares, the past member shall not be liable to contribute any amount exceeding the amount, if any, unpaid on the shares in respect of which he is liable as such member.

The given case and analysis of the case

3. Mr. A ceased to be a member of IJK Limited with effect from 1st June, 2017.
4. The winding up of IJK commenced on 15th March, 2018.
5. As on the date of commencement of winding up, one year has not elapsed since Mr. A ceased to be a member, and therefore, he shall be liable as a past member.

Conclusions

6. As per clause (26) of section 2, Mr. A shall be termed as a contributory, since a sum of Rs. 5,000 is due and remains unpaid on the shares previously held by him and so he is liable to contribute to the assets of the company in the event of winding up of the company.
7. Mr. A is liable in the capacity of a past member.
8. Limitation on liability of Mr. A:

   As per section 285, Mr. A shall not be liable to contribute –
   (a) in respect of any debt or liability of the company contracted after he ceased to be a member;
   (b) unless it appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them;
   (c) anything more than the amount remaining unpaid on the shares held by him, *i.e.* Rs. 5,000, being the unpaid calls on shares previously held by him.

Note: The first line of the question asked in Nov. 2018 is as under:

"M/s IJK Limited was wound up with effect from 15th March 2018 by an order of the Court."

In the opinion of the Author, it should have been as under:

M/s IJK Limited was wound up with effect from 15th March 2018 by an order of the Tribunal.

9.18 Obligations of directors and managers (Section 286)

1. Liability of a director or manager

In the case of a limited company, any person who is or has been a director or manager, whose liability is unlimited under the provisions of this Act, shall, in addition to his liability, if any, to contribute as an ordinary member, be liable to make a further contribution as if he were at the commencement of winding up, a member of an unlimited company.

2. Conditions with respect to liability of a director or manager

(a) A person who has been a director or manager shall not be liable to make such further contribution, if he has ceased to hold office for a year or upwards before the commencement of the winding up.

(b) A person who has been a director or manager shall not be liable to make such further contribution in respect of any debt or liability of the company contracted after he ceased to hold office.

(c) Subject to the articles of the company, a director or manager shall not be liable to make such further contribution unless the Tribunal deems it necessary to require the contribution in order to satisfy the debts and liabilities of the company, and the costs, charges and expenses of the winding up.

9.19 Advisory committee (Section 287)

1. Constitution of advisory committee by the Tribunal

The Tribunal may, while passing an order of winding up of a company, direct that there shall be an advisory committee to advise the Company Liquidator and to report to the Tribunal on such matters as the Tribunal may direct.

2. Members of the advisory committee

The advisory committee appointed by the Tribunal shall consist of not more than 12 members, being creditors and contributories of the company or such other persons in such proportion as the Tribunal may, keeping in view the circumstances of the company under liquidation, direct.

3. Calling of meeting of creditors and contributories by the Company Liquidator

The Company Liquidator shall convene a meeting of creditors and contributories, as ascertained from the books and documents of the company, within 30 days from the date of order of winding up, for enabling the Tribunal to determine the persons who may be members of the advisory committee.

4. Rights of the advisory committee

The advisory committee shall have the right to inspect the books of account and other documents, assets and properties of the company under liquidation at a reasonable time.

5. Procedure for meetings of the advisory committee

The provisions relating to the convening of the meetings, the procedure to be followed thereat and other matters relating to conduct of business by the advisory committee shall be such as may be prescribed.

6. Chairman of the advisory committee

The meetings of the advisory committee shall be chaired by the Company Liquidator.

9.20 Submission of periodical reports to the Tribunal (Section 288)

1. Reports to be sent by the Company Liquidator to the Tribunal

The Company Liquidator shall make periodical reports to the Tribunal and in any case make a report at the end of each quarter with respect to the progress of the winding up of the company in such form and manner as may be prescribed.

2. Review of orders passed by the Tribunal

The Tribunal may, on an application by the Company Liquidator, review the orders made by it and make such modifications as it may think fit.

9.21 Powers and duties of Company Liquidator (Section 290)

1. Powers of the Company Liquidator

Subject to directions by the Tribunal, if any, in this regard, the Company Liquidator, in a winding up of a company by the Tribunal, shall have the following powers:

(a) To carry on the business of the company so far as may be necessary for the beneficial winding up of the company

(b) To do all acts and to execute, in the name and on behalf of the company, all deeds, receipts and other documents, and for that purpose, to use, when necessary, the company's seal

(c) To sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels

(d) To sell the whole of the undertaking of the company as a going concern

(e) To raise any money required on the security of the assets of the company

(f) To institute or defend any suit, prosecution or other legal proceeding, civil or criminal, in the name and on behalf of the company

(g) To invite and settle claim of creditors, employees or any other claimant and distribute sale proceeds in accordance with priorities established under this Act

(h) To inspect the records and returns of the company on the files of the Registrar or any other authority

(i) To prove rank and claim in the insolvency of any contributory for any balance against his estate, and to receive dividends in the insolvency, in respect of that balance, as a separate debt due from the insolvent, and rateably with the other separate creditors;

(j) To draw, accept, make and endorse any negotiable instruments including cheque, bill of exchange, hundi or promissory note in the name and on behalf of the company, with the same effect with respect to the liability of the company as if such instruments had been drawn, accepted, made or endorsed by or on behalf of the company in the course of its business

(k) To take out, in his official name, letters of administration to any deceased contributory, and to do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate which cannot be conveniently done in the name of the company, and in all such cases, the money due shall, for the purpose of enabling the Company Liquidator to take out the letters of administration or recover the money, be deemed to be due to the Company Liquidator himself

(l) To obtain any professional assistance from any person or appoint any professional, in discharge of his duties, obligations and responsibilities and for protection of the assets of the company, appoint an agent to do any business which the Company Liquidator is unable to do himself

(m) To take all such actions, steps, or to sign, execute and verify any paper, deed, document, application, petition, affidavit, bond or instrument as may be necessary, –

(i) for winding up of the company;

(ii) for distribution of assets;

(iii) in discharge of his duties and obligations and functions as Company Liquidator.

(n) To apply to the Tribunal for such orders or directions as may be necessary for the winding up of the company.

2. **Control of the Tribunal on the exercise of powers by the Company Liquidator**

The exercise of powers by the Company Liquidator under this section shall be subject to the overall control of the Tribunal.

3. **Duties of the Company Liquidator**

Notwithstanding the provisions contained in this section, the Company Liquidator shall perform such other duties as the Tribunal may specify in this behalf.

9.22. Provision for professional assistance to Company Liquidator (Section 291)

1. **Power of Company Liquidator to seek assistance of professionals**

The Company Liquidator may, with the sanction of the Tribunal, appoint one or more chartered accountants or company secretaries or cost accountants or legal practitioners or such other professionals on such terms and conditions, as may be necessary, to assist him in the performance of his duties and functions under this Act.

2. **Duty of professional to make disclosure of conflict of interest**

Any person appointed under this section shall disclose forthwith to the Tribunal in the prescribed form any conflict of interest or lack of independence in respect of his appointment.

9.23 Exercise and control of Company Liquidator's powers (Section 292)

1. **Duty of Company Liquidator to consider the directions of the creditors and contributories**

   Subject to the provisions of this Act, the Company Liquidator shall, in the administration of the assets of the company and the distribution thereof among its creditors, have regard to any directions which may be given by the resolution of the creditors or contributories at any general meeting or by the advisory committee.

2. **Directions of creditors or contributories to override the directions given by the advisory committee**

   Any directions given by the creditors or contributories at any general meeting shall, in case of conflict, be deemed to override any directions given by the advisory committee.

3. **Duty and power of the Company Liquidator to summon meetings of the creditors or contributories**

   The Company Liquidator –

   (a) may summon meetings of the creditors or contributories, whenever he thinks fit, for the purpose of ascertaining their wishes; and

   (b) shall summon such meetings at such times, as the creditors or contributories, as the case may be, may, by resolution, direct, or whenever requested in writing to do so by not less than 1/10th in value of the creditors or contributories, as the case may be.

4. **Situation where any person is aggrieved by any decision or order of the Company Liquidator**

   Any person aggrieved by any act or decision of the Company Liquidator may apply to the Tribunal, and the Tribunal may confirm, reverse or modify the act or decision complained of and make such further order as it thinks just and proper in the circumstances.

9.24 Books to be kept by Company Liquidator (Section 293)

1. **Duty of Company Liquidator to maintain books with respect to proceedings of meetings**

   The Company Liquidator shall keep proper books in such manner, as may be prescribed, in which he shall cause entries or minutes to be made of proceedings at meetings and of such other matters as may be prescribed.

2. **Right of creditors and contributories to inspect such books**

   Any creditor or contributory may, subject to the control of the Tribunal, inspect any such books, personally or through his agent.

9.25 Audit of Company Liquidator's accounts (Section 294)

1. **Duty of Company Liquidator to maintain books of account**

   The Company Liquidator shall maintain proper and regular books of account including accounts of receipts and payments made by him in such form and manner as may be prescribed.

2. **Duty of Company Liquidator to submit Receipts and Payments Account to the Tribunal**

   The Company Liquidator shall, at such times as may be prescribed but not less than twice in each year during his tenure of office, present to the Tribunal an account of the receipts and payments in the prescribed form in duplicate, which shall be verified by a declaration in such form and manner as may be prescribed.

3. **Audit of books of account by the Tribunal**

   The Tribunal shall cause the accounts to be audited in such manner as it thinks fit, and for the purpose of the audit, the Company Liquidator shall furnish to the Tribunal with such vouchers and information as the Tribunal may require, and the Tribunal may, at any time, require the production of, and inspect, any books of account kept by the Company Liquidator.

4. **Filing of audited accounts with the Tribunal and Registrar**

   When the accounts of the company have been audited, one copy thereof shall be filed by the Company Liquidator with the Tribunal, and the other copy shall be delivered to the Registrar which shall be open to inspection by any creditor, contributory or person interested.

5. **Filing of audited accounts in case of a Government company**

   Where an account of the company relates to a Government company, the Company Liquidator shall forward a copy thereof –

   (a) to the Central Government, if that Government is a member of the Government company; or

(b) to any State Government, if that Government is a member of the Government company; or

(c) to the Central Government and any State Government, if both the Governments are members of the Government company.

6. **Duty of the Company Liquidator to send a printed copy of accounts to creditors and contributories**

(a) The Company Liquidator shall cause the accounts when audited, or a summary thereof, to be printed, and shall send a printed copy of the accounts or summary thereof by post to every creditor and every contributory.

(b) The Tribunal may dispense with the compliance of this provision if it deems fit.

9.26 Payment of debts by contributory and extent of set-off (Section 295)

1. **Power of the Tribunal to make an order requiring a contributory to pay monies**

The Tribunal may, at any time after passing of a winding up order, pass an order requiring any contributory for the time being on the list of contributories to pay, in the manner directed by the order, any money due to the company, from him or from the estate of the person whom he represents, exclusive of any money payable by him or the estate by virtue of any call in pursuance of this Act.

2. **Power of the Tribunal to allow set off**

The Tribunal may –

(a) in the case of an unlimited company, allow to the contributory, by way of set-off, any money due to him from the company, on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit; and

(b) in the case of a limited company, allow to any director or manager whose liability is unlimited, such set-off.

3. **Set off to be allowed where all the creditors have been paid in full**

In the case of any company, whether limited or unlimited, when all the creditors have been paid in full, any money due on any account whatever to a contributory from the company may be allowed to him by way of set-off against any subsequent call.

9.27 Power of Tribunal to make calls (Section 296)

The Tribunal may, at any time after the passing of a winding up order, and either before or after it has ascertained the sufficiency of the assets of the company, –

(a) make calls on all or any of the contributories for the time being on the list of the contributories, to the extent of their liability, for payment of any money which the Tribunal considers necessary to satisfy the debts and liabilities of the company, and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves; and

(b) make an order for payment of any calls so made.

9.28 Adjustment of rights of contributories (Section 297)

The Tribunal shall adjust the rights of the contributories among themselves and distribute any surplus among the persons entitled thereto.

9.29 Power to order costs (Section 298)

The Tribunal may, in the event of the assets of a company being insufficient to satisfy its liabilities, make an order for the payment out of the assets, of the costs, charges and expenses incurred in the winding up, in such order of priority *inter se* as the Tribunal thinks just and proper.

9.30 Power to summon persons suspected of having property of company, etc. (Section 299)

1. **Summon by Tribunal to persons suspected of having possession of property, books etc. of the company**

The Tribunal may, at any time after the appointment of a provisional liquidator or the passing of a winding up order, summon before it any officer of the company or person known or suspected to have in his possession any property or books or papers, of the company, or known or suspected to be indebted to the company, or any person whom the Tribunal thinks to be capable of giving information concerning the promotion, formation, trade, dealings, property, books or papers, or affairs of the company.

2. **Examination of any person on oath and notes of examination**

   The Tribunal may examine any officer or person so summoned on oath concerning the matters aforesaid, either by word of mouth or on written interrogatories or on affidavit and may, in the first case, reduce his answers to writing and require him to sign them.

3. **Power of the Tribunal to require any person to produce books in his custody**

   The Tribunal may require any officer or person so summoned to produce any books and papers relating to the company in his custody or power, but, where he claims any lien on books or papers produced by him, the production shall be without prejudice to such lien, and the Tribunal shall have power to determine all questions relating to that lien.

4. **Directions by the Tribunal to the liquidator to file a report with respect to property in possession of any other person**

   The Tribunal may direct the liquidator to file before it a report in respect of debt or property of the company in possession of other persons.

5. **Power of the Tribunal to order any person to pay money or deliver property**

   If the Tribunal finds that –

   (a) a person is indebted to the company, the Tribunal may order him to pay to the provisional liquidator or, as the case may be, the liquidator at such time and in such manner as the Tribunal may consider just, the amount in which he is indebted, or any part thereof, either in full discharge of the whole amount or not, as the Tribunal thinks fit, with or without costs of the examination;

   (b) a person is in possession of any property belonging to the company, the Tribunal may order him to deliver to the provisional liquidator or, as the case may be, the liquidator, that property or any part thereof, at such time, in such manner and on such terms as the Tribunal may consider just.

   Where any person makes any payment or delivery in pursuance of an order made by the Tribunal, he shall by such payment or delivery be, unless otherwise directed by such order, discharged from all liability whatsoever in respect of such debt or property.

6. **Costs to be imposed where a person is summoned but he fails to appear before the Tribunal**

   If any officer or person so summoned fails to appear before the Tribunal at the time appointed without a reasonable cause, the Tribunal may impose an appropriate cost.

   Recovery of such costs shall be made in the same manner as decrees for the payment of money or for the delivery of property are executed under the Code of Civil Procedure, 1908.

9.31 Power to order examination of promoters, directors, etc. (Section 300)

1. **Power of Tribunal to order a person suspected of having committed a fraud to attend before the Tribunal**

   Where an order has been made for the winding up of a company by the Tribunal, and the Company Liquidator has made a report to the Tribunal under this Act, stating that in his opinion a fraud has been committed by any person in the promotion, formation, business or conduct of affairs of the company since its formation, the Tribunal may, after considering the report, direct that such person or officer shall attend before the Tribunal on a day appointed by it for that purpose, and be examined as to the promotion or formation or the conduct of the business of the company or as to his conduct and dealings as an officer thereof.

2. **Company Liquidator to participate in such examination**

   The Company Liquidator shall take part in the examination, and for that purpose he or it may, if specially authorised by the Tribunal in that behalf, employ such legal assistance as may be sanctioned by the Tribunal.

3. **Duty of person examined to answer questions**

   The person shall be examined on oath and shall answer all such questions as the Tribunal may put, or allow to be put, to him.

4. **Rights of person examined**

   A person ordered to be examined under this section –

   (a) shall, before his examination, be furnished at his own cost with a copy of the report of the Company Liquidator; and

(b) may at his own cost employ chartered accountants or company secretaries or cost accountants or legal practitioners entitled to appear before the Tribunal under section 432, who shall be at liberty to put to him such questions as the Tribunal may consider just for the purpose of enabling him to explain or qualify any answers given by him.

5. **Company Liquidator to appear on the hearing**

If any such person applies to the Tribunal to be exculpated from any charges made or suggested against him, it shall be the duty of the Company Liquidator to appear on the hearing of such application and call the attention of the Tribunal to any matters which appear to the Company Liquidator to be relevant.

6. **Power of the Tribunal to allow costs**

If the Tribunal, after considering any evidence given or hearing witnesses called by the Company Liquidator, allows an application to exculpate any person from any charges made or suggested against him, the Tribunal may order payment to the applicant of such costs as it may think fit.

7. **Notes of examination**

Notes of the examination shall be taken down in writing, and shall be read over to or by, and signed by, the person examined, a copy be supplied to him and may thereafter be used in evidence against him, and shall be open to inspection by any creditor or contributory at all reasonable times.

8. **Adjournment of hearing**

The Tribunal may, if it thinks fit, adjourn the examination from time to time.

9. **Examination before any other person or authority**

The Tribunal may direct that an examination of any person shall be held before any other person or authority authorised by the Tribunal.

Such person or authority shall have all the powers to conduct the examination, but shall not have the power to allow costs.

9.32 Arrest of person trying to leave India or abscond (Section 301)

At any time either before or after passing a winding up order, if the Tribunal is satisfied that a contributory or a person having property, accounts or papers of the company in his possession is about to leave India or otherwise to abscond, or is about to remove or conceal any of his property, for the purpose of evading payment of calls or of avoiding examination respecting the affairs of the company, the Tribunal may cause –

(a) the contributory to be detained until such time as the Tribunal may order; and

(b) his books and papers and movable property to be seized and safely kept until such time as the Tribunal may order.

Practical Problems from CA Examinations

Validity of orders of Tribunal restricting a contributory from leaving India and seizure of books of account of a person planning to abscond

P 9.32A. Info-tech Overtrading Ltd. was ordered to be compulsory wound up by an order dated 10th March, 2019 by the Tribunal. The official liquidator who has taken control of the assets and other records of the company has noticed that:

(i) One of the contributory whose calls are pending to be paid is about to leave India for evading payment of calls and;

(ii) A person having books of accounts of the company in his possession may abscond to avoid examination of books of accounts in respect of the affairs of the company.

Apprehending such possibilities, Tribunal detained such contributory for next 6 month disallowing him to leave India as well as arrest & seize books of accounts from the person who may possibly abscond to avoid examination of the affairs of the company.

Referring to the provisions of Companies Act, 2013, answer the following in current scenario:

(i) What is the validity of Tribunal's order for detention of contributory disallowing him to leave India?

(ii) Is it correct on Tribunal's part to arrest and seize books of accounts from the person planning to abscond to avoid examination of books of accounts in respect of the affairs of the company? [CA (Final) May 2019]

Ans. The given problem relates to section 301 of the Companies Act, 2013.

Section 301 empowers the Tribunal to make an order for –

(a) detention of a contributory where the Tribunal is satisfied that such contributory is about to leave India or otherwise to abscond for the purpose of evading payment of calls;

(b) seizure of books and papers and movable property of a person where the Tribunal is satisfied that such person has property, accounts, or papers of the company in his possession, and he is about to leave India or otherwise to abscond, or is about to remove or conceal any of his property for the purpose of avoiding examination with respect to the affairs of a company.

The given questions are answered as under:

(i) The order of the Tribunal detaining the contributory from whom calls are payable to the company, and disallowing him to leave India is valid, assuming that there is sufficient material on record by which the Tribunal is satisfied that such contributory intends to abscond for the purpose of evading payment of calls.

(ii) The order of the Tribunal directing seizure of books of a person is valid assuming that the Tribunal is satisfied that such person is planning to abscond to avoid examination with respect to the affairs of the company.

9.33 Dissolution of company by Tribunal (Section 302)

1. **Application to the Tribunal by the Company Liquidator**

   When the affairs of a company have been completely wound up, the Company Liquidator shall make an application to the Tribunal for dissolution of such company.

2. **Order of dissolution by the Tribunal**

   The Tribunal shall on an application filed by the Company Liquidator or when the Tribunal is of the opinion that it is just and reasonable in the circumstances of the case that an order for the dissolution of the company should be made, make an order that the company be dissolved from the date of the order, and the company shall be dissolved accordingly.

3. **Copy of order of the Tribunal to be sent to the Registrar**

   A copy of the order shall, within 30 days from the date thereof, be forwarded by the Company Liquidator to the Registrar who shall record in the register relating to the company a minute of the dissolution of the company.

4. **Punishment for non-compliance**

   If the Company Liquidator makes a default in forwarding a copy of the order within 30 days from the date of the order of the Tribunal, he shall be punishable with fine which may extend to Rs. 5,000 for every day during which the default continues.

9.34 Appeals from orders made before commencement of Act (Section 303)

In case any order of winding up was passed by any Court before the commencement of this Act, such order shall be enforceable and appeal against such order shall be maintainable before such authority as was competent to hear appeals before the commencement of this Act, and the provisions contained in Chapter XX of the Companies Act, 2013 shall not apply.

9.35 Debts of all descriptions to be admitted to proof (Section 324)

In every winding up, all debts payable on a contingency, and all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company, a just estimate being made, so far as possible, of the value of such debts or claims as may be subject to any contingency, or may sound only in damages, or for some other reason may not bear a certain value.

In the case of insolvent companies, the provisions of this section (*i.e.* Section 324) shall be subject to the other provisions of this Act and the provisions contained in the Insolvency and Bankruptcy Code, 2016. *In other words*, any other provision contained in this Act or in the Insolvency and Bankruptcy Code, 2016 shall also apply in addition to the provisions contained in section 324.

9.36 Overriding preferential payments (Section 326)

1. **Certain debts to be paid in priority to all other debts**

   In the winding up of a company, the following debts shall be paid in priority to all other debts:

   (a) Workmen's dues; and

   (b) Where a secured creditor has realised a secured asset, so much of the debts due to such secured creditor as could not be realised by him or the amount of the workmen's portion in his security (if payable under the law), whichever is less, *pari passu* with the workmen's dues.

2. **Payment of certain debts to be made within 30 days of sale of assets**

   The following sums which are payable for a period of 2 years preceding the winding up order or such other period as may be prescribed, shall be paid in priority to all other debts (including debts due to secured creditors), within a period of 30 days of sale of assets and shall be subject to such charge over the security of secured creditors as may be prescribed:

   (a) All wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947.

   (b) All accrued holiday remuneration becoming payable to any workman or, in the case of his death, to any other person in his right on the termination of his employment before or by the effect of the winding up order.

   These debts shall be paid in full before any payment is made to secured creditors. Thereafter, the following debts shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions:

   (a) Workmen's dues; and

   (b) Where a secured creditor has realised a secured asset, so much of the debts due to such secured creditor as could not be realised by him or the amount of the workmen's portion in his security (if payable under the law), whichever is less, *pari passu* with the workmen's dues.

3. **Meaning of certain terms**

   For the purposes of this section, and section 327 –

   (a) 'Workmen', in relation to a company, means the employees of the company, being workmen as defined under section 2(s) of the Industrial Disputes Act, 1947;

   (b) 'Workmen's dues', in relation to a company, means the aggregate of the following sums due from the company to its workmen:

      (i) All wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947.

      (ii) All accrued holiday remuneration becoming payable to any workman or, in the case of his death, to any other person in his right on the termination of his employment before or by the effect of the winding up order.

      (iii) Unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company or unless the company has, at the commencement of the winding up, under such a contract with insurers as is mentioned in section 14 of the Workmen's Compensation Act, 1923, rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company.

      (iv) All sums due to any workman from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the workmen, maintained by the company.

   (c) 'Workmen's portion', in relation to the security of any secured creditor of a company, means the amount which bears to the value of the security the same proportion as the amount of the workmen's dues bears to the aggregate of the amount of workmen's dues and the amount of the debts due to the secured creditors.

4. **Illustration**

   The value of the security of a secured creditor of a company is Rs. 1,00,000. The total amount of the workmen's dues is Rs. 1,00,000. The amount of the debts due from the company to its secured creditors is Rs. 3,00,000. The aggregate of the amount of workmen's dues and the amount of debts due to secured creditors is Rs. 4,00,000. The workmen's portion of the security is, therefore, one-fourth of the value of the security, that is Rs. 25,000.

Section 326 shall not apply in the event of liquidation under the Insolvency and Bankruptcy Code, 2016.

Theoretical Questions from CA Examinations

Q 9.36A. In relation to winding up of a company incorporated under the Companies Act, 2013, explain clearly the meaning of the term 'overriding preferential payments'. [CA (Final) Nov. 2010]

9.37 Preferential payments (Section 327)

1. **Certain debts termed as 'preferential payments'**

   In a winding up, subject to the provisions of section 326, following debts shall be paid in priority to all other debts:

   (a) All revenues, taxes, cesses and rates due, within 12 months immediately before the relevant date, to –
      (i) the Central Government; or
      (ii) any State Government; or
      (iii) to a local authority.

   (b) All wages or salaries or commissions due to any employee for a period not exceeding 4 months within 12 months immediately before the relevant date.

      Such amount payable to any employee shall not exceed the amount as may be notified.

   (c) All accrued holiday remuneration becoming payable to any employee, or in the case of his death, to any other person claiming under him.

   (d) All amounts due in respect of contributions payable under the Employees' State Insurance Act, 1948 or any other law for the time being in force during the period of 12 months immediately before the relevant date.

   (e) All amounts due in respect of any compensation or liability for compensation under the Workmen's Compensation Act, 1923 in respect of the death or disablement of any employee of the company.

   (f) All sums due to any employee from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the employees, maintained by the company.

   (g) The expenses of any investigation held in pursuance of sections 213 and 216, in so far as they are payable by the company.

2. **Situation where assets are insufficient**

   The debts payable under this section shall rank equally among themselves and be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

3. **Priority over debentures secured by a floating charge**

   The debts payable under this section shall have priority over the claims of holders of debentures under any floating charge created by the company

4. **Payments of debts forthwith**

   Subject to the retention of such sums as may be necessary for the costs and expenses of the winding up, the debts under this section shall be discharged forthwith so far as the assets are sufficient to meet them.

5. **Meaning of 'employee'**

   For the purposes of this section, the expression 'employee' does not include a 'workman'.

6. **Meaning of 'relevant date'**

   In the case of a company being wound up by the Tribunal, relevant date means the date of appointment of a provisional liquidator or if no appointment of a provisional liquidator was made, the date of the winding up order, unless, in either case, the company had commenced to be wound up voluntarily before that date under the Insolvency and Bankruptcy Code, 2016.

1. The provisions of section 327 shall apply subject to the provisions of section 326.
2. Section 327 shall not apply in the event of liquidation under the Insolvency and Bankruptcy Code, 2016.

Practical Problems from CA Examinations

How cash is to be distributed towards payment of various liabilities?

P 9.37A. Consider the following cases:

Case (a).

M/s. Sunset Construction Limited is being wound by the Tribunal. The Liquidator after realisation of the assets has an amount of Rs. 28,00,000 at his disposal towards payment to the creditors of the company. The list of creditors is given below:

(i)	Dues to secured creditors	Rs. 20,00,000
(ii)	Dues to workers	Rs. 15,00,000
(iii)	Taxes, etc, payable to the government authorities	Rs. 2,00,000
(iv)	Unsecured creditors	Rs. 40,00,000

Since the available amount is insufficient to meet the claims of all the creditors, explain the procedure to be followed for payment of dues as provided in the Companies Act, 2013, assuming that the company has created a charge on all the assets of the company in favour of the secured creditors. [CA (Final) May 1999 (Modified)]

OR

Best Plastics Limited is being wound up by the Tribunal. The Liquidator after realization of the assets has an amount of Rs. 28 lakhs in his hand towards payment of creditors of the company. Details of creditors are as follows:

(i) Secured Creditors: Rs. 20 lakhs

(ii) Workers' wages: Rs. 15 lakhs

(iii) Income Tax payable: Rs. 2 lakhs

(iv) Unsecured Creditors: Rs. 40 lakhs

Total Creditors: Rs. 77 lakhs

Since the available amount in the hands of Liquidator is only Rs. 28 lakhs, which is insufficient to meet the claims of all the above creditors, explain the procedure you would follow for payment of the above in accordance with the provisions of the Companies Act, 2013, assuming that the company has created a charge on all the assets of the company in favour of secured creditors. [CA (Final) Nov. 2015 (Modified)]

Case (b).

M/s XYZ limited is being wound up by the Tribunal. The Liquidator after realisation of the assets has an amount of Rs. 56,00,000 at his disposal towards payment of creditors of the company. Details of creditors are as under:

(i)	Dues to secured creditors	Rs. 40,00,000
(ii)	Dues to workers	Rs. 30,00,000
(iii)	Taxes and duties payable to Government authorities	Rs. 4,00,000
(iv)	Unsecured creditors	Rs. 80,00,000

Since the available amount is insufficient to meet the claims of all the creditors, explain the procedure to be followed for payment of dues as provided in the Companies Act, 2013, assuming that the company has created a charge on all the assets of the company in favour of the secured creditors. [CA (Final) May 2003 (Modified)]

Case (c).

M/s. Raman Ltd. was wound up by the Tribunal. The liquidator invited claims from its creditors which stood as under:

Income tax dues:	Rs. 11 lakhs
Sales tax dues:	Rs. 5 lakhs
Dues of Workers:	Rs. 25 lakhs
Unsecured loans payable to directors:	Rs. 25 lakhs
Trade creditors who supplied raw material:	Rs. 15 lakhs
Secured creditor being the bankers of the company:	Rs. 75 lakhs
	Rs. 156 lakhs

Liquidator could realise only Rs. 80 lakhs by sale of assets and realisations made from the company's debtors, which is not sufficient to pay to all the creditors. Please decide the order of priority for payment to creditors explaining the relevant provisions of the Companies Act, 2013. [CA (Final) Nov. 2009]

Case (d).

Mars India Limited, a company incorporated under the Companies Act, 2013 is being wound up by the Tribunal. After realisation of the assets of the company, the liquidator has an amount of Rs. 70,00,000 at his disposal towards payment of creditors of the said company. The details of creditors are as follows:

(i)	Unsecured creditors	Rs. 50,00,000
(ii)	Taxes and duties payable to Government	Rs. 5,00,000
(iii)	Dues to workers	Rs. 30,00,000
(iv)	Dues to secured creditors	Rs. 40,00,000

The available amount with the liquidator, obviously, is not sufficient to meet the claims of all the creditors. Moreover, the company had already created a charge on all the assets of the company in favour of the secured creditors. Explain the procedure to be followed by the liquidator for payment of dues as provided in the Companies Act, 2013. [CA (Final) Nov. 2008]

Case (e).

The Liquidator of the Bogus Limited (in liquidation) has realised 50 lakhs by selling the land owned by the company. The company owes Rs. 1 crore to its bankers towards a loan secured by the company's land and factory buildings. The bank has claimed that the amount realised by sale of land must be paid in full to it in preference to the 'workmen' dues' to the extent of Rs. 25 lakhs. Examine the bank's claim with reference to the relevant provisions of the Companies Act, 2013.

[CA (Final) Nov. 2002]

OR

Explain the term "Overriding Preferential Payments" under the provisions of the Companies Act, 2013. ABC Limited is being wound up by the Tribunal. The liquidator has realised Rs. 100 lakh by selling the land and buildings mortgaged by the company in favour of its bankers. The company owes Rs. 200 lakh to the bank. The bank has claimed that the amount realised by sale of land and buildings must be paid in full to it in preference to the workmen's dues to the extent of Rs. 50 lakh. Examine the Bank's claim with reference to the provisions of the Companies Act, 2013. [CA (Final) Nov. 2012]

Case (f).

PQR Limited is being wound up by the Tribunal. All the assets of the company have been charged to the company's bankers to whom the company owes I crore. The company owes the following amounts to others:

(i)	**Dues to workers**	**Rs. 25,00,000**
(ii)	**Taxes payable to Government**	**Rs. 5,00,000**
(iii)	**Unsecured creditors**	**Rs. 10,00,000**

You are required to compute with reference to the provisions of the Companies Act, 2013 the amount each kind of creditors is likely to get if the amount realized by the official liquidator from the secured assets and available for distribution among the creditors is only 80 lakhs. [CA (Final) Nov. 2010]

Ans. Section 326 prescribes the debts which shall be paid in priority to all other debts, *i.e.* overriding preferential payments. Accordingly, the following debts shall be paid *in priority to all other debts:*

(a) Workmen's dues.

(b) Debts due to secured creditors to the extent such debts rank pari passu with workmen's dues.

The debts listed under section 326 shall be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

The order of payment of liabilities adopted by the liquidator shall be as under:

1. Overriding preferential payments under section 326 (i.e. workers' dues and debts due to secured creditors).
2. Costs and expenses of winding up.
3. Preferential payments under section 327.
4. Creditors secured by a floating charge.
5. Unsecured creditors.

Case (a).

In the present case, only Rs. 28 lakhs are available whereas the overriding preferential payments (workers' dues and secured creditors) amount to Rs. 35 lakhs. Therefore, the workers dues and dues payable to secured creditors shall abate in equal proportions, *i.e.* payments to workers and secured creditors shall be made in the proportion of amount owed by the company to them (*i.e.* in the ratio of 20:15). Accordingly, the workers shall be paid Rs. 12 lakhs and the secured creditors shall be paid Rs. 16 lakhs. No payment shall be made to the Government authorities for tax dues or to unsecured creditors.

Case (b).

In the present case, only Rs. 56 lakhs are available whereas the overriding preferential payments (workers' dues and secured creditors) amount to Rs. 70 lakhs. Therefore, the workers dues and dues payable to secured creditors shall abate in equal proportions, *i.e.* payments to workers and secured creditors shall be made in the proportion of amount owed by the company to them (*i.e.* in the ratio of 40:30). Accordingly, the workers shall be paid Rs. 24 lakhs and the secured creditors shall be paid Rs. 32 lakhs. No payment shall be made to the Government authorities for tax dues or to unsecured creditors.

Case (c).

In this case, Rs. 80 lakhs have been realised by the sale of all the assets of the company. The amount due to secured creditors is Rs. 75 lakhs and the workmen's dues are Rs. 25 lakhs. Overriding preferential payments (workmen's dues and secured creditors) amount to Rs. 100 lakhs.

Therefore, the workmen's dues and dues payable to secured creditors shall abate in equal proportions, *i.e.* payments to workmen and secured creditors shall be made in the proportion of amount owed by the company to them (*i.e.* in the ratio of 75:25). Accordingly, the workers shall be paid Rs. 20 lakhs and the secured creditors shall be paid Rs. 60 lakhs. No payment shall be made to the Government authorities for income tax dues, sales tax dues, unsecured loans payable to directors or to trade creditors who supplied raw material.

Case (d).

In this case, Rs. 70 lakhs have been realised by the sale of all the assets of the company. The amount due to secured creditors is Rs. 40 lakhs and the workmen's dues are Rs. 30 lakhs. Overriding preferential payments (workmen's dues and secured creditors) amount to Rs. 70 lakhs. Since the amount realised is sufficient to pay the overriding preferential payments in full, the secured creditors will receive the full amount of Rs. 40 lakhs due to them, and similarly workers will get their entire claims of Rs. 30 lakhs. No payment shall be made to the Government authorities for tax and duties due or to unsecured creditors.

Case (e).

In this case, Rs. 50 lakhs have been realised by the sale of land (mortgaged with the bank on account of a loan taken by the bank). The loan taken from the bank is Rs. 1 crore and the workmen' dues are Rs. 25 lakhs, *i.e.* overriding preferential payment under section 326 amount to Rs. 125 lakhs but available cash is Rs. 50 lakhs only. Therefore, the workers dues and dues payable to bank shall abate in equal proportions, *i.e.* payments to workers and bank shall be made in the proportion of amount owed by the company to them (*i.e.* in the ratio of 4:1). Accordingly, the workers shall be paid Rs. 10 lakhs and Rs. 40 lakhs shall be paid towards the bank loan.

In view of the provisions of section 326, the contention of the bank that whole of Rs. 50 lakhs realised from sale of land must be paid to the bank towards repayment of loan, is not tenable. Only a sum of Rs. 40 lakhs shall be paid to the bank.

Case (f).

In this case, Rs. 80 lakhs have been realised by the sale of all the assets of the company. The amount due to secured creditors is Rs. 1 crore and the workmen's dues are Rs. 25 lakhs. Overriding preferential payments (workmen's dues and secured creditors) amount to Rs. 1.25 crore. Since the amount realised is not sufficient to pay the overriding preferential payments in full, the workmen's dues and dues payable to secured creditors shall abate in equal proportions, *i.e.* payments to workmen and secured creditors shall be made in the proportion of amount owed by the company to them (*i.e.* in the ratio of 100:25). Accordingly, the workers shall be paid Rs. 16 lakhs and the secured creditors shall be paid Rs. 64 lakhs. No payment shall be made towards taxes payable to the Government and unsecured creditors.

Whether a decree holder can claim payment in priority to workmen's dues?

Q.37B. OGC Ltd. was a supplier of raw material to SAM Ltd., which could not make payment to OGC Ltd. owing to huge losses and financial constraints. Ultimately, SAM Ltd. went into liquidation and Liquidator was appointed. OGC Ltd. filed a suit for recovery of its dues. The Court awarded a decree in favour of OGC Ltd. Armed with the Court's decree, OGC Ltd. approached the Liquidator to pay the amount to it in preference over dues of the workmen. The workmen protested the demand of OGC Ltd. and contended that their dues rank pari passu with the secured creditors and will override all other claims of other creditors even where a decree has been passed. You are required to ascertain the validity of the argument of the workmen in the light of the provisions of the Companies Act, 2013 and the decided cases on the subject. [CA (Final) May 2008, Nov. 2005]

Ans. The given problem relates to section 326 of the Companies Act, 2013.

1. The duty of the liquidator is to ensure that the property of the company is applied in satisfaction of its liabilities amongst its just and proper creditors, *i.e.* the persons who are justly, legally and properly creditors.
2. As per section 326, following debts shall be paid in priority to all other debts:
   (a) Workmen's dues.
   (b) Debts due to secured creditors to the extent such debts rank *pari passu* with workmen's dues.

   The effect of section 326 is that, in the event of liquidation, the assets of the company remain charged for the payment of workmen's dues and such charge will be *pari passu* with the claim of the secured creditors. In other words, the dues of the workmen and debts due to the secured creditors are to be treated *pari passu* and have to be paid in priority to all other dues. Thus, by operation of law (*i.e.* section 326), the 'workmen dues' amount to over-riding preferential payments and are entitled to proportional payment along with secured creditors.
3. Where an unsecured creditor obtains a Court decree, he does not become a secured creditor **[*Ananta Mills Ltd. v City Deputy Collector, Ahmedabad*]**. Accordingly, section 326 overrides claims of the unsecured creditors even where a decree has been passed by the Court.
4. In the given case, the Court has passed a decree in favour of OGC Ltd. to recover the price of raw materials supplied to SAM Ltd. However, such decree does not make OGC Ltd. a secured creditor. Therefore, the assets of the company shall be first applied towards payment of workmen's dues and debts due to secured creditors.

Conclusion: The contention of the workmen of SAM Ltd. is correct. The payment to OGC Ltd. cannot be made until the claims of the workmen are fully satisfied.

Whether employees salaries due for 8 months, PF dues, gratuity and investigation expenses amount to preferential payments?

Q.37C. Examine the provisions of the Companies Act and decide whether the following debts of a company under the winding up shall be 'Preferential payments' and shall be paid in priority to the claim of unsecured creditors:

(a) Wages amounting to Rs. 30,000/- (Rupees Thirty thousand) only of employees for services rendered for a period of 8 months within the preceding 12 months next before the relevant date.

(b) Rs. 1 lac due to an employee from Provident Fund and Rs. 50,000/- towards gratuity.

(c) Rs. 20,000/- payable by the company on account of expenses incurred in respect of investigation held under Section 213 of the Companies Act, 2013. [CA (Final) Nov. 2010]

Ans. The given problem relates to section 327 of the Companies Act, 2013. As per section 327, following debts shall be paid in priority to all other debts (termed as 'preferential payments'):

(a) All wages and salaries of any employee, due for a period not exceeding 4 months within 12 months before the relevant date. However, such amount payable to any employee shall not exceed the amount as may be notified.
Thus, the whole amount of wages of Rs. 30,000 shall not amount to preferential payments. Wages for a period of 4 months within 12 months preceding the relevant date (subject to a maximum of such amount as may be notified) shall amount to preferential payments.

(b) All sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees, maintained by the company.
Thus, Rs. 1 lac due from Provident Fund and Rs. 50,000 due towards gratuity shall amount to preferential payments.

(c) The expenses of any investigation held in pursuance of section 213 and 216, in so far as they are payable by the company.
Thus, Rs. 20,000 payable by the company on account of expenses incurred in respect of investigation held under Section 213 of the Companies Act, 2013, amounts to preferential payments.

Amount incurred by the liquidator for preservation of security – How to be dealt with?

P 9.37D. What shall be the amount to be borne by the secured creditors out of the expenses incurred by the liquidator if:

(a) The value of the security of secured creditors of a company is Rs. 1 lakh;

(b) Total amount of workmen's due is Rs. 1 lakh;

(c) Debts due from the company to its secured creditors is Rs. 3 lakh; and

(d) The liquidator incurred Rs. 10,000 for the preservation of the security before it is realised by the secured creditors.

[CA (Final) May 2017]

Ans. Section 326 prescribes the debts which shall be paid in priority to all other debts, *i.e.* overriding preferential payments. Accordingly, the following debts shall be paid in priority to all other debts:

(a) Workmen's dues.

(b) Debts due to secured creditors to the extent such debts rank pari passu with workmen's dues.

The debts listed under section 326 shall be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

- Value of the security: Rs. 1 lakh.
- Amount due towards workmen's dues: Rs. 1 lakh.
- Amount due to secured creditors: Rs. 3 lakh.
- Overriding preferential payments (workmen's dues and secured creditors): Rs. 4 lakh.

Since the amount realised is not sufficient to pay the overriding preferential payments in full, the workmen's dues and dues payable to secured creditors shall abate in equal proportions, *i.e.* payments to workmen and secured creditors shall be made in the proportion of amount owed by the company to them (*i.e.* in the ratio of 1:3).

Accordingly, the amount payable towards workmen's dues would have been Rs. 25,000 and the amount payable to secured creditors would have been Rs. 75,000, had the liquidator not incurred any expense towards preservation of security.

Since the liquidator has incurred Rs. 10,000 towards preservation of the security, this amount of Rs. 10,000 shall have to be borne by the 'workmen dues' and secured creditors in the proportion of 1:3. Accordingly, the workmen shall have to bear Rs. 2,500 and the secured creditor shall bear Rs. 7,500.

9.38 Fraudulent preference (Section 328)

1. Power of the Tribunal to declare the fraudulent preference as void

Where a company has given preference to a person who is one of the creditors of the company or a surety or guarantor for any of the debts or other liabilities of the company, and the company does anything which has the effect of putting that person into a position which, in the event of the company going into liquidation, will be better than the position he would have been in, if that thing had not been done prior to 6 months of making a petition for winding up of the company, the Tribunal, if satisfied that, such transaction is a fraudulent preference may order as it may think fit for restoring the position to what it would have been if the company had not given that preference.

2. Power of the Tribunal to declare certain transactions as void

If the Tribunal is satisfied that there is a preference transfer of property, movable or immovable, or any delivery of goods, payment, execution made, taken or done by or against a company within 6 months before making winding up application, the Tribunal may make such order as it may think fit and may declare such transaction invalid and restore the position.

1. **Meaning of fraudulent preference**
   Fraudulent preference means giving an improper benefit or favourable treatment to some of the creditors. The object of avoidance of fraudulent preference is to grant protection to the creditors of the company.
2. **Conditions for terming any transaction as 'fraudulent preference'**
   A transaction shall be deemed to be a fraudulent preference if all the following conditions are satisfied:
   (a) The transaction relates to transfer of property, delivery of goods, payment of money or other act relating to the property of the company.
   (b) It took place within 6 months preceding the date of presentation of petition for winding up of the company.
   (c) It was an entirely voluntary act and not made under any pressure.
   (d) The dominant motive was to give a creditor a preference over other creditors.
3. **Effects of order of Tribunal declaring a transaction as fraudulent preference**
   If the Tribunal is satisfied that a transaction is a fraudulent preference, it may –
   (a) declare the fraudulent preference as invalid; and
   (b) make such order as it may think fit for restoring the position to what it would have been if the company had not given fraudulent preference.
4. **Involuntary acts do not amount to fraudulent preference**
   Payments made under pressure shall not be treated as fraudulent preference. Accordingly, –
   (a) Payments made to a creditor solely with a view to avoid civil or criminal proceedings do not amount to fraudulent preference **[*Re, Blackpool Motorcar Co. Ltd. (1901) 1 Ch. 77*]**.
   (b) Payments made by the directors under pressure and to keep good relations with the creditor do not amount to fraudulent preference.
5. **Purpose must be to give preference to a creditor**
   (a) Any transaction would amount to a fraudulent preference only if the dominant motive behind the transaction is to give a creditor some preference over the other creditors. It is not enough to show that preference was given to a particular creditor; it must also be shown that it was done with a view to give him the favoured treatment.
   (b) If the dominant motive of the transaction is tainted with an element of dishonesty, it amounts to fraudulent preference.
   (c) Fraudulent preference cannot be inferred by mere suspicion. The fraud must be clearly alleged, proved and established and there should be a legal evidence **[*M. Kushler Ltd. (1943) 2 All ER 22*]**.
   (d) There is no fraudulent preference when a debtor's dominant intention is to benefit himself rather than to confer an advantage on his creditor. Thus, where a company created a legal mortgage in favour of a bank in the hope that by keeping good faith with the bank it could get further advance from the bank which could be utilised to revive the company, the mortgage was held not to be a fraudulent preference even though the mortgage was created after it was fairly clear that the company had become insolvent **[*Re, F.L.E. Holdings Ltd. (1967) 3 All ER 553*]**.
6. **Examples of fraudulent preference**
   (a) A director of a company had given guarantee for certain overdrafts granted to the company on the agreement that the company would give him security over the assets whenever called upon by him to do so. The agreement was not registered. The director later received a debenture charging the assets of the company. Within a month thereafter, winding up of the company commenced. Held, the charge created on the assets of the company was a fraudulent preference and was void **[*Re, Jackson & Bassford Ltd. (1906) 2 Ch 467*]**.
   (b) A shareholder advanced money to the company on the condition that the company would execute formal mortgages in his favour whenever asked by him. When the company became unable to pay its debts, mortgages were executed by the company in his favour. Two months later, winding up of the company commenced. Held, the mortgages created in favour of the shareholder amounted to a fraudulent preference and were therefore void **[*Re, Eric Holmes (Property) Ltd. (1965) 2 All ER 333*]**.

Theoretical Questions from CA Examinations

Q 9.38A. What do you understand by 'fraudulent preference' of creditors under Company Law? [CA (Final) Nov. 1998]

Q 9.38B. What is meant by fraudulent preference? Explain briefly the effects of such a fraudulent preference in the event of a company being wound up. [CA (Final) Nov. 1990]

Practical Problems from CA Examinations

Plant mortgaged in favour of a creditor without any consideration – Consequences

P 9.38A. M/s. LMN Limited has been running in losses and has defaulted payment to its creditors. On 1.8.2017, the company mortgaged its plant and machinery to Mr. Patel, a close friend of the managing director of the company, against payment of his dues of Rs. 10 lakhs payable by the company. The other creditors were left in lurch. Another creditor, Mr. Raman was not paid by the company for supply of raw material of the value of Rs. 50,000. A petition for winding up of the company was presented before the Tribunal on 31.12.2017. The company was ordered to be wound up by the Tribunal on 30.4.2018. Can the Tribunal declare the transaction of mortgage with Mr. Patel as invalid? [CA (Final) May 2005 (Modified)]

Ans. As per section 328, a transaction shall be deemed to be a fraudulent preference and consequently the Tribunal shall be empowered to declare such transaction as invalid if all the following conditions are satisfied:

(a) The transaction relates to transfer of property, delivery of goods, payment of money or other act relating to the property of the company.

(b) It took place within 6 months prior to the presentation of winding up petition.

(c) It was an entirely voluntary act and not made under any pressure.

(d) The dominant motive was to give a creditor a preference over other creditors.

In the given case, the petition for winding up of LMN Limited was presented to the Tribunal on 31.12.2017. M/s LMN Limited mortgaged its plant and machinery in favour of Mr. Patel on 1.8.2017, *i.e.* within 6 months prior to the presentation of winding up petition. The mortgage was made voluntarily by the company, without any consideration, and not under any pressure. Thus, the dominant motive behind the transaction was to give Mr. Patel some preference over the other creditors. Since all the requirements of section 328 are satisfied in the given case, the mortgage of plant and machinery made in favour of Mr. Patel amounts to fraudulent preference, and therefore, the Tribunal is empowered to declare it as invalid.

Whether pledge of immovable property with a bank amounts to fraudulent preference?

P 9.38B. A company was in financial distress. They pledged certain immovable properties with a nationalised bank in the belief that their loan limits would be increased. However within 3 months, a petition for winding up of the company was presented to the Tribunal. The management was accused of fraudulent preference.

(i) In the above context discuss fraudulent preference.

(ii) Would your answer be different if the charge was created in favour of an NBFC? [CA (Final) May 2016]

OR

Modern Textiles Limited incurred huge losses during the last three financial years and its financial position was bad. The Company created a legal mortgage on some of its immovable properties in favour of a bank on 1st September, 2017 in the hope that by keeping good faith with the bank it could get further advances from the bank and the same could be utilized to revive the Company. A winding up petition before the Tribunal was filed on 15th January, 2018. The Tribunal passed an order of winding up on 1st April, 2018. Answer the following with reference to the provisions of the Companies Act, 2013:

(i) What is meant by 'Fraudulent Preference'? State the effect of 'Fraudulent Preference'.

(ii) Whether the creation of legal mortgage by the Company in favour of the bank would amount to fraudulent preference?

[CA (Final) Nov. 2013]

Ans. As per section 328, a transaction shall be deemed to be a fraudulent preference and consequently the Tribunal shall be empowered to declare such transaction as invalid if all the following conditions are satisfied:

(a) The transaction relates to transfer of property, delivery of goods, payment of money or other act relating to the property of the company.

(b) It took place within 6 months prior to presentation of winding up petition.

(c) It was an entirely voluntary act and not made under any pressure.

(d) The dominant motive was to give a creditor a preference over other creditors.

In the given case, the petition for winding up was presented to the Tribunal within 3 months of pledge of immovable property by the company. Thus, the condition given under section 328 that preference must have been given within 6 months prior to presentation of winding up petition, has been satisfied.

A transaction shall amount to fraudulent preference only if there is an element of dishonesty, *i.e.* there is a malafide intention to give preference to a creditor over others.

There is no fraudulent preference when a debtor's dominant intention is to benefit himself rather than to confer an advantage on his creditor. Thus, where a company created a legal mortgage in favour of a bank in the hope that by keeping good faith with the bank it could get further advance from the bank which could be utilised to revive the company, the mortgage was held not to be a fraudulent preference even though the mortgage was created after it was fairly clear that the company had become insolvent ***[Re, F.L.E. Holdings Ltd. (1967) 3 All ER 553]***.

In the given case, the immovable property was pledged by the company under a belief that the loan limit would be increased. Thus, the dominant motive was not to give to the bank any preference over other creditors, and so pledge of immovable property by the company does not amount to fraudulent preference. Therefore, the Tribunal shall not declare the pledge of immovable property as void.

Even where the charge was created in favour of NBFC, and not in favour of a bank, the answer would have remained same, since in determining as to whether a transaction is a fraudulent preference or not, it is immaterial that the creditor is a bank or NBFC or any other person.

9.39 Transfers not in good faith to be void (Section 329)

1. **Voluntary transfers to be void**

   Any transfer of property (whether movable or immovable) or any delivery of goods made by a company shall be void against the Company Liquidator, if it was made within a period of 1 year prior to the presentation of winding up petition.

2. **Transactions not be invalid**

   The following transactions shall remain valid even if made within a period of 1 year prior to the presentation of winding up petition:

   (a) Any transfer of property or delivery of goods made in the ordinary course of business.

   (b) Any transfer of property or delivery of goods made in favour of a purchaser in good faith and for valuable consideration.

9.40 Certain transfers to be void (Section 330)

Any transfer or assignment by a company of all its properties or assets to trustees for the benefit of all its creditors shall be void.

9.41 Liabilities and rights of certain persons fraudulently preferred (Section 331)

1. **Rights and liabilities of the person fraudulently preferred where fraudulent preference is declared invalid**

   Where a company is being wound up and anything made, taken or done is invalid under section 328 as a fraudulent preference of a person interested in property mortgaged or charged to secure the company's debt, then, without prejudice to any rights or liabilities arising, apart from this provision, the person preferred shall be subject to the same liabilities, and shall have the same rights, as if he had undertaken to be personally liable as a surety for the debt, to the extent of–

   (a) the mortgage or charge on the property; or

   (b) the value of his interest,

   whichever is less.

   For this purpose, the value of the interest of the person preferred shall be determined as at the date of the transaction constituting the fraudulent preference, as if the interest were free of all encumbrances other than those to which the mortgage or charge for the debt of the company was then subject.

2. **Power of the Tribunal to determine questions**

   On an application made to the Tribunal with respect to any payment on the ground that the payment was a fraudulent preference of a surety or guarantor, the Tribunal shall have jurisdiction to determine any questions with respect to the payment arising between the person to whom the payment was made and the surety or guarantor and to grant relief in respect thereof, notwithstanding that it is not necessary so to do for the purposes of the winding up.

   This provision shall apply *mutatis mutandis* in relation to transactions other than payment of money.

   For this purpose, the Tribunal may give leave to bring in the surety or guarantor as a third party as in the case of a suit for the recovery of the sum paid.

9.42 Effect of floating charge (Section 332)

1. **Purpose of section 332**

   Section 332 prevents an insolvent company from creating a floating charge on its undertaking to secure past debts or for moneys which do not come into the hands of the company.

2. **Floating charge to be invalid**

   A floating charge created by the company within 12 months preceding the commencement of its winding up shall be invalid.

   Where the floating charge becomes invalid, the debt is not affected. However, the debt becomes an unsecured debt.

3. **Floating charge not to be invalid in two cases**
   (a) A floating charge shall not be invalid where it is proved that the company was solvent immediately after the creation of the charge.
   (b) A floating charge shall be valid upto the amount of any cash paid to the company (whether at the time of creation of charge or thereafter) as a consideration for the charge. Also, interest shall be allowed on that amount at the rate of 5% per annum or such other rate as may be notified by the Central Government.

   The words '*as a consideration for the charge*' means that the money was paid in consideration of the fact that charge is created. *In other words*, it will be treated as if the cash has been paid to the company in the following cases:
   (i) Where the cash is paid to the company simultaneously with creation of the charge.
   (ii) Where the cash is paid a few days before the charge is created provided it was paid in reliance upon the promise to create the charge.
   (iii) Where the cash is paid to the company subsequent to the creation of charge provided the cash would not have been paid to the company had the company not given the security (by way of creation of floating charge).

Practical Problems from CA Examinations

Advance of Rs. 10 lakhs by a bank subsequent to the creation of a floating charge – Whether the floating charge is invalid?

P 9.42A. A company created a floating charge of its current assets in favour of a bank to secure a current account, which was in debit of Rs. 5 lakhs and also to secure further working capital facilities provided by the bank. The charge created on 1st January, 2015 was duly registered with the Registrar of Companies. The bank advanced Rs. 10 lakhs subsequent to the creation of charge. The winding up of the company commenced on 1st September, 2015. Examine the validity of the floating charge in case there is no fraudulent preference. [CA (Final) May 2004 (Modified)]

Ans.

The legal position

As per section 332, a floating charge created by the company within 12 months prior to the commencement of winding up shall be invalid. However, this provision is subject to the following two exceptions:

(a) A floating charge shall not be invalid where it is proved that the company was solvent immediately after the creation of the charge.

(b) A floating charge shall be valid upto the amount of any cash paid to the company (whether at the time of creation of charge or thereafter) as a consideration for the charge. Also, interest shall be allowed on that amount at the rate of 5% per annum or such other rate as may be notified by the Central Government.

As per section 357, in case of a winding up by the Tribunal, the winding up shall be deemed to have commenced at the time of presentation of the petition for the winding up.

The given case and analysis of the case

A company has created a floating charge on its assets in favour of a bank on 1st January, 2015. The winding up of the company commenced on 1st September, 2015. It is evident that winding up of the company has commenced within 12 months of creation of floating charge, *i.e.* the floating charge was created within 12 months preceding the commencement of winding up. Therefore, this case is covered under section 332.

As on the date of creation of floating charge (*i.e.* 1st January, 2015), the company is already indebted towards the bank for Rs. 5 lakh. The bank has advanced Rs. 10 lakhs to the company subsequent to the creation of the floating charge.

The bank would not have advanced Rs. 10 lakhs if the company had not given the security (by way of creation of floating charge) to the bank. Therefore, the money advanced to the company by the bank was in consideration of creation of charge, and so the charge shall be held to be valid. The same decision was given on the same facts in ***Re, Yeovil Glove Co. Ltd.* (1962) 3 All ER 400.**

Conclusions

(i) The floating charge created by the company on 1st January, 2015 shall be valid to the extent of Rs. 10 lakhs alongwith interest on Rs. 10 lakhs at the rate of 5% per annum or such other rate as may be notified by the Central Government.

(ii) The floating charge shall be valid for Rs. 15 lakhs (*i.e.* Rs. 10 lakhs advanced to the company subsequent to the creation of the floating charge as well as for Rs. 5 lakhs which were already due to the bank from the company before the creation of floating charge) along with interest, if it is proved that the company was solvent immediately after the creation of the floating charge.

Floating charge for Rs. 25 lakhs created to secure 5 lakhs already due and Rs. 15 lakhs further advance, but the company wound up in next 12 months – Implications

P 9.42B. Imprudent Company Limited approached Safe Finance Company Limited for loan of Rs. 20 lakhs to finance purchase of some essential machinery. The company created a floating charge on some of its assets on 1st December, 2016 for Rs. 25 lakhs to secure Rs. 5 lakhs already due to Safe Finance Company Limited and additional amount to be advanced by the said Finance company. Safe Finance Company Limited advanced Rs. 15 lakhs on 15th December, 2016 towards purchase of certain machinery. A winding up petition was filed before the Tribunal on 1st January, 2017 and the company was ordered to be wound up on 15th March, 2017. Examine with reference to the provisions of the Companies Act, 2013 whether the floating charge is valid.

Ans.

The legal position

As per section 332, a floating charge created by the company within 12 months prior to the commencement of winding up shall be invalid.

However, this provision has following 2 exceptions:

(a) A floating charge shall not be invalid where it is proved that the company was solvent immediately after the creation of the charge.

(b) A floating charge shall be valid upto the amount of any cash paid to the company (whether at the time of creation of charge or thereafter) as a consideration for the charge. Also, interest shall be allowed on that amount at the rate of 5% per annum or such other rate as may be notified by the Central Government.

As per section 357, in case of a winding up by the Tribunal, the winding up shall be deemed to have commenced at the time of presentation of the petition for the winding up.

The given case and analysis of the case

- In the given case, the winding up petition was filed in the Tribunal on 1st January, 2017 and the company was ordered to be wound up on 15th March, 2017. As per section 357, winding up commenced on 1st January, 2017.
- On 1st December, 2016, the company created a floating charge on some of its assets in favour of Safe Finance Company Limited. The amount secured by the floating charge was Rs. 25 lakhs. Thus, the floating charge was created within 12 months prior to the commencement of winding up. Therefore, this case is covered under section 332.
- The amount of Rs. 15 lakhs advanced by Safe Finance Company Limited towards purchase of machinery falls under one of the exceptions (*i.e.* cash paid to the company as a consideration for the charge), and therefore, the floating charge is valid upto Rs. 15 lakhs alongwith interest @ 5% per annum or such other rate as may be notified by the Central Government.

Conclusion

(i) Floating charge for Rs. 5 lakhs not yet advanced by Safe Finance Company Limited is void.

(ii) The floating charge is valid for Rs. 15 lakhs alongwith interest @ 5% per annum or such other rate as may be notified by the Central Government.

(iii) The floating charge shall be valid for Rs. 20 lakhs (*i.e.* Rs. 15 lakhs advanced to the company subsequent to the creation of the floating charge as well as for Rs. 5 lakhs which were already due from the company before the creation of floating charge) along with interest, if it is proved that the company was solvent immediately after the creation of the floating charge.

Consequences where properties of the company are sold at gross undervalue to a private company in which son of MD is interested, and floating charge is created on current assets?

P 9.42C. M/s Info-tech Overtrading Ltd. was ordered to be wound up by an order dated 15th October, 2017. The official liquidator who has taken control of the assets and other records of the company has noticed the following:

(i) The Managing Director of the company has sold certain properties belonging to the company to a private company in which his son was interested causing loss to the company to the extent of Rs. 50 lakhs. The sale took place on 10th May, 2017.

(ii) The company created a floating charge on 1st January, 2017 in favour of a private bank for the overdraft facility to the extent of Rs. 5 crores, by hypothecating the current assets viz. stocks and book debts.

Examine what action the official liquidator can take in this matter having regard to the provisions of the Companies Act, 2013.

[CA (Final) Nov. 2007 (Modified)]

Ans. (i) The given problem relates to Section 329 of the Companies Act, 2013, as explained below:

As per section 329, any transfer of property or delivery of goods made by a company shall be void if it was made within a period of 1 year prior to the presentation of a winding up petition. However, the following transactions shall remain valid:

(a) Any transfer of property or delivery of goods made in the ordinary course of business.

(b) Any transfer of property or delivery of goods made in favour of a purchaser in good faith and for valuable consideration.

In the given case, the date of order of winding up is given (i.e. 15th October 2017) but the date of presentation of petition for winding up is not given.

The company has sold certain properties to a private company in which the son of the managing director is interested. Such sale has been effected at a price which is much below the market price (causing loss of Rs. 50 lakhs to the company). Such transaction is void since it was not entered into in the ordinary course of business, and such transaction was not entered into in good faith and for valuable consideration. It has been assumed that such sale was made within 1 year prior to presentation of winding up petition.

Ans. (ii) The given problem relates to Section 332 of the Companies Act, 2013, as explained below:

As per section 332, a floating charge created by the company within 12 months prior to the commencement of winding up shall be invalid.

Exceptions.

(a) A floating charge shall not be invalid where it is proved that the company was solvent immediately after the creation of the charge.

(b) A floating charge shall be valid upto the amount of any cash paid to the company (whether at the time of creation of charge or thereafter) as a consideration for the charge. Also, interest shall be allowed on that amount at the rate of 5% per annum or such other rate as may be notified by the Central Government.

In the given case, –

Date of commencement of winding up	– Not given.
Date of order of winding up	– 15th October, 2017
Date of creation of floating charge	– 1st January, 2017

In the given case, section 332 is attracted assuming that the floating charge was created within preceding 12 months prior to the commencement of winding up.

Floating charge upto Rs. 5 crores alongwith interest @ 5% p.a. or such other rate as may be notified by the Central Government shall be valid. However, if the whole amount of overdraft facility is not utilised by the company, the floating charge shall be valid only upto such amount as is actually advanced by the bank to the company plus interest @ 5% p.a. or such other rate as may be notified by the Central Government.

9.43 Disclaimer of onerous property (Section 333)

1. Disclaimer of onerous property by the Company Liquidator

Where any part of the property of a company which is being wound up consists of –

(a) land of any tenure, burdened with onerous covenants; or

(b) shares or stocks in companies; or

(c) any other property which is not saleable or is not readily saleable by reason of the possessor thereof being bound either to the performance of any onerous act or to the payment of any sum of money; or

(d) unprofitable contracts,

the Company Liquidator may disclaim such property in accordance with the provisions of this section.

The Company Liquidator may disclaim the onerous property in accordance with the provisions of this section, notwithstanding that he has –

(a) endeavoured to sell such property; or

(b) taken possession of such property; or

(c) exercised any act of ownership in relation such property; or

(d) done anything in pursuance of any contract.

2. Conditions for disclaiming the onerous property

(a) The Company Liquidator may disclaim the onerous property within 12 months after the commencement of the winding up or such extended period as may be allowed by the Tribunal.

If the Company Liquidator had not become aware of the existence of any onerous property within 1 month from the commencement of the winding up, the power of disclaiming the property may be exercised at any time within 12 months after he has become aware thereof or such extended period as may be allowed by the Tribunal.

(b) The disclaimer shall be in writing and signed by the Company Liquidator.

(c) The disclaimer may be made only with the leave of the Tribunal.

3. **Procedure adopted by the Tribunal before granting leave to disclaim the onerous property**

   Before granting leave to disclaim any onerous property, the Tribunal may –

   (a) require notices to be given to persons interested;

   (b) impose such terms as a conditions of granting leave as the Tribunal may consider just and proper; and

   (c) make such other order in the matter as the Tribunal may consider just and proper.

4. **No disclaimer in certain cases**

   The Company Liquidator shall not be entitled to disclaim any property in a case where –

   (a) an application in writing has been made to him by any person interested in the property requiring him to decide whether he will or will not disclaim; and

   (b) the Company Liquidator has not, within a period of 28 days after the receipt of the application or such extended period as may be allowed by the Tribunal, given notice to the applicant that he intends to apply to the Tribunal for leave to disclaim the onerous property.

5. **Rights of person affected by operation of a disclaimer**

   Any person affected by the operation of a disclaimer shall be deemed to be a creditor of the company to the amount of the compensation or damages payable in respect of such effect, and may accordingly prove the amount as a debt in the winding up.

Theoretical Questions from CA Examinations

Q 9.43A. What is meant by 'disclaimer of onerous property' and how the same is exercised during winding up? Explain the circumstances under which such a disclaimer is not allowed. [CA (Final) May 2000]

Q 9.43B. Examine the powers of the liquidator to disclaim onerous properties belonging to the company in liquidation. [CA (Final) Nov. 1996]

Q 9.43C. What is meant by 'onerous property' in the case of a company being wound up? What are the rights of the liquidator in the matter of disclaimer of such properties? [CA (Final) May 1994]

9.44 Transfers, etc., after commencement of winding up to be void (Section 334)

Any disposition of the property including actionable claims, of the company and any transfer of shares in the company or alteration in the status of its members, made after the commencement of the winding up shall, unless the Tribunal otherwise orders, be void.

9.45 Certain attachments, executions, etc., in winding up by Tribunal to be void (Section 335)

1. **Attachment, distress, sale etc. to be void**

   Where any company is being wound up by the Tribunal, –

   (a) any attachment, distress or execution put in force, without leave of the Tribunal against the estate or effects of the company, after the commencement of the winding up; or

   (b) any sale held, without leave of the Tribunal of any of the properties or effects of the company, after such commencement,

   shall be void.

2. **Non-applicability**

   Nothing in this section shall apply to any proceedings for the recovery of any tax or impost or any dues payable to the Government.

9.46 Offences by officers of companies in liquidation (Section 336)

1. **Nature of offences covered under section 336**

   Any person, who is or has been an officer of a company which, at the time of the commission of the alleged offence, is being wound up by the Tribunal or which is subsequently ordered to be wound up by the Tribunal, shall be punishable with imprisonment for a term which shall not be less than 3 years but which may extend to 5 years and with fine which shall not be less than Rs. 1 lakh but which may extend to Rs. 3 lakh, if he –

(a) does not, to the best of his knowledge and belief, fully and truly disclose to the Company Liquidator all the property, movable and immovable, of the company, and how and to whom and for what consideration and when the company disposed of any part thereof, except such part as has been disposed of in the ordinary course of the business of the company;

(b) does not deliver to the Company Liquidator, or as he directs, all such part of the movable and immovable property of the company as is in his custody or under his control and which he is required by law to deliver up;

(c) does not deliver up to the Company Liquidator, or as he directs, all such books and papers of the company as are in his custody or under his control and which he is required by law to deliver up;

(d) within the 12 months immediately before the commencement of the winding up or at any time thereafter, –

- (i) conceals any part of the property of the company having a value of Rs. 1,000 or more, or conceals any debt due to the company or any debt due from the company;
- (ii) fraudulently removes any part of the property of the company to the value of Rs. 1,000 or more;
- (iii) conceals, destroys, mutilates or falsifies, or is privy to the concealment, destruction, mutilation or falsification of, any book or paper affecting or relating to, the property or affairs of the company;
- (iv) makes, or is privy to the making of, any false entry in any book or paper affecting or relating to, the property or affairs of the company;
- (v) fraudulently parts with, alters or makes any omission in, or is privy to the fraudulent parting with, altering or making of any omission in, any book or paper affecting or relating to the property or affairs of the company;
- (vi) by any false representation or other fraud, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for;
- (vii) under the false pretence that the company is carrying on its business, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for; or
- (viii) pawns, pledges or disposes of any property of the company which has been obtained on credit and has not been paid for, unless such pawning, pledging or disposing of the property is in the ordinary course of business of the company;

  Where any person pawns, pledges or disposes of any property in circumstances as are mentioned above, every person who takes in pawn or pledge or otherwise receives the property, knowing it to be pawned, pledged, or disposed of in such circumstances as aforesaid, shall be punishable with imprisonment for a term which shall not be less than 3 years but which may extend to 5 years and with fine which shall not be less than Rs. 3 lakh but which may extend to Rs. 5 lakh.

(e) makes any material omission in any statement relating to the affairs of the company;

(f) knowing or believing that a false debt has been proved by any person under the winding up, fails for a period of 1 month to inform the Company Liquidator thereof;

(g) after the commencement of the winding up, prevents the production of any book or paper affecting or relating to the property or affairs of the company;

(h) after the commencement of the winding up or at any meeting of the creditors of the company within the 12 months next before the commencement of the winding up, attempts to account for any part of the property of the company by fictitious losses or expenses; or

(i) is guilty of any false representation or fraud for the purpose of obtaining the consent of the creditors of the company or any of them, to an agreement with reference to the affairs of the company or to the winding up.

It shall be a good defence if the accused proves that he had no intent to defraud or to conceal the true state of affairs of the company or to defeat the law.

2. Meaning of the term 'officer'

For the purposes of this section, the expression 'officer' includes any person in accordance with whose directions or instructions the directors of the company have been accustomed to act.

9.47 Statement that company is in liquidation (Section 344)

1. Disclosure of the fact that company is being wound up

Where a company is being wound up, every document in which the name of the company appears, if issued on behalf of the company, shall contain a statement that the company is being wound up.

2. **Punishment for contravention**

Any person who is wilfully a party to contravention of this section, shall be punishable with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 3 lakh.

9.48 Books and papers of company to be evidence (Section 345)

Where a company is being wound up, all books and papers of the company and of the Company Liquidator shall be *prima facie* evidence of the truth of all matters recorded therein.

9.49 Inspection of books and papers by creditors and contributories (Section 346)

1. **Inspection to be in accordance with the Rules**

At any time after the making of an order for the winding up of a company by the Tribunal, any creditor or contributory of the company may inspect the books and papers of the company only in accordance with, and subject to such rules as may be prescribed.

2. **No restrictions on rights of the Government etc.**

The provisions contained in section 346 shall not exclude or restrict any rights conferred by any law for the time being in force on –

(a) the Central Government or a State Government;

(b) any authority or officer of the Central Government or State Government; or

(c) any person acting under the authority of any such Government or of any such authority or officer.

9.50 Disposal of books and papers of company (Section 347)

1. **Condition for disposal of books and papers**

When the affairs of a company have been completely wound up and it is about to be dissolved, the books and papers of such company and those of the Company Liquidator may be disposed of in such manner as the Tribunal directs.

2. **No liability of any person after 5 years**

After the expiry of 5 years from the dissolution of the company, no responsibility shall devolve on the company, the Company Liquidator, or any person to whom the custody of the books and papers has been entrusted, by reason of any book or paper not being forthcoming to any person claiming to be interested therein.

3. **Rules with respect to preservation of books etc.**

The Central Government may, by rules, –

(a) prevent for such period as it thinks proper the destruction of the books and papers of a company which has been wound up and of its Company Liquidator; and

(b) enable any creditor or contributory of the company to make representations to the Central Government and to appeal to the Tribunal from any order which may be made by the Central Government in the matter.

4. **Punishment for contravention**

If any person acts in contravention of any rules framed under this section, he shall be punishable with imprisonment for a term which may extend to 6 months or with fine which may extend to Rs. 50,000, or with both.

9.51 Company Liquidation Dividend and Undistributed Assets Account (Section 352)

1. **Duty of the Liquidator to deposit unpaid money during winding up**

Where any company is being wound up and the liquidator has in his hands or under his control any money representing –

(a) dividends payable to any creditor but which had remained unpaid for 6 months after the date on which they were declared; or

(b) assets refundable to any contributory which have remained undistributed for 6 months after the date on which they became refundable,

the liquidator shall forthwith deposit the said money into a separate special account to be known as the Company Liquidation Dividend and Undistributed Assets Account maintained in a scheduled bank.

2. **Duty of the Liquidator to deposit unpaid money on dissolution**
The liquidator shall, on the dissolution of the company, pay into the Company Liquidation Dividend and Undistributed Assets Account any money representing unpaid dividends or undistributed assets in his hands as on the date of dissolution.
3. **Receipt to be provided on making any deposit of money**
The liquidator shall be entitled to a receipt from the scheduled bank for any money paid into the bank account, and such receipt shall be an effectual discharge of the Company Liquidator in respect thereof.
4. **Duty of the liquidator to furnish a statement to the Registrar**
When making any payment into the Company Liquidation Dividend and Undistributed Assets Account, the liquidator shall furnish to the Registrar, a statement in the prescribed form, stating therein with respect to all sums included in such payment –
(a) the nature of such sums;
(b) the names and last known addresses of the persons entitled to such sums;
(c) the amount to which each is entitled and the nature of his claim thereto; and
(d) such other particulars as may be prescribed.
5. **Right to obtain payment from Company Liquidation Dividend and Undistributed Assets Account**
(a) Any person claiming to be entitled to any money paid into the Company Liquidation Dividend and Undistributed Assets Account, may apply to the Registrar for payment thereof.
(b) The Registrar may make a payment of such money if it is satisfied that the person claiming is entitled to such money.
(c) The Registrar shall settle the claim of such person within a period of 60 days from the date of receipt of such claim, failing which the Registrar shall make a report to the Regional Director giving reasons of such failure.
6. **Right to obtain payment after 15 years**
(a) If any money paid into the Company Liquidation Dividend and Undistributed Assets Account remains unclaimed for a period of 15 years, it shall be transferred to the general revenue account of the Central Government.
(b) Such money may also be claimed by making an application to the Registrar.
(c) The Registrar may make a payment of such money if it is satisfied that the person claiming is entitled to such money.
(d) The Registrar shall settle the claim of such person within a period of 60 days from the date of receipt of such claim, failing which the Registrar shall make a report to the Regional Director giving reasons of such failure.
7. **Punishment for contravention**
If the liquidator retains any money which should have been paid by him into the Company Liquidation Dividend and Undistributed Assets Account, following consequences shall follow:
(a) The liquidator shall have to pay interest at the rate of 12% per annum on the amount so retained.
The Central Government may, in any proper case, remit either in part or in whole the amount of interest payable by the liquidator.
(b) The Company Liquidator shall be liable to such penalty as may be determined by the Registrar.
(c) He shall be liable to pay any expenses occasioned by reason of his default.
(d) All or such part of his remuneration shall be disallowed, as the Tribunal may consider just and proper.
(e) The Tribunal may remove the liquidator.

Theoretical Questions from CA Examinations

Q 9.51A. As the liquidator of a company how would you deal with the money in your hand and under your control representing the 'unpaid dividends' and 'undistributed assets'? Explain. [CA (Final) May 1992]

Q 9.51B. Explain the duties of a liquidator of a company with regard to the following under the Companies Act, 2013:
(i) the money in his hand representing the dividend payable to any creditor, which remained unpaid for a period of six months after the date on which the dividend was declared; and
(ii) assets under his control, which were refundable to any contributory, and remained undistributed for six months after the date on which these became refundable. [CA (Final) May 1995]

10.1 Definition of a foreign company [Section 2(42)]

The term 'foreign company' is defined under Clause (42) of section 2 of the Companies Act, 2013.

As per section 2(42), 'foreign company' means any company or body corporate incorporated outside India which –

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

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

A reading of Paragraphs 1.10 and 20.1 contained in the Report of the Companies Law Committee (Ministry of Corporate Affairs) issued in February, 2016 suggests that a company which is incorporated outside India and conducts any business activity in India without having any place of business in India would also be covered under Clause (42) of section 2, *i.e.* it shall be a foreign company.

Thus, the interpretation of Clause (42) of section 2 is as follows (Exceptional Construction):

Any company or body corporate incorporated outside India shall be a foreign company if it satisfies any of the following two conditions:

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

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

Meaning of 'electronic mode' [Clause (c) of Sub-Rule (1) of Rule 2 of the Companies (Registration of Foreign Companies) Rules, 2014]. For the purpose of section 2(42) of the Companies Act, 2013, 'electronic mode' includes carrying out electronically based –

(i) business to business and business to consumer transactions, data interchange and other digital supply transactions;

(ii) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India;

(iii) financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management;

(iv) online services such as telemarketing, telecommuting, telemedicine, education and information research; and

(v) all related data communication services, whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

The definition of 'electronic mode' is inclusive. Thus, a transaction which does not fall under (i) to (v) above, may also be termed as 'electronic mode'.

If a transaction falls within the meaning of 'electronic mode' as defined above, it shall be termed as 'electronic mode' whether the main server is installed in India or outside India.

1. **Status of a foreign company**
   (a) A foreign company is not a 'company' as defined under section 2(20) of the Companies Act, 2013.
   (b) A foreign company is a 'body corporate' as defined under section 2(11) of the Companies Act, 2013.
2. **Meaning of 'Registrar' [Rule 8 of the Companies (Registration of Foreign Companies) Rules, 2014]**
   (a) Any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.
   (b) Wherever the term 'Registrar' is referred to in Chapter XXII of the Act (*viz.* the Chapter 'Companies Incorporated Outside India' consisting of sections 379 to 393) or in the Companies (Registration of Foreign Companies) Rules, 2014, it shall mean the Registrar having jurisdiction over New Delhi.
3. **Action for improper use or description as a foreign company [Rule 12 of the Companies (Registration of Foreign Companies) Rules, 2014]**
   If any person trades or carries on business in any manner under any name or title or description as a foreign company, that person shall, unless duly registered as a foreign company, shall be liable for investigation under section 210 of the Act and action consequent upon that investigation shall be taken against that person.

Theoretical Questions from CA Examinations

Q 10.1A. What is a foreign company? [CA (Final) Nov. 1988]

10.2 Meaning of certain terms (Section 386)

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

(e) The Tribunal may exercise its power to declare the dissolution as void, where the company was dissolved –
   (i) in pursuance of Chapter XX of the Companies Act, 2013; or
   (ii) in pursuance of an order passed under section 232; or
   (iii) otherwise.

2. **Filing of order of the Tribunal**
   (a) It shall be the duty of the Company Liquidator or the person on whose application the order was made, to file with the Registrar a certified copy of the order of the Tribunal.
   (b) Such filing shall be made within 30 days of the date of the order of the Tribunal or within such further time as the Tribunal may allow.
   (c) On receipt of the order of the Tribunal, the Registrar shall register the same.
   (d) If a person (*i.e.* the Company Liquidator or the person on whose application the order was made) fails to file the order of the Tribunal with the Registrar, he shall be punishable with fine which may extend to Rs. 10,000 for every day during which the default continues.

9.56 Commencement of winding up by Tribunal (Section 357)

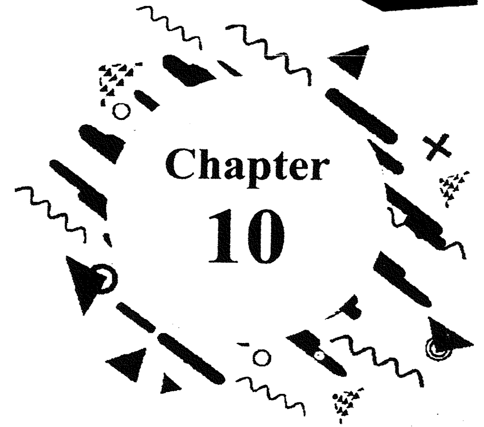
The winding up of a company by the Tribunal shall be deemed to have commenced at the time of the presentation of the petition for the winding up.

9.57 Exclusion of certain time in computing period of limitation (Section 358)

In computing the period of limitation specified for any suit or application in the name and on behalf of a company which is being wound up by the Tribunal, the period from the date of commencement of the winding up of the company to a period of . year immediately following the date of the winding up order shall be excluded.

The provisions of this section shall apply notwithstanding anything contained in the Limitation Act, 1963, or in any other law for the time being in force.

Companies Incorporated Outside India



(Chapter XXII of the Companies Act, 2013 consisting of Sections 379 to 393 and the Companies (Registration of Foreign Companies) Rules, 2014)

Bird's eye-view of the Chapter

Introduction

1. Definition of a foreign company [Sec. 2(42) and Rule 2(1)(c) and Rule 8]
2. Meaning of 'place of business' (Sec. 386)

Provisions applicable to foreign companies

1. Application of Act to foreign companies (Sec. 379)
2. Documents, etc., to be delivered to Registrar by foreign companies (Sec. 380 and Rules 3, 8 and 10)
3. Accounts, audit and list of places of business (Sec. 381 and Rules 4, 5 and 6)
4. Display of name, etc. of foreign company (Sec. 382 and Rule 12)
5. Service of documents on foreign company (Sec. 383)
6. Debentures, annual return, registration of charges, books of account and their inspection (Sec. 384 and Rule 7)
7. Fee for registration of documents (Sec. 385)

Provisions applicable to companies incorporated outside India

1. Dating of prospectus and particulars to be contained therein (Sec. 387)
2. Provisions as to expert's consent and allotment (Sec. 388)
3. Registration of prospectus (Sec. 389 and Rule 11)
4. Offer of Indian Depository Receipts (Sec. 390 and Rule 13)
5. Application of sections 34 to 36 and Chapter XX (Sec. 391)

(ii) A company incorporated outside India employs agents it India, but it has not established any place of business in India. As per section 2(42), where a company incorporated outside India does not have any place of business India by itself, but has a place of business through an agent, such a company is a foreign company. Therefore, in the given problem, the company incorporated outside India employing agents in India, is a foreign company.

Difference in answer as compared to the answer given by ICAI

The Author's answer to this part of the question differs from the answer given in the Suggested Answers issued by the Board of Studies, ICAI. The answer given in the Suggested Answers is reproduced hereunder:

"A company incorporated outside India which has a place of business in India whether by itself or through an agent, physically or through electronic mode, will be considered as foreign company. Thus, a company incorporated outside India which does not have a place of business in India, will not be considered a 'Foreign Company'."

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

(iii) A company incorporated outside India has shareholders who are all Indian citizens. The company has neither established any place of business in India nor does it conduct any business activity in India in any manner. So, the company cannot be said to be a foreign company. The fact that all the shareholders of the company are Indian citizens is immaterial in deciding whether the company is a foreign company or not.

Whether a company incorporated in Thailand and having a place of business through an agent In Bangalore, is a foreign company?

P 10.2F. Transtar Limited, a company incorporated in Thailand, has a place of business through an agent in Bangalore. The agent transacts the business on behalf of the company through electronic mode. Whether Transtar Limited shall be called a foreign company within the meaning of the Companies Act, 2013? [CA (Final) Nov. 2019]

Ans. As per clause (42) of section 2 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.

In the given case, Transtar Ltd. is a company incorporated outside India, it has a place of business in India through an agent, and the agent transacts business through electronic mode on behalf of Transtar Ltd. Therefore, Transtar Ltd. is a foreign company as per section 2(42) of the Companies Act, 2013.

Whether the company is a foreign company? - Various cases

P 10.2G. In the light of the provisions of the Companies Act, 2013, examine whether the following companies can be considered as foreign companies:

(i) M/s Red Stone Limited is a company registered in Singapore. The Board of directors meets and executes business decisions at their Board Meeting held in India.

(ii) M/s Blue Star Public Company Limited registered in Thailand has authorized Mr. 'Y' in India to find customers and to enter into contracts with them on behalf of the company.

(iii) M/s Xex Limited Liability Company registered in Dubai has installed its main server in Dubai for maintaining office automation software by cloud computing for its client in India. [CA (Final) Nov. 2019]

Ans. As per 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.

The answer to the given problem is as follows:

(i) The mere fact that the Board meetings of Red Stone Limited are held in India does not imply that it has established any place of business in India. Assuming that Red Stone Limited has not established any place of business in India, and it does not conduct any business activity in India in any manner, Red Stone Limited is not a foreign company.

(ii) M/s Blue Star Public Company Limited is incorporated in Thailand, i.e. it is incorporated outside India. It has authorized Mr. Y in India to find customers and to enter into contracts with them on behalf of the company. It implies that Mr. Y is an agent of M/s Blue Star Public Company Limited, and that M/s Blue Star Public Company Limited has established a place of business in India through an agent. It also implies that M/s Blue Star Public Company Limited is conducting business activity in India. Therefore, M/s Blue Star Public Company Limited is a foreign company as per section 2(42) of the Companies Act, 2013.

(iii) M/s Xex Limited Liability Company is incorporated in Dubai, i.e. it is a body corporate incorporated outside India. It has installed its main server in Dubai for maintaining office automation software by cloud computing for its client in India. It implies that M/s Xex Limited Liability Company has established a place of business in India through electronic mode. It also implies that M/s Xex Limited Liability Company is conducting business activity in India. Therefore, M/s Xex Limited Liability Company is a foreign company as per section 2(42) of the Companies Act, 2013.

9.52 Liquidator to make returns, etc. (Section 353)

1. **Application to the Tribunal to make an order to the Company Liquidator to make good the default**

   If any Company Liquidator who has made any default in filing, delivering or making any return, account or other document, or in giving any notice which he is by law required to file, deliver, make or give, fails to make good the default within 14 days after the service on him of a notice requiring him to do so, the Tribunal may, on an application made to it by any contributory or creditor of the company or by the Registrar, make an order directing the Company Liquidator to make good the default within such time as may be specified in the order.

2. **Orders of the Tribunal**

   The order of the Tribunal may provide that all costs of, and incidental to, the application shall be borne by the Company Liquidator.

3. **Company Liquidator to be subject to penalties**

   The provisions of this section shall not prejudice the operation of any enactment imposing penalties on a Company Liquidator in respect of any such default.

9.53 Meetings to ascertain wishes of creditors or contributories (Section 354)

1. **Power of the Tribunal to determine wishes of creditors and contributories**

   In all matters relating to the winding up of a company, the Tribunal may –

   (a) have regard to the wishes of creditors or contributories of the company, as proved to it by any sufficient evidence;

   (b) if it thinks fit for the purpose of ascertaining those wishes, direct meetings of the creditors or contributories to be called, held and conducted in such manner as the Tribunal may direct; and

   (c) appoint a person to act as chairman of any such meeting and to report the result thereof to the Tribunal.

2. **Criteria for determining wishes of creditors and contributories**

   (a) While ascertaining the wishes of creditors, regard shall be had to the value of each debt of the creditor.

   (b) While ascertaining the wishes of contributories, regard shall be had to the number of votes which may be cast by each contributory.

9.54 Court, Tribunal or person, etc., before whom affidavit may be sworn (Section 355)

1. **Before whom an affidavit may be sworn?**

   Any affidavit required to be sworn under any provision of Chapter XX of the Companies Act, 2013, may be sworn–

   (a) in India before any Court, Tribunal, Judge or person lawfully authorised to take and receive affidavits; and

   (b) in any other country before any Court, Judge or person lawfully authorised to take and receive affidavits in that country or before an Indian diplomatic or consular officer.

2. **Tribunal etc. to use seal, stamp or signature**

   All Tribunals, Judges, Justices, Commissioners and persons acting judicially in India shall take judicial notice of the seal, stamp or signature, as the case may be, of any such Court, Tribunal, Judge, person, diplomatic or consular officer, attached, appended or subscribed to any such affidavit or to any other document to be used.

9.55 Powers of Tribunal to declare dissolution of company void (Section 356)

1. **Time limit for declaring dissolution as void and related matters**

   (a) Where a company has been dissolved, the Tribunal may, at any time within 2 years of the date of the dissolution, make an order declaring the dissolution to be void.

   (b) When the dissolution is declared as void, further proceedings shall be conducted as if the company had not been dissolved.

   (c) The Tribunal may declare the dissolution to be void on such terms as it may think fit.

   (d) The Tribunal may exercise its power to declare the dissolution as void on receipt of an application from –

   (i) the Company Liquidator; or

   (ii) any other person who appears to the Tribunal to be interested.

(b) The expression 'director', in relation to a foreign company, includes any person in accordance with whose directions or instructions the Board of directors of the company is accustomed to act.

(c) The expression 'place of business' includes a share transfer office or share registration office.

Practical Problems from CA Examinations

Meaning of foreign company – A few cases

P 10.2A. Examine with reference to the provisions of the Companies Act, 2013 whether the following companies can be treated as foreign companies:

(i) A company incorporated outside India having a share registration office at Mumbai.

(ii) Indian citizens incorporated a company in Singapore for the purpose of carrying on business there.

[CA (Final) May 2003, Nov. 1996]

OR

As per provisions of the Companies Act, 2013, what is the status of XYZ Ltd., a company incorporated in London, U.K., which has a share transfer office at Mumbai? [CA (Final) Nov. 2004]

Ans. As per 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.

The answer to the given problem is as follows:

(i) A share transfer office or share registration office constitutes a place of business (Section 386).
Thus, a company incorporated outside India having a share registration office at Mumbai shall be a foreign company, whether or not it conducts any business activity in India.

(ii) In this case, Indian citizens have formed a company outside India. The company has neither established any place of business in India nor does it conduct any business activity in India in any manner. So, the company cannot be said to be a foreign company. The fact that Indian citizens have formed a company in a foreign country is immaterial in deciding whether the company is a foreign company or not.

Whether a company incorporated in U.K. by Indian citizens or by a company registered in India is a foreign company?

P 10.2B. Indian citizens incorporated a company in U.K. for the purpose of carrying on business there. Examine with reference to the relevant provisions of the Companies Act, 2013 whether it is a "Foreign Company". What would be your answer in case the U.K. company was incorporated by a company registered in India? [CA (Final) Nov. 2008 (Modified)]

Ans. As per 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.

Thus, for deciding as to whether a company is a foreign company or not, the criterion is to see as to whether the company has established a place of business in India or not, and whether the company conducts any business activity in India in any manner, and not the persons who have incorporated the company.

In this case, Indian citizens have formed a company outside India. The company has neither established any place of business in India nor does it conduct any business activity in India in any manner. So, the company cannot be said to be a foreign company. The fact that Indian citizens have formed a company in a foreign country is immaterial in deciding whether the company is a foreign company or not.

The answer would have remained same even if the U.K. Company had been incorporated by a company registered in India for the same reason as stated above.

Whether the company is a foreign company? - Various cases

P 10.2C. Examine in the light of the provisions of the Companies Act, 2013 whether the following companies can be considered as "Foreign Companies":

(i) A company incorporated outside India having a share registration office at New Delhi;

(ii) A company incorporated outside India having shareholders who are all Indian Citizens;

(iii) A company incorporated in India but all the shares are held by foreigners.

Also examine whether the above companies can issue Indian Depository Receipts under the provisions of the Companies Act, 2013? [CA (Final) May 2013]

Ans. As per 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.

The answer to the given problem is as follows:

(i) A share transfer office or share registration office constitutes a place of business (Section 386).

Thus, a company incorporated outside India having a share registration office at Mumbai shall be a foreign company, whether or not it conducts any business activity in India.

(ii) A company incorporated outside India does not become a foreign company by the mere fact that all its shareholders are Indian citizens. Assuming that the company has not established any place of business in India, and the company does not conduct any business activity in India in any manner, the company is not a foreign company.

(iii) A company incorporated in India is a 'company' within the meaning of Clause (20) of Section 2 of the Companies Act, 2013. It cannot become a foreign company by the mere fact that all the shares of the company are held by foreigners.

Section 390 of the Companies Act, 2013 authorises a company incorporated outside India (whether or not it has established a place of business in India, i.e. whether or not it is a foreign company) to issue Indian Depository Receipts in accordance with the Rules prescribed by the Central Government. Accordingly, -

(i) 'A company incorporated outside India having a share registration office at New Delhi' can issue IDRs in accordance with the Rules prescribed by the Central Government.

(ii) 'A company incorporated outside India having shareholders who are all Indian Citizens' can issue IDRs in accordance with the Rules prescribed by the Central Government.

(iii) 'A company incorporated in India but all the shares are held by foreigners' cannot issue IDRs.

Whether a company carrying on business through telemarketing in India is a foreign company?

P 10.2D. Robertson Ltd. is a company registered in Thailand. Although, it has no place of business established in India, yet it is doing online business through telemarketing in India.

Whether it will be treated as a Foreign Company under the Companies Act, 2013? Explain. [CA (Final) Nov. 2015]

Ans. As per clause (42) of section 2 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.

Clause (c) of Sub-Rule (1) of Rule 2 of the Companies (Registration of Foreign Companies) Rules, 2014 defines 'electronic mode'. As per the said clause, electronic mode includes providing online services such as telemarketing.

In the given case, Robertson Ltd. is carrying on online business through telemarketing in India. Since Robertson Ltd. is a company incorporated outside India and it also conducts business activities in India, it is a foreign company.

Whether a company carrying on online business, another company employing agents in India and a company having Indian citizens as its shareholders are foreign companies?

P 10.2E. In the light of the provisions of the Companies Act, 2013 explain whether the following companies can be considered as a 'foreign companies':

(i) A company which has no place of business established in India, yet, is doing online business through telemarketing in India.

(ii) A company which is incorporated outside India employs agents in India but has no place of business in India.

(iii) A company incorporated outside India having shareholders who are all Indian citizens. [CA (Final) Nov. 2018]

Ans. The given problems relate to clause (42) of section 2 of the Companies Act, 2013 and clause (c) of sub-rule (1) of rule 2 of the Companies (Registration of Foreign Companies) Rules, 2014.

The legal position

1. As per section 2(42), 'foreign company' means any company or body corporate incorporated outside India which–

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

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

   As per Rule 2(1)(c), electronic mode includes providing online services such as telemarketing.

Answers to the problems asked

(i) A company is doing online business through telemarketing in India, though it has not established any physical place of business in India. Since the company is incorporated outside India and it also conducts business activities in India, it is a foreign company.

Consequences of contravention

1. Punishment for contravention (Sec. 392)
2. Company's failure to comply with provisions of this Chapter not to affect validity of contracts, etc. (Sec. 393)

Bird's eye-view of the Companies (Registration of Foreign Companies) Rules, 2014

Rule No.	Marginal Heading
1	Short title and commencement
2	Definitions
3	Particulars relating to directors and secretary to be furnished to the Registrar by foreign Companies
4	Financial Statement of foreign company
5	Audit of accounts of foreign company
6	List of places of business of foreign company
7	Annual Return
8	Office where documents to be delivered and fee for registration of documents
9	Certification
10	Authentication of translated documents
11	Documents to be annexed to prospectus
12	Action for improper use or description as foreign company
13	Issue of Indian Depository Receipts (IDRs)

Bird's eye-view of the Forms used in this Chapter

Form No.	Description of E-Form (Purpose of E-Form)	Relevant Section	Relevant Rule
FC-1	Information to be filed by foreign company	380	3
FC-2	Return of alteration in the documents filed for registration by foreign company	380	3
FC-3	Annual accounts along with list of all principal places of business in India	381	6
FC-4	Annual return of a foreign company	384	7
FC-5	Nomination by IDR holder	390	13

Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, –
   (a) any reference to any section means reference to the sections of the Companies Act, 2013; and
   (b) any reference to any rule means reference to the Rules contained in the Companies (Registration of Foreign Companies) Rules, 2014.

However, as per section 380 of the Companies Act, 2013 read with Rule 8 of the Companies (Registration of Foreign Companies) Rules, 2014, there is no requirement of delivering the documents with the Registrar of the State in which the principal place of business of the foreign company is situated; the only requirement is to deliver the documents with the Registrar, New Delhi.

10.5 Accounts of foreign company (Section 381)

(A) Provisions contained in the Act.

1. Preparation and filing of Balance Sheet and Profit and Loss Account

(a) Every foreign company shall prepare and file with the Registrar, a balance sheet and profit and loss account –

(i) in such form as may be prescribed;

(ii) containing such particulars as may be prescribed; and

(iii) including or having annexed or attached thereto such documents as may be prescribed.

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

(c) However, the Central Government may, by notification, direct that, in the case of any foreign company or class of foreign companies, these requirements shall not apply, or shall apply subject to such exceptions and modifications as may be specified in that notification.

2. Time limit for filing

A copy of the balance sheet and profit and loss account shall be delivered to the Registrar in every calendar year.

3. List of places of business in India

(a) Every foreign company shall prepare a list of all the places of business in India established by it.

(b) The list shall be prepared in the prescribed form.

(c) The list shall be prepared as at the date of the balance sheet.

(d) The list shall be filed with the Registrar along with the balance sheet and profit and loss account.

(B) Provisions contained in the Rules [Rules 4, 5 and 6 of the Companies (Registration of Foreign Companies) Rules, 2014].

1. Preparation of financial statement (Rule 4)

(a) The financial statement of Indian business operations shall be prepared in the same form as in Schedule III or as near thereto as may be possible.

(b) All such documents as are required to be annexed to the financial statement of a company as per Chapter IX of the Companies Act, 2013 (*viz.* 'Accounts of Companies' consisting of sections 128 to 138) shall be annexed to the financial statement of the foreign company.

(c) All such documents relating to consolidated financial statement of the parent foreign company as submitted by the parent foreign company to the prescribed authority in the country of its incorporation, shall also be filed.

(d) The foreign company shall file, along with the financial statement, –

(i) a Statement (containing the prescribed particulars) with respect to related party transactions;

(ii) a Statement (containing the prescribed particulars) of repatriation of profits; and

(iii) a Statement (containing the prescribed particulars) of transfer of funds.

2. Time limit for filing (Rule 4)

(a) The documents shall be filed within 6 months of the close of the financial year.

(b) However, the Registrar may grant extension upto 3 months. The extension may be granted if there is any special reason justifying such extension. The extension may be granted only if an application seeking extension is made by the foreign company.

3. Audit of accounts (Rule 5)

(a) The accounts pertaining to the Indian business operations shall be audited by a practicing Chartered Accountant in India or a firm or limited liability partnership of practicing chartered accountants.

(b) The provisions of Chapter X (*viz.* 'Audit and Auditors' consisting of sections 139 to 148) and Rules made thereunder, as far as applicable, shall apply, *mutatis mutandis*, to the foreign company.

4. List of places of business of foreign company (Rule 6)

The list of all the places of business in India established by a foreign company shall be in Form FC-3.

Ans. The given problem relates to section 379 read with section 2(42) and section 386 of the Companies Act, 2013.

As per Section 2(42), 'foreign company' means any company or body corporate incorporated outside India which –

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

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

As per Section 386, a share transfer office or share registration office constitutes a place of business.

As per section 379, if 50% or more of the paid-up share capital (whether equity or preference or partly equity and partly preference) of a foreign company is held (whether singly or in the aggregate) by –

(a) one or more Indian citizens; or

(b) one or more companies or bodies corporate incorporated in India; or

(c) one or more Indian citizens and one or more companies or bodies corporate incorporated in India,

then, such a foreign company shall, in respect of its Indian business, comply with Chapter XXII of the Companies Act, 2013 (*viz.* the Chapter 'Companies Incorporated Outside India' consisting of sections 379 to 393) and such other provisions of the Act as may be prescribed by the Central Government, as if it were a company incorporated in India.

In the given case, Laurel Steven Limited is a company incorporated in Singapore (*viz.* outside India) and it has a share transfer office (*viz.* a place of business) at New Delhi (*viz.* in India). So, Laurel Steven Limited is a foreign company within the meaning of section 2(42) read with section 386.

An Indian Citizen (*viz.* Mr. Ziyan) along with a company incorporated in India (Swaraj Limited) hold in aggregate more than 50% of the paid up capital of Laurel Steven Limited. So, Laurel Steven Limited shall be covered under section 379. Accordingly, it shall have to comply with, in respect of its Indian business, Chapter XXII of the Companies Act, 2013 (viz. Chapter 'Companies Incorporated Outside India' consisting of sections 379 to 393) and such other provisions of the Act as may be prescribed by the Central Government, as if it were a company incorporated in India.

Formalities to be complied with by Laurel Steven Limited

1. It shall file with the Registrar the documents and information as contained in section 380. Such documents and information have to be filed within 30 days of establishment of place of business in India (Section 380).
2. Where any alteration is made in the documents delivered to the Registrar under section 380, it shall, within 30 days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration (Section 380).
3. It shall prepare and file with the Registrar a balance sheet and profit and loss account (Section 381).
4. It shall prepare and file with the Registrar a list of all the places of business established in India (Section 381).
5. It shall exhibit outside every office or place where it carries on business in India, the name of the foreign company, the country of incorporation and the fact that the liability of members is limited (Section 332).
6. It shall exhibit in all business letters, billheads and letter papers, and in all notices and other official publications, the name of the foreign company, the country of incorporation and the fact that the liability of members is limited (Section 382).
7. It shall comply with the provisions contained in sections 71, 92, 128, 77 to 87, 206 to 229 and 135 to the extent the provisions contained in these sections are applicable to it as per section 384 (Section 384).

Regulatory requirements to be complied with by a foreign company with respect to delivery of documents etc. to the Registrar

P 10.3B. What are the regulatory requirements under the Companies Act, 2013 to be complied with by a company which has established its place of business in India with respect to delivery of documents etc. to Registrar? [CA (Final) Nov. 2019]

Ans. Where a company incorporated outside India establishes a place of business in India, it is termed as a foreign company [Section 2(42)]. A foreign company has to comply with the following regulatory requirements with respect to filing of documents with the Registrar:

1. It shall file with the Registrar the documents and information as contained in section 380. Such documents and information have to be filed within 30 days of establishment of place of business in India (Section 380).
2. Where any alteration is made in the documents delivered to the Registrar under section 380, it shall, within 30 days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration (Section 380).
3. It shall prepare and file with the Registrar a balance sheet and profit and loss account (Section 381).
4. It shall prepare and file with the Registrar a list of all the places of business established in India (Section 381).

10.4 Documents, etc., to be delivered to Registrar by foreign companies (Section 380)

1. Legal requirements when place of business is established

Every foreign company shall deliver the following documents to the Registrar for registration:

(a) A certified copy of the charter, statutes or memorandum and articles or other instrument defining the constitution of the company. If such instrument is not in the English language, a certified translation thereof in the English language shall be filed.

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

(c) The full address of the principal place of business in India.

(d) The particulars of opening and closing of a place of business in India on earlier occasion(s).

(e) A list of the directors and secretary of the company containing such particulars as may be prescribed.
Rule 3(2) of the Companies (Registration of Foreign Companies) Rules, 2014 prescribes the following particulars for this purpose:

- Personal name and surname in full
- Any former name(s) and surname(s) in full
- Name of father, mother and spouse
- Date of birth
- Residential address
- E-mail ID
- Nationality
- Nationality of origin
- Passport Number, date of issue and country of issue
- Income Tax Permanent Account Number (PAN), if applicable
- Occupation, if any
- Membership Number (for Secretary only)
- Where directorship is held by him in any other Indian company, Director Identification Number (DIN), Name and Corporate Identity Number (CIN) of such company
- Other directorship(s) held by him

(f) The name(s) and address(s) of person(s) resident in India authorised to accept on behalf of the company notices or other documents required to be served on the company.

(g) A 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.

(h) Any other information as may be prescribed.

2. Time limit for filing

The required documents shall be delivered to the Registrar for registration within 30 days of the establishment of place of business in India by the foreign company.

3. Provisions with respect to existing companies

Every foreign company existing at the commencement of Companies Act, 2013 shall, if it has not delivered to the Registrar before such commencement, the documents and particulars specified in sub-section (1) of section 592 of the Companies Act, 1956, continue to be subject to the obligation to deliver those documents and particulars in accordance with the provisions of the Companies Act, 1956.

4. Intimation of alterations to the registrar

Where any alteration is made in the documents delivered to the Registrar, the foreign company shall, within 30 days of such alteration, deliver to the Registrar for registration, a return containing the particulars of the alteration in the prescribed form (*viz.* Form No. FC-2).

1. Manner of filing of documents [Rule 3(3) of the Companies (Registration of Foreign Companies) Rules, 2014]

Within 30 days of establishment of place of business in India, the foreign company shall file with the Registrar –

(a) the documents required to be filed under section 380;

(b) Form FC-1;

(c) an attested copy of approval from the Reserve Bank of India under the Foreign Exchange Management Act, 1999 and Regulations made thereunder; and

(d) an attested copy of approval from any other Regulator, or where no such approval is required, a declaration from the authorised representative of such foreign company that no such approval is required.

2. Notice of cessation of place of business in India [Rule 8(3) of the Companies (Registration of Foreign Companies) Rules, 2014]

(a) If any foreign company ceases to have a place of business in India, it shall forthwith give notice of such fact to the Registrar.

(b) As from the date the notice is given to the Registrar, the obligation of the company to deliver any document to the Registrar shall cease, provided it has no other place of business in India.

3. Application form to be accompanied with prospectus [Section 387(3)]

(a) No person shall issue to any person in India any application form for securities of a company incorporated outside India, unless the following conditions are satisfied:

(i) Such application form is issued with a prospectus which complies with the provisions of this Chapter.

(ii) Such issue of securities does not contravene the provisions of section 388.

(b) However, this requirement shall not apply if it is shown that the form of application was issued in connection with a *bonafide* invitation to a person to enter into an underwriting agreement with respect to securities.

The provisions of section 387 shall apply with respect to any prospectus of a company –

(a) incorporated outside India (and whether or not it has established a place of business in India); or

(b) to be incorporated outside India (and whether or not it will establish a place of business in India).

Theoretical Questions

Q 10.10A. Under section 387 of the Companies Act, 2013, what particulars are required to be incorporated in a prospectus issued by an existing foreign company? [CA (Final), RTP, May 2009]

Practical Problems from CA Examinations

Validity of prospectus issued by a company incorporated outside India which does not state country of incorporation

P 10.10A. Blue Berry Ltd. is a company incorporated outside India. 50% of its preference share capital and 20% of its equity share capital are held by companies incorporated in India. It issued prospectus inviting subscriptions in India for its shares but did not state the country in which it is incorporated. Examine in the light of the provisions of the Companies Act, 2013 whether the issue of prospectus by the company is valid. [CA (Final) May 2003, Nov. 1996]

Ans. As per section 387 of the Companies Act, 2013, the prospectus issued by a company incorporated outside India shall contain the following particulars:

(i) The instrument constituting or defining the constitution of the company, and if such instrument is not in the English language, a certified translation of such instrument in the English language

(ii) The enactment under which the company was incorporated, and if such enactment is not in the English language, a certified translation of such enactment in the English language

(iii) Address in India where the said instrument, enactment, or copies thereof can be inspected

(iv) Date and country of incorporation

(v) Address of principal office in India, if any

In the given case, Blue Berry Ltd. is a company incorporated outside India, and it has issued a prospectus in India. Therefore, the provisions contained in section 387 shall become applicable to Blue Berry Ltd. even if it does not have any place of business in India, it does not carry on any business in India and it is not a foreign company as per section 2(42).

As per section 387, it is mandatory for a company incorporated outside India to state the name of the country of incorporation in the prospectus issued by it. Since Blue Berry Ltd. has defaulted in including in the prospectus the country of its incorporation, it amounts to contravention of section 387, and therefore, the issue of prospectus is not valid.

10.11 Provisions as to expert's consent and allotment (Section 388)

1. Conditions for issue or circulation of prospectus [Section 388(1)]

Where a prospectus by which securities are offered for subscription includes a statement purporting to be made by an expert, no person shall issue, circulate or distribute in India such prospectus, if –

(a) the expert has not given his written consent to the issue of the prospectus; or

(b) the expert has before delivery of the prospectus for registration, withdrawn his written consent to the issue of the prospectus; or

(c) the prospectus does not contain a statement that the expert has given and has not withdrawn his consent.

2. When is a statement deemed to be included in prospectus? [Section 388(2)]

A statement shall be deemed to be included in a prospectus, if –

(a) it is contained in any report or memorandum appearing on the face of the prospectus; or

(b) a reference of such statement is included in the prospectus; or

(c) it is issued along with the prospectus.

The provisions of section 388 shall apply with respect to any prospectus of a company –

(a) incorporated outside India (and whether or not it has established a place of business in India); or

(b) to be incorporated outside India (and whether or not it will establish a place of business in India).

A company registered under the Companies Act, 1956 is a subsidiary of a foreign company – Can it describe itself as a foreign company, and consequences in case of contravention

P 10.2H. Trans Asia Limited is registered as a public company u/s 4(7) of the erstwhile Companies Act, 1956 which is a subsidiary of Galilio Limited, a foreign company. Trans Asia Limited carries on business in India describing itself as a foreign company. Can it do so? State the actions that can be taken against the company for improper use or description as foreign company under the provisions of the Companies Act, 2013. [CA (Final) Nov. 2018]

Ans. The given problem relates to section 2(42) of the Companies Act, 2013 and Rule 12 of the Companies (Registration of Foreign Companies) Rules, 2014.

1. As per Section 2(42), 'foreign company' means any company or body corporate incorporated outside India which –
   (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
   (b) conducts any business activity in India in any other manner.
2. It is evident that a company incorporated in India is a 'company' within the meaning of Clause (20) of Section 2 of the Companies Act, 2013. Therefore, a company incorporated in India cannot become a foreign company by the mere fact that it is a subsidiary of a company incorporated outside India or of a foreign company.
3. As per Rule 12, if any person trades or carries on business in any manner under any name or title or description as a foreign company, that person shall, unless duly registered as a foreign company, shall be liable for investigation under section 210 of the Act and action consequent upon that investigation shall be taken against that person.
4. Trans Asia Limited is not a foreign company, but it has been carrying on business in India describing itself as a foreign company. It amounts to contravention of Rule 12. As per Rule 12 read with section 210, the Central Government is empowered to order an investigation into the affairs of Trans Asia Limited and on receipt of report of investigation, action may be taken against Trans Asia Limited and other persons guilty of any offence in accordance with the provisions of section 224.

10.3 Application of Act to foreign companies (Section 379)

1. Applicability of various provisions of the Act to foreign companies

Sections 380 to 386 (both inclusive) and sections 392 and 393 shall apply to all foreign companies.

Power of the Central Government to exempt

1. The Central Government may, by Order published in the Official Gazette, exempt any class of foreign companies, specified in the Order, from any of the provisions of sections 380 to 386 and sections 392 and 393.
2. A copy of every such Order shall, as soon as may be after it is made, be laid before both Houses of Parliament.

2. Applicability of Chapter XXII and other provisions prescribed by the Central Government

If 50% or more of the paid-up share capital (whether equity or preference or partly equity and partly preference) of a foreign company is held (whether singly or in the aggregate) by –

(a) one or more Indian citizens; or

(b) one or more companies or bodies corporate incorporated in India; or

(c) one or more Indian citizens and one or more bodies corporate incorporated in India,

then, such a foreign company shall, in respect of its Indian business, comply with Chapter XXII of the Companies Act, 2013 (*viz.* the Chapter 'Companies Incorporated Outside India' consisting of sections 379 to 393) and such other provisions of the Act as may be prescribed by the Central Government, as if it were a company incorporated in India.

Practical Problems from CA Examinations

Legal requirements to be complied with by a company incorporated in Singapore having a share transfer office in India

P 10.3A. Mr. Ziyan an Indian citizen holds 25% of the paid up capital of Laurel Steven Limited, a company which was incorporated in Singapore with a paid up capital of 10 million Singapore Dollars. Swaraj Limited a company registered in India holds 30% of the paid up capital of Laurel Steven Limited. Laurel Steven Limited has recently established a share transfer office at New Delhi. The company seeks your advice as to what formalities it should observe as a foreign company under Companies Act, 2013. [CA (Final) Nov. 2017]

OR

M/s Joel Ltd. was incorporated in London with a paid up capital of 10 million pounds. Mr. Y an Indian citizen holds 25% of the paid up capital. M/s. X Ltd. a company registered in India holds 30% of the paid up capital of Joel Ltd. M/s. Joel Ltd. has recently established a share transfer office at New Delhi. The company seeks your advice as to what formalities it should observe as a foreign company under Companies Act, 2013. State briefly the requirements relating to filing of accounts with the Registrar of Companies by the foreign company in respect of its global business as well as Indian business. [CA (Final) Nov. 2007]

Notice of cessation of place of business in India [Rule 8(3) of the Companies (Registration of Foreign Companies) Rules, 2014]

(a) If any foreign company ceases to have a place of business in India, it shall forthwith give notice of such fact to the Registrar.

(b) As from the date the notice is given to the Registrar, the obligation of the company to deliver any document to the Registrar shall cease, provided it has no other place of business in India.

Theoretical Questions from CA Examinations

Q 10.5A. Galilio Ltd. is a foreign company in Germany and it established a place of business in Mumbai. Explain the relevant provisions of the Companies Act, 2013 and rules made thereunder relating to preparation and filing of financial statements, as also the documents to be attached alongwith the financial statements by the foreign company. [CA (Final) May 2016]

10.6 Display of name, etc. of foreign company (Section 382)

1. **Duty to exhibit its name etc. outside place of business**

   Every foreign company shall exhibit outside every office or place where it carries on business in India, –
   (a) the name of the foreign company;
   (b) the country of incorporation; and
   (c) the fact that the liability of members is limited.

   The above particulars shall be conspicuously exhibited in –
   (a) letters easily legible in English characters; and
   (b) legible characters of one of the local languages.

2. **Duty to exhibit its name etc. in bills, letters etc.**

   Every foreign company shall exhibit, in legible English characters, –
   (a) the name of the foreign company.
   (b) the country of incorporation.
   (c) the fact that the liability of members is limited.

   The above particulars shall be exhibited in all business letters, billheads and letter paper, and in all notices, and other official publications of the company.

Theoretical Questions from CA Examinations

Q 10.6A. The liability of members of Style Limited, a company incorporated in Singapore, is limited. The company plans to start a place of business in Mumbai from 1st Dec., 2016. It has taken an office space in Andheri (West), Mumbai for that purpose. The person who is to take charge of Mumbai Office seeks your advice regarding the provisions of the Companies Act, 2013, in respect of displaying of the company's name etc., at its Mumbai office as well as in its business letters and other documents. Advise him with reference to the provisions of the Companies Act, 2013 governing foreign companies. [CA (Final) Nov. 2016]

10.7 Service of documents on foreign company (Section 383)

Any document required to be served on a foreign company shall be deemed to be sufficiently served, if –

(a) it is addressed to any person whose name and address have been delivered to the Registrar under section 380, *i.e.* a person resident in India who is authorised to accept on behalf of the foreign company notices or other documents required to be served on the foreign company; and

(b) (i) it is left at the address which has been delivered to the Registrar under section 380, i.e. it is hand delivered; or
   (ii) it is sent by post; or
   (iii) it is sent by electronic mode.

Practical Problems from CA Examinations

Manner of service of show cause notice by the VAT Officer on a foreign company

P 10.7A. X Inc. is a company registered in UK and carrying on Trading Activity, with Principal Place of Business in Chennai. Since the company did not obtain registration or make arrangement to file Return, the State VAT Officer having jurisdiction, intends to serve show cause notice on the Foreign Company. As Standing Counsel for the Department, advise the VAT Officer on valid service of Notice. [CA (Final) Nov. 2014]

Ans. The VAT Officer is advised to serve the show cause notice on the foreign company in accordance with the provisions of section 383 of the Companies Act, 2013, i.e. by addressing it to the person whose name and address had been delivered to the Registrar under section 380, and sending it to such person by –

(i) post; or

(ii) leaving at the address which has been delivered to the Registrar under section 380, i.e. hand delivery; or
(iii) electronic mode, viz. e-mail.

10.8 Debentures, annual return, registration of charges, books of account and their inspection (Section 384)

Certain provisions of the Companies Act, 2013 shall also apply to the foreign companies, explained as below:

1. The provisions relating to debentures as contained in section 71 shall apply *mutatis mutandis* to a foreign company.
2. The provisions relating to annual return as contained in 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.

   Provisions contained in Rule 7 of the Companies (Registration of Foreign Companies) Rules, 2014 are as follows:
   (a) Every foreign company shall prepare an annual return in Form FC-4.
   (b) The annual return shall be filed with the Registrar within 60 days of the last day of the financial year.
   (c) The annual return shall contain the particulars as on the last day of the financial year.
3. The provisions relating to corporate social responsibility as contained in section 135 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.
4. The provisions relating to Books of account etc. to be kept by a company as contained in section 128 shall apply to a foreign company to a limited extent. A foreign company is required to keep at its principal place of business in India, the books of account referred to in section 128, 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.
5. The provisions relating to registration of charges as contained in Chapter VI (consisting of sections 77 to 87) shall apply *mutatis mutandis* to properties acquired by any foreign company.
6. The provisions relating to Inspection, Inquiry and Investigation as contained in Chapter XIV (consisting of sections 206 to 229) shall apply *mutatis mutandis* to the Indian business of a foreign company as they apply to a company incorporated in India.

10.9 Fee for registration of documents (Section 385)

Where any provision contained in Chapter XXII (*viz.* the Chapter 'Companies Incorporated Outside India' consisting of sections 379 to 393) requires registration of any document, there shall be paid to the Registrar such fee, as may be prescribed.

As per Rule 8(2) of the Companies (Registration of Foreign Companies) Rules, 2014, fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 shall be paid to the Registrar for registration of any document.

10.10 Dating of prospectus and particulars to be contained therein (Section 387)

1. Matters to be stated in prospectus [Section 387(1)]

No person shall issue, circulate or distribute in India any prospectus offering to subscribe for securities of a company incorporated outside India, unless the following conditions are satisfied:

(a) The prospectus is dated and signed.
(b) The prospectus contains the following particulars:
   (i) The instrument constituting or defining the constitution of the company, and if such instrument is not in the English language, a certified translation of such instrument in the English language
   (ii) The enactment under which the company was incorporated, and if such enactment is not in the English language, a certified translation of such enactment in the English language
   (iii) Address in India where the said instrument, enactment, or copies thereof can be inspected
   (iv) Date and country of incorporation
   (v) Address of principal office in India, if any
(c) The prospectus discloses all such matters as are specified under section 26.

2. No waiver of compliances [Section 387(2)]

Any condition requiring or binding an applicant for securities to waive compliance with any requirement imposed by virtue of sub-section (1) shall be void.

Theoretical Questions from CA Examinations

Q 10.4A. What legal requirements under the Companies Act, 2013, is a foreign company wishing to establish a place of business in India, required to comply with relating to delivery of documents to the registrar of companies? [CA (Final) Nov. 1994]

Q 10.4B. A company incorporated outside India decides to establish a place of business in India. State the documents that are required to be filed by such foreign companies under the Companies Act, 2013 soon after establishment of place of business in India. [CA (Final) May 1999]

Q 10.4C. A company incorporated in Singapore has established its place of business at Chennai. State the documents which are required to be furnished on such establishment of business in India under the Companies Act, 2013 and the authorities to whom such documents are to be furnished. [CA (Final) June 2009]

Q 10.4D. DEJY AS Company Limited incorporated in Singapore, desires to establish a place of business at Mumbai. You being a practicing Chartered Accountant have been appointed by the company as a liaison officer, for compliance of legal formalities on behalf of the company. Examining the provisions of the Companies Act, 2013, state the documents you are required to furnish on behalf of the company, on the establishment of a place of business at Mumbai. [CA (Final) May 2012]

Q 10.4E. State the documents that are required to be delivered by a foreign company at the time of establishment of a place of business in India. State to whom the said documents are to be delivered. [CA (Final) May 2014]

Practical Problems from CA Examinations

Manner of translation of documents where the documents are not in English

P 10.4A. Qinghai Huading Industrial Company Ltd. incorporated in China established a place of business at Mumbai. The Charter/Documents constituting the Company is in Mandarian Chinese (Chinese local language). It is required *inter alia* to file a certified translation of above documents with the Registrar of Companies in India. Who can authenticate the translated charter/documents as per the provisions of the Companies Act, 2013 and Rules made thereunder governing foreign companies in case such translation is made at Mumbai? [CA (Final) May 2018]

Ans. The given problem relates to section 380 of the Companies Act, 2013 and Rule 10 of the Companies (Registration of Foreign Companies) Rules, 2014.

Section 380 requires a foreign company to deliver such documents to the Registrar as are specified in that section. Section 380 further requires that where such documents are in a language other than English, a certified English translation of such documents shall be filed with the Registrar.

As per Rule 10 of the Companies (Registration of Foreign Companies) Rules, 2014, where the translation is made at a place in India, such translation shall be authenticated by–

(a) an advocate, attorney or pleader entitled to appear before any High Court; or

(b) an affidavit, of a competent person having, in the opinion of the Registrar, an adequate knowledge of the language of the original and of English.

In the given case, the English translation of the documents required to be filed with the Registrar under section 380 shall be authenticated as per the above stated provisions.

Tutorial Note:

Rule 10 of the Companies (Registration of Foreign Companies) Rules, 2014 was not incorporated in any Publication of ICAI (viz. the Study Material, Revision Test Papers (RTPs), or Practice Manual) as applicable for May, 2018 Exams, and so this Rule was not incorporated in the Book prepared by the Author for May, 2018 Exams. This makes it evident that a few questions may form part of the CA (Final) Exams conducted by ICAI, though such questions might not be covered in any ICAI Publication and this Book.

To whom are the documents required to be delivered?

P 10.4B. ABC Ltd., a foreign company having its Indian principal place of business at Kolkata, West Bengal is required to deliver various documents to Registrar of Companies under the provisions of the Companies Act, 2013. You are required to state, where the said company should deliver such documents. [CA (Final) Nov. 2004]

Ans. The given problem relates to section 380 of the Companies Act, 2013 and Rule 8 of the Companies (Registration of Foreign Companies) Rules, 2014.

Section 380 requires a foreign company to deliver such documents to the Registrar as are specified in that section.

As per Rule 8 of the Companies (Registration of Foreign Companies) Rules, 2014, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.

In the given case, the principal place of the foreign company (viz. ABC Ltd.) is situated at Kolkata, in the State of West Bengal. As per Rule 8, the documents required to be delivered to the registrar shall be delivered to the Registrar, New Delhi. There is no requirement of delivering the document with the Registrar, West Bengal.

Tutorial Note:

Under the Companies Act, 1956, the documents were required to be delivered to the Registrar, New Delhi as well as the Registrar of the State in which the principal place of business of the foreign company was situated (Section 597 of the Companies Act, 1956).

10.12 Registration of prospectus (Section 389)

1. **Conditions for issue or circulation of prospectus**

   No person shall issue, circulate or distribute in India any prospectus by which securities are offered for subscription unless before such issue, circulation or distribution, –

   (a) a certified copy of the prospectus is delivered to the Registrar for registration;

   (b) the prospectus states on the face of it that a copy has been so delivered;

   (c) expert's consent to the issue of the prospectus (as required under section 388) is attached to the prospectus; and

   (d) such documents as may be prescribed are attached to the prospectus.

   Documents to be annexed to prospectus as per Rule 11 of the Companies (Registration of Foreign Companies) Rules, 2014:

   (a) Expert's consent to the issue of the prospectus.

   (b) A copy of contract for appointment of managing director or manager and in case such contract is not in writing, then, a memorandum containing full particulars of such contract.

   (c) A copy of any other material contract, other than a contract entered into in the ordinary course of business, entered into within preceding 2 years.

   (d) A copy of underwriting agreement.

   (e) A copy of power of attorney, if the prospectus is signed by any agent of a director.

2. **Manner of certification of prospectus**

   The copy of the prospectus shall be certified by –

   (a) the chairperson of the company; and

   (b) 2 other directors of the company.

The provisions of section 389 shall apply with respect to any prospectus of a company –

(a) incorporated outside India (and whether or not it has established a place of business in India); or

(b) to be incorporated outside India (and whether or not it will establish a place of business in India).

Theoretical Questions from CA Examinations

Q 10.12A. Chang Limited, a company incorporated in Singapore proposes to issue prospectus offering its securities in India. The company has no established place of business in India. The officer in charge of the issue of the prospectus in India seeks your opinion regarding the provisions relating to registration of the prospectus under the Companies Act, 2013. List out the documents required to be enclosed with the prospectus. [CA (Final) May 2018]

10.13 Offer of Indian Depository Receipts (Section 390)

1. **Concept of Indian Depository Receipts (IDRs) in simple terms**

   - An IDR is a security denominated in Indian Rupees.
   - An IDR is in the form of a depository receipt created by a Domestic Depository against the underlying equity shares of issuing company (i.e. a company or body corporate incorporated outside India) to enable such issuing company to raise funds from the Indian securities Markets.
   - An Overseas Custodian Bank (i.e. a banking company established in a country outside India and having a place of business in India) acts as custodian for the equity shares of the issuing company against which IDRs are issued.
   - The Domestic Depository acts as a custodian of securities. The Domestic Depository must be registered with the Securities and Exchange Board of India. The Domestic Depository is authorised by the issuing company to issue the IDRs.
   - IDRs can be purchased by any 'person resident in India' as defined under the Foreign Exchange Management Act, 1999.

2. **Provisions contained in section 390 of the Companies Act, 2013**

   The Central Government may make rules for –

   (a) the offer of Indian Depository Receipts;

   (b) the requirement of disclosures in prospectus or letter of offer issued in connection with Indian Depository Receipts;

   (c) the manner in which the Indian Depository Receipts shall be dealt with in depository mode and by custodian and underwriters; and

   (d) the manner of sale, transfer or transmission of Indian Depository Receipts,

by a company incorporated or to be incorporated outside India, whether the company has or has not established, or will or will not establish, any place of business in India.

The provisions of section 390 shall apply notwithstanding anything contained in any other law for the time being in force.

10.14 Application of sections 34 to 36 and Chapter XX (Section 391)

1. The provisions of sections 34 to 36 (both inclusive) shall apply to the issue of a prospectus by a company incorporated outside India as they apply to the issue of a prospectus by an Indian company.
2. The provisions of sections 34 to 36 (both inclusive) shall apply to the issue of Indian Depository Receipts by a foreign company.
3. The provisions of Chapter XX (*viz.* winding up) shall apply *mutatis mutandis* for closure of the place of business of a foreign company in India as if it were a company incorporated in India in case such foreign company has raised monies through offer or issue of securities under this Chapter which have not been repaid or redeemed.

Section 34: Criminal liability for mis-statements in prospectus
Section 35: Civil liability for mis-statements in prospectus
Section 36: Punishment for fraudulently inducing persons to invest money

10.15 Punishment for contravention (Section 392)

If a foreign company contravenes the provisions of Chapter XXII (*viz.* the Chapter 'Companies Incorporated Outside India' consisting of sections 379 to 393), the punishment shall be as follows:

(a) The foreign company shall be punishable with –
   (i) a minimum fine of Rs. 1 lakh;
   (ii) a maximum fine of Rs. 3 lakh;
   (iii) an additional fine upto Rs. 50,000 per day, in the case of a continuing offence.

(b) Every officer of the foreign company who is in default shall be punishable with –
   (i) imprisonment upto 6 months; or
   (ii) a minimum fine of Rs. 25,000 and a maximum fine of Rs. 5 lakh; or
   (iii) both.

The punishment prescribed under section 392 is without prejudice to the provisions of section 391.

Theoretical Questions from CA Examinations

Q 10.15A. In case, a foreign company does not deliver its documents to the Registrar of Companies as required under section 380 of the Companies Act, 2013, state the penalty prescribed under the said Act, which can be levied. [CA (Final) Nov. 2004]

Q 10.15B. ABC Limited, a foreign company failed to deliver some desired documents to the Registrar of Companies as required under section 380 of the Companies Act, 2013. State the provision of penalty prescribed under the said Act, which can be levied on ABC Limited for its failure. [CA (Final) May 2015]

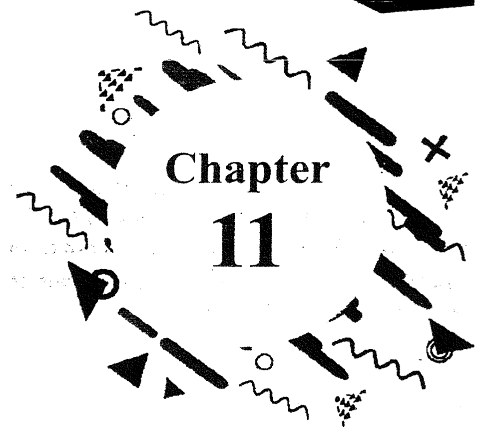
Q 10.15C. Ronnie Coleman Ltd., a foreign company failed to deliver some documents to the Registrar of Companies as required under section 380 of the Companies Act, 2013. State the provisions of penalty prescribed under the Act, which can be levied on Ronnie Coleman Ltd. for its failure to deliver the documents. [CA (Final) Nov. 2018]

10.16 Company's failure to comply with provisions of this Chapter not to affect validity of contracts, etc. (Section 393)

If a company fails to comply with any of the provisions of Chapter XXII (*viz.* the Chapter 'Companies Incorporated Outside India' consisting of sections 379 to 393), the consequences shall be as under:

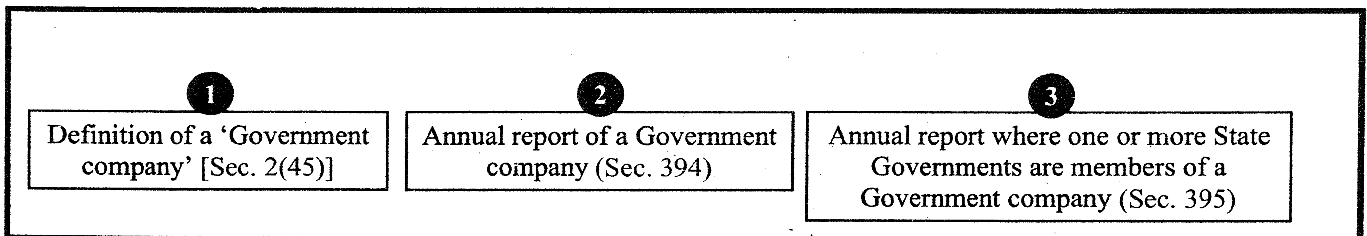
1. The validity of any contract, dealing or transaction entered into by a foreign company shall not be affected.
2. The company may be sued in respect of any such contract, dealing or transaction.
3. The company shall not be entitled to bring any suit, claim any set-off, make any counter claim or institute any legal proceeding in respect of any such contract, dealing or transaction, until it has complied with the relevant provisions.

Government Companies



(Chapter XXIII of the Companies Act, 2013 consisting of Sections 394 and 395)

Bird's eye-view of the Chapter



Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, any reference to any section means reference to the sections of the Companies Act, 2013.

11.1 Definition of a Government company [Section 2(45)]

Government company means any company –

(a) in which not less than 51% of the paid up share capital is held –
- (i) by the Central Government; *or*
- (ii) by any State Government(s); *or*
- (iii) jointly by the Central Government and any State Government(s).

(b) which is a subsidiary of a Government company.

1. The term 'paid up share capital' means the aggregate of paid up equity share capital and paid up preference share capital.
2. For the purposes of section 2(45), the term "paid-up share capital" shall be construed as "total voting power", where shares with differential voting rights have been issued [Notification No. G.S.R. 463(E) dated 5th June, 2015].

Theoretical Questions from CA Examinations

Q 11.1A. What is a Government company? [CA (Final) May 1985]

Practical Problems from CA Examinations

To decide whether companies in question are Government companies?

P 11.1A.

(i) Central Government and Government of Maharashtra together hold 40% of the paid-up share capital of MN Limited. A Government company also holds 20% of the paid-up share capital in MN Limited.

(ii) PQ Limited is a subsidiary but not a wholly owned subsidiary of a Government company.

Examine with reference to the provisions of the Companies Act, 2013 whether MN Limited and PQ Limited can be considered as Government Companies. [CA (Final) May 2016]

Ans.

A company shall be a Government company if it satisfies any of the following 2 conditions:

(a) It is a subsidiary company of a Government company.

(b) 51% or more of its paid up share capital is held –

(i) by the Central Government; or

(ii) by any State Government(s); or

(iii) jointly by the Central Government and any State Government(s).

The given cases are discussed as under:

(i) A Government company holds only 20% of the paid up share capital of MN Limited. As per section 2(87), a company shall be a subsidiary of another company if more than 50% of its paid up share capital is held by such other company. Since only 20% of the paid up share capital of MN Limited is held by a Government company, MN Limited is not a subsidiary of any Government company.

The Central Government and a State Government (viz. Government of Maharashtra) together hold 40% of the paid up share capital of MN Limited which is less than the required 51% for being a Government company. For this purpose, the shares held by any Government company are not to be considered.

Conclusion: MN limited is not a government company since it is neither a subsidiary of any Government company nor 51% or more of its paid up share capital is held by the Central Government or one or more State Governments or jointly by the Central Government and one or more State Governments.

(ii) Since PQ Limited is a subsidiary of a Government company, it shall be considered as a Government company. For being a Government company, there is no requirement that it has to be a wholly owned subsidiary.

11.2 Annual report of a Government company (Section 394)

1. Duties of the Central Government

(a) Where the Central Government is a member of a Government company, it shall cause to be prepared an annual report on the working and affairs of that Government company.

(b) The annual report shall be prepared within 3 months of the AGM of that Government company.

(c) The Central Government shall lay before both the Houses of Parliament –

(i) a copy of the annual report;

(ii) a copy of the audit report; and

(iii) comments upon or supplement to the audit report, made by CAG.

2. Duties of the Central Government and the State Government

(a) Where the Central Government as well as any State Government is a member of a Government company, the Central Government shall cause to be prepared an annual report on the working and affairs of that Government company.

(b) The annual report shall be prepared within 3 months of the AGM of that Government company.

(c) The Central Government shall lay before both the Houses of Parliament, and the State Government shall lay before the House or both the Houses of the State Legislature –

(i) a copy of the annual report;

(ii) a copy of the audit report; and

(iii) comments upon or supplement to the audit report, made by CAG.

3. **Applicability of Section 394**

The provisions of section 394 shall, so far as may be, apply to a Government company in liquidation as they apply to any other Government company.

11.3 Annual report where one or more State Governments are members of a Government company (Section 395)

1. **Duties of the State Government**

(a) Where the Central Government is not a member of a Government company, every State Government which is a member of that company, or where only one State Government is a member of the company, that State Government shall cause to be prepared an annual report on the working and affairs of that Government company.

(b) The annual report shall be prepared within 3 months of the AGM of that Government company.

(c) The State Government(s) shall lay before the House or both Houses of the State Legislature –

(i) a copy of the annual report;

(ii) a copy of the audit report; and

(iii) comments upon or supplement to the audit report, made by CAG.

2. **Applicability of Section 395**

The provisions of section 395 shall, so far as may be, apply to a Government company in liquidation as they apply to any other Government company.

Theoretical Questions from CA Examinations

Q 11.2A. Explain the provisions of the Companies Act, 2013 relating to the preparation of annual report of a Government company.

[CA (Final) Nov. 1997 (Modified)]

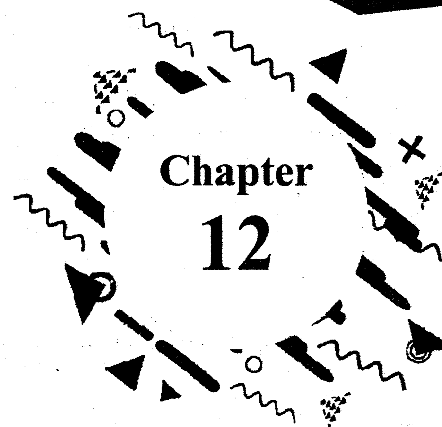
Q 11.2B. Discuss the provisions relating to annual reports of Government Companies –

(i) Where in addition to the Central Government, any State Government is a member of the company.

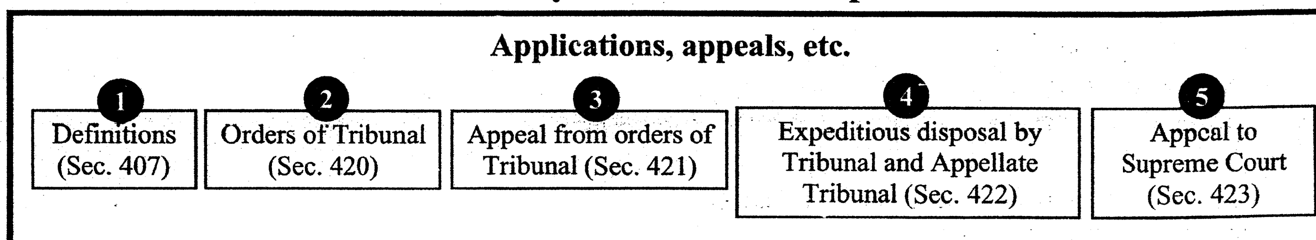
(ii) Where the Central Government is not a member of the Government Company. [CA (Final) Nov. 2016]

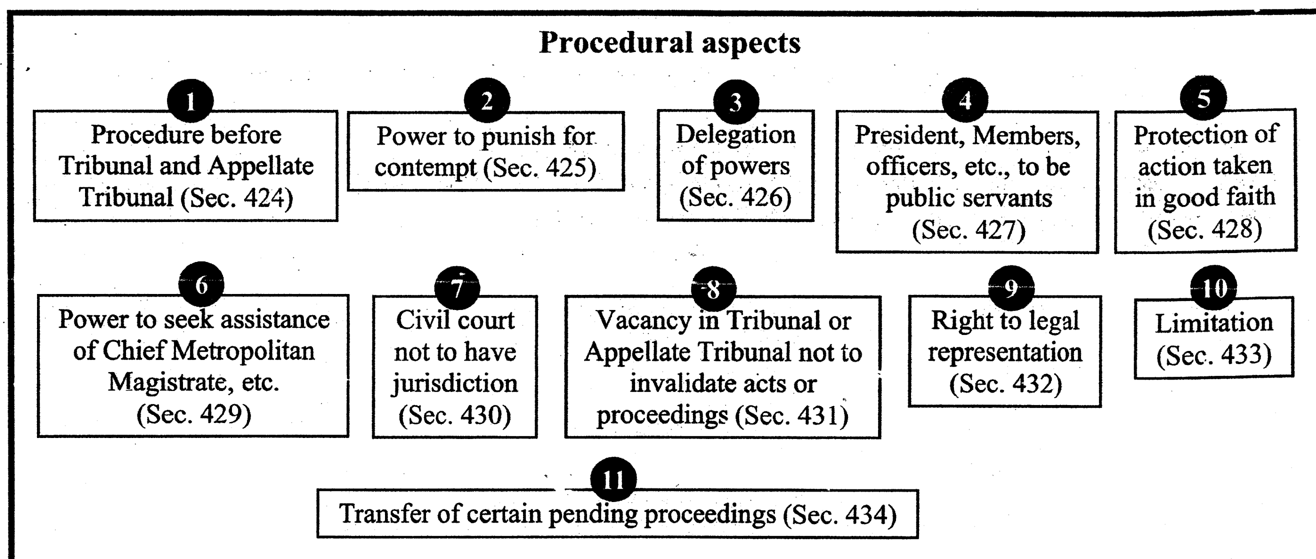
National Company Law Tribunal and Appellate Tribunal

(Chapter XXVII of the Companies Act, 2013 consisting of Sections 407 to 434)



Bird's eye-view of the Chapter





Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, any reference to any section means reference to the sections of the Companies Act, 2013.

3. Sections 408 to 419 have been excluded from the Syllabus vide ICAI Announcements dated 24th June 2019, 3rd July, 2019, 9th July 2019, 22nd July, 2019 and 15th July 2020, and therefore, these sections have not been included in this Book.

12.1 Definitions (Section 407)

1. **Chairperson**

   "Chairperson" means the Chairperson of the Appellate Tribunal.

2. **Judicial Member**

   "Judicial Member" means a member of the Tribunal or the Appellate Tribunal appointed as such and includes the President or the Chairperson, as the case may be.

3. **Member**

   "Member" means a member, whether Judicial or Technical of the Tribunal or the Appellate Tribunal and includes the President or the Chairperson, as the case may be.

4. **President**

   "President" means the President of the Tribunal.

5. **Technical Member**

   "Technical Member" means a member of the Tribunal or the Appellate Tribunal appointed as such.

12.2 Orders of Tribunal (Section 420)

1. **Order, only after SCN**

   The Tribunal may, after giving the parties to any proceeding before it, a reasonable opportunity of being heard, pass such orders thereon as it thinks fit.

2. **Amendment of order of Tribunal**

   (i) If the Tribunal is of the opinion that any order passed by it contains a mistake apparent from record, it may, with a view to rectify such mistake, amend any order passed by it –

   - *suo motu*; or
   - when such mistake is brought to its notice by any of the parties.

   (ii) Such order may be passed by the Tribunal at anytime but within 2 years from the date of the order.

   (iii) However, the Tribunal shall not amend any order against which an appeal has been preferred under this Act.

3. **Copies of order to be sent to the parties**

   The Tribunal shall send a copy of every order passed by it to all the parties concerned.

12.3 Appeal against orders of Tribunal (Section 421)

1. **Appeal against order of the Tribunal**

   Any person aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal.

2. **No appeal in certain cases**

   Where an order is made by the Tribunal with the consent of the parties, no party shall have a right to prefer an appeal to the Appellate Tribunal.

3. **Time limit for filing appeal**

   (a) Every appeal before the Appellate Tribunal shall be filed within 45 days from the date on which a copy of the order of the Tribunal is made available to the person aggrieved.

   (b) However, the Appellate Tribunal may entertain an appeal after the expiry of the said period of 45 days but within a further period not exceeding 45 days, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within that period.

4. **Form and fees**
   The appeal shall be in such form, and accompanied by such fees, as may be prescribed.
5. **Orders of the Appellate Tribunal**
   On the receipt of an appeal, the Appellate Tribunal shall, after giving the parties to the appeal a reasonable opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
6. **Copies of order to be sent to parties**
   The Appellate Tribunal shall send a copy of the order to the Tribunal and the parties to appeal.

Practical Problems from CA Examinations

Whether an appeal preferred on 5th December, 2017 against an order of Tribunal passed on 5th October, 2017 is admissible?

P 12.3A. JSK, a shareholder of CRI (Private) Ltd. filed an application before erstwhile Company Law Board, alleging various acts of oppression and mis-management in the affairs of the Company and sought certain relief measures. The petition was transferred to NCLT on its constitution. The NCLT passed an order on 5th October, 2017 without the consent of the parties. Aggrieved by the order, the shareholder decided to prefer an appeal. Nevertheless the shareholder was suffering from low blood pressure. He was medically advised not to move and he did not move. Therefore, he preferred the appeal with NCLAT on 5th December, 2017. Examine whether the appeal is admissible with reference to time limitation?

Identify the provisions governing further appeal on the orders of NCLAT under Section 423 of the Companies Act, 2013.

[CA (Final) May 2018]

Ans. The given problem relates to section 421 read with section 434 and section 423 of the Companies Act, 2013, as discussed below:

The legal position

1. As per section 434, all such proceedings or cases as were pending before the Company Law Board shall stand transferred to the Tribunal, and the Tribunal shall dispose of such proceedings or cases.
2. Section 421 contains the provisions with respect to appeals against the orders of Tribunal, as explained below:
   (a) Any person who is aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal.
   (b) However, no appeal can be preferred to the Appellate Tribunal against an order of Tribunal passed with the consent of the parties.
   (c) The appeal may be preferred within 45 days of receipt of order of the Tribunal.
   (d) The Appellate Tribunal is empowered to grant extension of time for preferring the appeal. However, such extension shall not exceed 45 days. The extension may be granted only if there was sufficient cause for not preferring the appeal within 45 days of receipt of order passed by the Tribunal.

The given case and analysis of the case

3. The Tribunal passed its order on 5th October, 2017.
4. In the absence of any information, assuming that the copy of the order was received by Mr. JSK on the same day, *i.e.* 5th October, 2017, the last date (without extension of time) for filing the appeal was 19th November, 2017.
5. As Mr. JSK was medically advised not to exert himself and was advised to take rest, he could not prefer the appeal till 19th November, 2017.
6. Generally, where a party is medically unfit and is advised not to move, it is considered to be a 'sufficient cause' for the purpose of granting extension of time. Assuming that the Appellate Tribunal also considers that there was a sufficient cause for Mr. JSK for not preferring the appeal upto 19th November, 2017, the Appellate Tribunal may grant extension of time upto a maximum of 45 days. The last date (considering extension of time of 45 days) for filing the appeal is 3rd January, 2018.
7. Mr. JSK preferred the appeal on 5th December, 2017, *i.e.* before the last date for preferring the appeal (with extension).

Conclusion

8. The appeal preferred on 5th December, 2017 by Mr. JSK with the Appellate Tribunal against the order of the Tribunal has been preferred within the time limit specified under section 421, and is therefore admissible.
9. Section 423 contains the provisions with respect to appeals against the orders of the Appellate Tribunal, as explained below:
   (a) Any person aggrieved by an order passed by the Appellate Tribunal may prefer an appeal to the Supreme Court.

(b) The appeal may be preferred within 60 days from the date of receipt of the order of the Appellate Tribunal to him. However, if the Supreme Court is satisfied that the appellant was prevented by sufficient cause from preferring the appeal within the said period of 60 days, it may allow the appeal to be preferred within a further period not exceeding 60 days.

(c) The appeal may be preferred only on a question of law arising out of the order of the Appellate Tribunal.

Whether an appeal preferred on 25th June, 2018 against an order of the Tribunal passed on 5th May, 2018 is admissible?

P 12.3B. Aggrieved by an order of NCLT dated 05.05.2018, passed without the consent of the parties, Madhruk Ltd. decided to file an appeal before NCLAT. Meanwhile, the employees and officers of the company went on a strike from 10.05.2018 demanding higher pay and allowances and as a result of which, the operational and management activities were badly affected. The strike was called-off on 15.06.2018. Thereafter, the appeal was filed on 25.06.2018 before NCLAT with a prayer for condoning the delay in filing the appeal. A single judicial member of NCLT started the hearing. With reference to the provisions of the Companies Act, 2013, examine the following.

(i) Whether the appeal is admissible?

(ii) Maximum period allowed for condonation

(iii) Is the appeal transferable to a Bench consisting of two members? **[CA (Final) Nov. 2018]**

Ans. The given problem relates to sections 421 and 419 of the Companies Act, 2013, as discussed below:

The legal position

1. Section 421 contains the provisions with respect to appeals against the orders of the Tribunal, as explained below:
   (a) Any person who is aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal.
   (b) However, no appeal can be preferred to the Appellate Tribunal against an order of the Tribunal passed with the consent of the parties.
   (c) The appeal may be preferred within 45 days of receipt of order of the Tribunal.
   (d) The Appellate Tribunal is empowered to grant extension of time for preferring the appeal. However, such extension shall not exceed 45 days. The extension may be granted only if there was sufficient cause for not preferring the appeal within 45 days of receipt of order passed by the Tribunal.
2. Section 419 contains the provisions with respect to Benches of Tribunal, as explained below:
   (a) It shall be competent for the Members of the Tribunal authorised in this behalf to function as a Bench consisting of a single Judicial Member and exercise the powers of the Tribunal in respect of such class of cases or such matters pertaining to such class of cases, as the President may, by general or special order, specify.
   (b) If at any stage of the hearing of such case or matter, it appears to the Member that the case or matter is of such a nature that it ought to be heard by a Bench consisting of 2 Members, the case or matter may be transferred by the President, or, as the case may be, referred to him for transfer, to such Bench as the President may deem fit.

The given case and analysis of the case

3. The Tribunal passed its order on 5th May, 2018.
4. In the absence of any information, assuming that the copy of the order was received by Madhruk Ltd. on the same day, *i.e.* 5th May, 2018, the last date (without extension of time) for filing the appeal was 19th June, 2018.
5. The employees and officers of the company were on strike from 10.05.2018 to 15.06.2018, as a result of which, the operational and management activities were badly affected, and consequently, Madhruk Ltd. could not prefer the appeal till 19th June, 2018.
6. Generally, where a party is unable to prefer an appeal by reason of circumstances beyond its control, like 'strike' in the given case, it is considered to be a 'sufficient cause' for the purpose of granting extension of time. Assuming that the Appellate Tribunal also considers that there was a sufficient cause for Madhruk Ltd. for not preferring the appeal upto 19th June, 2018, the Appellate Tribunal may grant extension of time upto a maximum of 45 days. The last date (considering extension of time of 45 days) for filing the appeal is 3rd August, 2018.
7. Madhruk Ltd. preferred the appeal on 25th June, 2018, *i.e.* before the last date for preferring the appeal (with extension).

Conclusions

(i) The appeal preferred on 25th June, 2018 by Madhruk Ltd. with the Appellate Tribunal against the order of the Tribunal has been preferred within the time limit specified under section 421, and is therefore admissible.

(ii) The Appellate Tribunal is empowered to condone the delay in filing the appeal, but such period shall not exceed 45 days.

(iii) As per section 419, the Members of the Tribunal are authorised to function as a Bench consisting of a single Judicial Member, subject to the condition that if at any stage of hearing of a case, it appears to the Member that the case is of such a nature that it ought to be heard by a Bench consisting of 2 Members, the case may be transferred by the President, or, as the case may be, referred to him for transfer, to such Bench as the President may deem fit.

However, the Companies Act, 2013 does not contain any provision with respect to transfer of appeal from one Bench of Appellate Tribunal to another Bench of Appellate Tribunal. Thus, it is not possible to transfer an appeal to a Bench consisting of 2 members.

Tutorial Note:

The question clearly states that an order was passed by NCLT and the aggrieved party has preferred an appeal before NCLAT against the order of NCLT. Therefore, use of the words "A single judicial member of NCLT started the hearing." in this question appears to be incorrect.

Further, answer given in the Suggested Answers issued by ICAI with respect to (iii) (*i.e.* Is the appeal transferable to a Bench consisting of two members?) differs from the answer given by the Author of this Book. In the Suggested Answers, ICAI has reproduced the bare text of section 419, but ICAI has not answered as to whether the appeal can be transferred to a Bench consisting of 2 members.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

Whether an appeal preferred on 25th June, 2018 against an order of the Tribunal passed on 5th May, 2018 is admissible?

P 12.3C. Aggrieved by an order of Hon'ble NCLT, dated 3rd April, 2018, passed without the consent of parties, Solan Minerals Limited decided to file an appeal before Hon'ble NCLAT. The order was received by the company on 4th April, 2018. The employees and officers went on a strike for a period of 10 days from 22nd May, 2018 demanding higher bonus and pay. In view of this, the management of the company was forced to a grinding halt during the strike period. Thereafter, the appeal was filed on 6th June, 2018 before the Hon'ble NCLAT and the company prayed for condonation of delay. Referring to and analysing the applicable provisions of the Companies Act, 2013, decide the following:

(i) Whether the proposed appeal would be admitted by the Hon'ble NCLAT.

(ii) What is the maximum period allowed by the NCLAT for condonation of delay? [CA (Final) May 2019]

Ans. The given problem relates to section 421 of the Companies Act, 2013, as discussed below:

The legal position

1. Section 421 contains the provisions with respect to appeals against the orders of the Tribunal, as explained below:
   (a) Any person who is aggrieved by an order of the Tribunal may prefer an appeal to the Appellate Tribunal.
   (b) However, no appeal can be preferred to the Appellate Tribunal against an order of the Tribunal passed with the consent of the parties.
   (c) The appeal may be preferred within 45 days of receipt of order of the Tribunal.
   (d) The Appellate Tribunal is empowered to grant extension of time for preferring the appeal. However, such extension shall not exceed 45 days. The extension may be granted only if there was sufficient cause for not preferring the appeal within 45 days of receipt of order passed by the Tribunal.

The given case and analysis of the case

2. The Tribunal passed its order on 3rd April, 2018.
3. The copy of the order of the Tribunal was received by Solan Minerals Limited on 4th April, 2018. Thus, the last date (without extension of time) for filing the appeal was 19th May, 2018.
4. The employees and officers of the company were on strike from 22nd May, 2018 to 31st May, 2018, as a result of which, the operational and management activities were halted.
5. Generally, where a party is unable to prefer an appeal by reason of circumstances beyond its control, like 'strike', it is considered to be a 'sufficient cause' for the purpose of granting extension of time. However, in the given case, the employees and officers of Solan Minerals Limited went on strike after the last date for filing the appeal, *i.e.* after 19th May, 2018. Therefore, strike by employees and workers resulting in halting the operational and management activities cannot be considered to be the reason for not filing the appeal upto the last date for filing the appeal. In other words, strike by employees and officers does not amount to 'sufficient cause' for not filing the appeal upto 19th May, 2018.
6. Solan Minerals limited preferred the appeal on 6th June, 2018, *i.e.* after the last date for preferring the appeal (without extension).

Conclusions

(i) The appeal preferred on 6th June, 2018 by Solan Minerals Limited before the Appellate Tribunal (NCLAT) against the order of the Tribunal has not been preferred within the time limit specified under section 421, and in the given facts and circumstances it is not possible for the Appellate Tribunal to be satisfied that there was 'sufficient cause' for not filing the appeal upto 19th May, 2018, and so the appeal shall not be admitted by the Appellate Tribunal.

(ii) The Appellate Tribunal is empowered to condone the delay in filing the appeal if there was sufficient cause for not filing the appeal within 45 days of receipt of order passed by the Tribunal. However, the period of extension shall not exceed 45 days.

12.4 Expeditious disposal by Tribunal and Appellate Tribunal (Section 422)

1. **Time limit for disposal of application or appeal**
   (i) Every application or petition presented before the Tribunal shall be disposed of by it as expeditiously as possible.
   (ii) The Tribunal shall endeavour to dispose of the application or petition within 3 months from the date of such application or petition.
   (iii) Every appeal filed before the Appellate Tribunal shall be disposed of by it as expeditiously as possible.
   (iv) The Appellate Tribunal shall endeavour to dispose of the appeal within 3 months from the date of filing of such appeal.
2. **Extension of time**
   Where any application or petition or appeal could not be disposed of within the said period of 3 months,–
   (i) the Tribunal or the Appellate Tribunal, as the case may be, shall record its reasons in writing for not disposing off the application or petition or appeal within the said period of 3 months; and
   (ii) the President or the Chairperson, as the case may be, may, after taking into account the reasons so recorded, extend the said period of 3 months by such period not exceeding 90 days, as he may consider necessary.

12.5 Appeal to Supreme Court (Section 423)

1. Any person aggrieved by any order of the Appellate Tribunal may file an appeal to the Supreme Court.
2. The appeal may be filed within 60 days from the date of receipt of the order of the Appellate Tribunal to him. However, if the Supreme Court is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period of 60 days, it may allow the appeal to be filed within a further period not exceeding 60 days.
3. The appeal may be filed only on a question of law arising out of the order of the Appellate Tribunal.

12.6 Procedure before Tribunal and Appellate Tribunal (Section 424)

1. **Power to regulate its own procedure**
   While disposing of any proceeding or appeal filed before it, the Tribunal and the Appellate Tribunal –
   (i) shall not be bound by the procedure laid down in the Code of Civil Procedure, 1908;
   (ii) shall be guided by the principles of natural justice;
   (iii) shall have the power to regulate their own procedure; and
   (iv) shall be subject to the provisions of this Act and the Insolvency and Bankruptcy Code, 2016.
2. **Powers of the Tribunal and Appellate Tribunal**
   The Tribunal and the Appellate Tribunal shall have, for the purposes of discharging their functions under this Act or under the Insolvency and Bankruptcy Code, 2016, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters:
   (i) Summoning and enforcing the attendance of any person and examining him on oath.
   (ii) Requiring the discovery and production of documents.
   (iii) Receiving evidence on affidavits.
   (iv) Requisitioning any public record or document or a copy of such record or document from any office.
   (v) Issuing commissions for the examination of witnesses or documents.
   (vi) Dismissing a representation for default or deciding it *ex parte*.
   (vii) Setting aside any order passed by it *ex parte*.
   (viii) Any other matter which may be prescribed.
3. **Enforcement of orders of Tribunal and Appellate Tribunal**
   Any order made by the Tribunal or the Appellate Tribunal may be enforced by that Tribunal in the same manner as if it were a decree made by a Court, and it shall be lawful for the Tribunal or the Appellate Tribunal to send for execution of its orders to the Court within the local limits of whose jurisdiction, –
   (i) in the case of an order against a company, the registered office of the company is situated; or
   (ii) in the case of an order against any other person, the person concerned voluntarily resides or carries on business or personally works for gain.

4. **Proceedings to be deemed as judicial proceedings**

   All proceedings before the Tribunal or the Appellate Tribunal shall be deemed to be judicial proceedings.

12.7 Power to punish for contempt (Section 425)

The Tribunal and the Appellate Tribunal shall have the same jurisdiction, powers and authority in respect of contempt of themselves as the High Court has, and may exercise, for this purpose, the powers under the provisions of the Contempt of Courts Act, 1971.

12.8 Delegation of powers (Section 426)

The Tribunal or the Appellate Tribunal may, by general or special order, direct, subject to such conditions, if any, as may be specified in the order, any of its officers or employees or any other person authorised by it to inquire into any matter connected with any proceeding or, as the case may be, appeal before it and to report to it in such manner as may be specified in the order.

12.9 President, Members, officers, etc., to be public servants (Section 427)

The President, Members, officers and other employees of the Tribunal and the Chairperson, Members, officers and other employees of the Appellate Tribunal shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code.

12.10 Protection of action taken in good faith (Section 428)

No suit, prosecution or other legal proceeding shall lie against –

(a) the Tribunal or the President, Member, officers or employees of the Tribunal; or

(b) the Appellate Tribunal or the Chairperson, Member, officers or employees of the Appellate Tribunal; or

(c) liquidator or any other person authorised by the Tribunal or the Appellate Tribunal

in discharge of any function or carrying out of any act by it or him done in good faith, even if any loss or damage is caused to any person by such act.

12.11 Power to seek assistance of Chief Metropolitan Magistrate, etc. (Section 429)

1. **Power to take the property etc. under its custody and control**

   Section 429 applies where the Tribunal intends to take into its custody or control the properties, books of account or other documents of a company, in any proceedings for winding up of a company –

   (i) under this Act; or

   (ii) under the Insolvency and Bankruptcy Code, 2016.

   Section 429 empowers the Tribunal to make a written request to the Chief Metropolitan Magistrate, Chief Judicial Magistrate or the District Collector within whose jurisdiction any such property, books of account or other documents of such company under this Act or of corporate persons under the Insolvency and Bankruptcy Code, 2016 are situated or found.

   When such a request is made, the Chief Metropolitan Magistrate, Chief Judicial Magistrate or the District Collector, as the case may be, shall, –

   (i) take possession of such property, books of account or other documents; and

   (ii) cause the same to be entrusted to the Tribunal or other person authorized by it.

2. **Manner of taking property etc. under control**

   The Chief Metropolitan Magistrate, Chief Judicial Magistrate or the District Collector may take such steps and use such force as he may deem fit.

3. **Validity of acts of Magistrate**

   No act of the Chief Metropolitan Magistrate, Chief Judicial Magistrate or the District Collector done in pursuance of this section shall be called in question in any Court or before any authority on any ground whatsoever.

12.12 Civil court not to have jurisdiction (Section 430)

The provisions of section 430 are intended to speed up the disposal of the matters to be decided by the Tribunal and the Appellate Tribunal. These provisions are explained hereunder:

(a) No Court shall have the jurisdiction to entertain any suit or proceeding in respect of any matter which the Tribunal or the Appellate Tribunal is empowered to determine.

(b) No Court shall have the jurisdiction to grant an injunction in respect of any action taken or proposed to be taken by the Tribunal or the Appellate Tribunal.

12.13 Vacancy in Tribunal or Appellate Tribunal not to invalidate acts or proceedings (Section 431)

No act or proceeding of the Tribunal or the Appellate Tribunal shall be questioned or shall be invalid merely by reason of –

(a) any vacancy in the Tribunal or the Appellate Tribunal.

(b) any defect in the constitution of the Tribunal or the Appellate Tribunal.

12.14 Right to legal representation (Section 432)

A party to any proceeding or appeal before the Tribunal or the Appellate Tribunal may –

(a) appear in person; or

(b) authorise one or more –

  (i) chartered accountants; or

  (ii) company secretaries; or

  (iii) cost accountants; or

  (iv) legal practitioners; or

  (v) any other person.

12.15 Applicability of the Limitation Act, 1963 (Section 433)

The provisions of the Limitation Act, 1963 shall, as far as may be, apply to proceedings or appeals before the Tribunal or the Appellate Tribunal.

12.16 Transfer of certain pending proceedings (Section 434)

1. **Transfer of proceedings pending before CLB to the Tribunal**

   On such date as may be notified by the Central Government in this behalf, all matters, proceedings or cases pending before the Board of Company Law Administration (hereinafter referred to as the Company Law Board) constituted under section 10E of the Companies Act, 1956, immediately before such date shall stand transferred to the Tribunal and the Tribunal shall dispose of such matters, proceedings or cases in accordance with the provisions of this Act.

2. **Appeal against orders passed by CLB**

   Any person who is aggrieved by any decision or order of the Company Law Board made before such date as may be notified by the Central Government in this behalf, may file an appeal to the High Court within 60 days from the date of communication of the decision or order of the Company Law Board to him on any question of law arising out of such order. However, the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing an appeal within the said period of 60 days, allow it to be filed within a further period not exceeding 60 days.

3. Transfer of proceedings pending before the Courts to the Tribunal

(i) All proceedings under the Companies Act, 1956, including proceedings relating to arbitration, compromise, arrangements and reconstruction and winding up of companies, pending immediately before such date as may be notified by the Central Government in this behalf, before any District Court or High Court, shall stand transferred to the Tribunal and the Tribunal may proceed to deal with such proceedings from the stage before their transfer.

(ii) Only such proceedings relating to the winding up of companies shall be transferred to the Tribunal as are at a stage as may be prescribed by the Central Government.

(iii) Only such proceedings relating to cases other than winding-up, for which orders for allowing or otherwise of the proceedings are not reserved by the High Courts, shall be transferred to the Tribunal.

(iv) All proceedings under the Companies Act, 1956 other than the cases relating to winding up of companies that are reserved for orders for allowing or otherwise such proceedings shall be dealt with in accordance with provisions of the Companies Act, 1956 and the Companies (Court) Rules, 1959.

(v) The proceedings relating to winding up of companies which have not been transferred from the High Courts shall be dealt with in accordance with provisions of the Companies Act, 1956 and the Companies (Court) Rules, 1959.

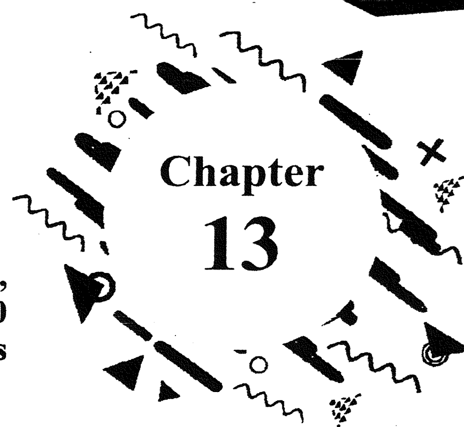
(vi) The proceedings relating to cases of voluntary winding up of a company where notice of the resolution by advertisement has been given under section 485 of the Companies Act, 1956 but the company has not been dissolved before the 1st April, 2017 shall continue to be dealt with in accordance with provisions of the Companies Act, 1956 and the Companies (Court) Rules, 1959.

4. Rules for timely transfer of matters and proceedings to the Tribunal

The Central Government may make rules consistent with the provisions of this Act to ensure timely transfer of all matters, proceedings or cases pending before the Company Law Board or the Courts, to the Tribunal.

Miscellaneous Provisions of the Companies Act, 2013

(Chapter XXVI, XXVIII and XXIX of the Companies Act, 2013 consisting of Sections 406, 435 to 446B and 447 to 470 respectively, the Nidhi Rules, 2014 and the Companies (Miscellaneous) Rules, 2014)



Bird's eye-view of the Chapter

Nidhis

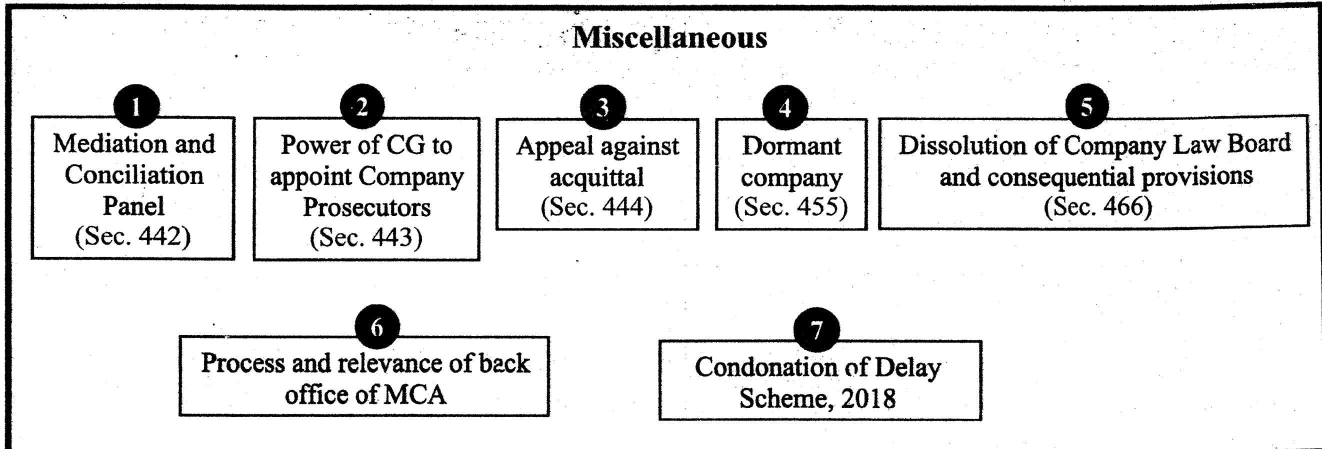
Provision relating to Nidhis and its application, etc. (Sec. 406 and the Nidhi Rules, 2014)

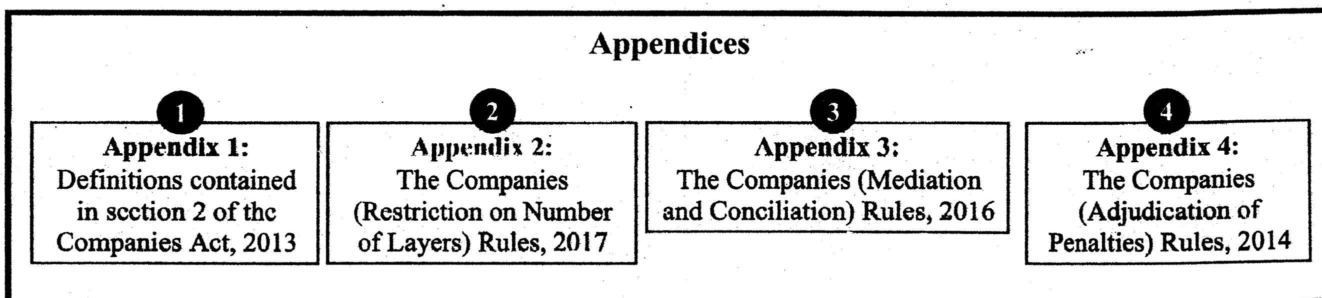
Special Courts

1. Establishment of Special Courts (Sec. 435)
2. Offences triable by Special Courts (Sec. 436)
3. Appeal and revision (Sec. 437)
4. Application of Code to proceedings before Special Court (Sec. 438)
5. Transitional provisions (Sec. 440)

Offences and Penalties

1. Offences to be non cognizable (Sec. 439)
2. Compensation for accusation without reasonable cause (Sec. 445)
3. Application of fines (Sec. 446)
4. Factors for determining level of punishment (Sec. 446A)
5. Lesser penalties for One Person Companies or small companies (Sec. 446B)
6. Punishment for fraud (Sec. 447)
7. Punishment where no specific penalty or punishment is provided (Sec. 450)
8. Adjudication of penalties (Sec. 454)
9. Penalty for repeated default (Sec. 454A)





Bird's eye-view of the Nidhi Rules, 2014

Rule No.	Marginal Heading
1	Short title and commencement
2	Application
3	Definitions
3A	Declaration of Nidhis
4	Incorporation and incidental matters
5	Requirements for minimum number of members, net owned fund etc.
6	General restrictions or prohibitions
7	Share capital and allotment
8	Membership
9	Net owned funds
10	Branches
11	Acceptance of deposits by Nidhis
12	Application form for deposit
13	Deposits
14	Un-encumbered term deposits
15	Loans

16	Rate of interest
17	Rules relating to Directors
18	Dividend
19	Auditor
20	Prudential norms
21	Filing of half yearly return
22	Auditor's certificate
23	Power to enforce compliance
23A	Compliance with Rule 3A by certain Nidhis
23B	Companies declared as Nidhis under previous company law to file Form NDH-4
24	Penalty for non-compliance

Bird's eye-view of the Companies (Miscellaneous) Rules, 2014

Rule No.	Marginal Heading
1	Short title and commencement
2	Definitions
3	Application for obtaining status of dormant company
4	Certificate of status of dormant company
5	Register of dormant companies
6	Minimum number of directors for dormant company
7	Return of dormant companies
8	Application for seeking status of an active company
9	Fees for application to Central Government
10	Association or partnership of persons exceeding certain number
11	Applications or forms pending before Central Government, Regional Director or Registrar of Companies

Bird's eye-view of the Forms prescribed under the Nidhi Rules, 2014

Form No.	Description of E-Form (Purpose of E-Form)	Relevant Section	Relevant Rule
NDH-1	Return of Statutory Compliances	406	5
NDH-2	Application for extension of time	406	5
NDH-3	Return of Nidhi company for the half year ended	406	21
NDH-4	Form for filling application for declaration as Nidhi Company and for updation status by Nidhis	406	3A, 23A and 23B

Bird's eye-view of the Forms prescribed under the Companies (Miscellaneous) Rules, 2014

Form No.	Description of E-Form (Purpose of E-Form)	Relevant Section	Relevant Rule
MSC-1	Application to Registrar for obtaining the status of dormant company	455	3
MSC-2	Certificate of status of a Dormant Company	455	4
MSC-3	Return of dormant companies	455	7 and 8
MSC-4	Application for seeking status of active company	455	8
MSC-5	Certificate of status of an active company	455	8

Notes:

1. Students may refer to Appendix 15 which contains the Arrangement of Sections in chronological order. Appendices have been given at the end of this Book.
2. In this Chapter, unless otherwise specified, any reference to any section means reference to the sections of the Companies Act, 2013.
3. Sections 405, 441, 448, 449, 451 to 453 and 456 to 470 have been excluded from the Syllabus vide ICAI Announcements dated 24th June 2019, 3rd July, 2019, 9th July 2019, 22nd July, 2019 and 15th July 2020, and therefore, these sections have not been included in this Book.

13.1 Provision relating to Nidhis and its application, etc. (Section 406)

(A) Provisions contained section 406 of the Act.

1. **Definition of 'Nidhi' or 'Mutual Benefit Society'**

   'Nidhi' or 'Mutual Benefit Society' means a company which the Central Government may, by notification in the Official Gazette, declare to be a Nidhi or Mutual Benefit Society, as the case may be.

2. **Exemptions to Nidhi or Mutual Benefit Society**

   The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act specified in the notification –

   (a) shall not apply to any Nidhi or Mutual Benefit Society; or

   (b) shall apply to any Nidhi or Mutual Benefit Society with such exceptions, modifications and adaptations as may be specified in the notification.

   1. Where any such notification is proposed to be issued, a copy of such notification shall be laid in draft before each House of Parliament, while it is in session, for a total period of 30 days, and if, both Houses agree in disapproving the issue of notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses.
   2. In reckoning any such period of 30 days, no account shall be taken of any period during which any House of the Parliament is prorogued or adjourned for more than 4 consecutive days.
   3. The copies of every notification issued under this section shall, as soon as may be after it has been issued, be laid before each House of Parliament.

(B) Provisions contained in the Nidhi Rules, 2014.

1. **Definition of 'Nidhi' [Rule 3(1)(da)]**

   "Nidhi" means a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit, and which complies with the rules made by the Central Government for regulation of such class of companies.

2. Application (Rule 2)

These rules shall apply to, –

(a) every company which had been declared as a Nidhi or Mutual Benefit Society under section 620A of the Companies Act, 1956;

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

(c) every company incorporated as a Nidhi pursuant to the provisions of section 406 of the Companies Act, 2013; and

(d) every company declared as Nidhi or Mutual Benefit Society under section 406 of the Companies Act, 2013.

3. Declaration of Nidhis (Rule 3A of the Nidhi Rules, 2014)

(a) The Central Government, on receipt of application (in Form NDH-4 along with fee thereon) of a public company for declaring it as Nidhi and on being satisfied that the company meets the requirements under these rules, shall notify the company as a Nidhi in the Official Gazette.

(b) A Nidhi incorporated under the Act on or after the commencement of the Nidhi (Amendment) Rules, 2019 shall file Form NDH-4 within 60 days from the date of expiry of –

(i) one year from the date of its incorporation; or

(ii) the period up to which extension of time has been granted by the Regional Director under Rule 5(3).

(c) If a company does not comply with the requirements of this rule, it shall not be allowed to file Form No. SH-7 (Notice to Registrar of any alteration of share capital) and Form PAS-3 (Return of Allotment).

4. Compliance with Rule 3A by certain Nidhis (Rule 23A)

(a) Following companies shall also get themselves declared as Nidhi in accordance with Rule 3A within a period of 1 year from the date of incorporation or within a period of 9 months from the date of commencement of Nidhi (Amendment) Rules, 2019 (*i.e.* within 9 months of 15th August, 2019), whichever is later:

(i) Every company functioning on the lines of a Nidhi company or Mutual Benefit Society but has either not applied for or has applied for and is awaiting notification to be a Nidhi or Mutual Benefit Society under section 620A of the Companies Act, 1956.

(ii) Every Nidhi incorporated under the Act, before the commencement of Nidhi (Amendment) Rules, 2019.

(b) If a company does not comply with the requirements of Rule 23A, it shall not be allowed to file Form No. SH-7 (Notice to Registrar of any alteration of share capital) and Form PAS-3 (Return of Allotment).

5. Companies declared as Nidhis under previous company law to file Form NDH-4 (Rule 23B)

(a) Every company which had been declared as a Nidhi or Mutual Benefit Society under section 620A of the Companies Act, 1956 shall file Form NDH-4 along with prescribed fees for updating its status.

(b) However, no fees shall be charged under this rule for filing Form NDH-4, in case it is filed within 9 months of the commencement of Nidhi (Amendment) Rules, 2019.

(c) If a company does not comply with the requirements of this rule, it shall not be allowed to file Form No. SH-7 (Notice to Registrar of any alteration of share capital) and Form PAS-3 (Return of Allotment).

6. Incorporation and incidental matters (Rule 4)

(a) A Nidhi shall be a public company. It shall have a minimum paid up equity share capital of Rs. 5 lakh.

(b) No Nidhi shall issue any preference shares.

(c) Any preference shares issued by a Nidhi before the commencement of the Companies Act, 2013, shall be redeemed in accordance with the terms of issue of such shares.

(d) No Nidhi shall have any object in its Memorandum of Association other than the object of cultivating the habit of thrift and savings amongst its members, receiving deposits only from its members, and lending only to its members, for their mutual benefit.

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

7. **Requirements with respect to minimum number of members, net owned fund etc. (Rule 5)**

As per Rule 5(1), every Nidhi shall, before the close of the first financial year after its incorporation, ensure that it has –

(a) not less than 200 members;

(b) unencumbered term deposits of not less than 10% of the outstanding deposits as specified in rule 14;

Un-encumbered term deposits [Rule 14]

Every Nidhi shall invest and continue to keep invested, in unencumbered term deposits with a Scheduled commercial bank (other than a co-operative bank or a regional rural bank), or post office deposits in its own name an amount which shall not be less than 10% of the deposits outstanding at the close of business on the last working day of the 2nd preceding month:

Provided that in cases of unforeseen commitments, temporary withdrawal may be permitted with the prior approval of the Regional Director for the purpose of repayment to depositors, subject to such conditions and time limit which may be specified by the Regional Director to ensure restoration of the prescribed limit of 10%.

(c) Net Owned Funds of Rs. 10 lakh or more; and

(d) ratio of Net Owned Funds to deposits of not more than 1:20.

Application by Nidhi to the Regional director for extension of time [Rule 5(3)]

If a Nidhi is not complying with point (a) or (d) as above, it shall, within 30 days from the close of the first financial year, apply to the Regional Director in Form NDH-2 along with **prescribed fees** for **extension** of time and the Regional Director may consider the application and pass orders within 30 days of receipt of the application. The Regional Director may extend the period upto 1 year from the date of receipt of application.

Consequences of default [Rule 5(4)]

If the failure to comply with Rule 5(1) extends beyond the second financial year, Nidhi shall not accept any further deposits from the commencement of the second financial year till it complies with the provisions contained in Rule 5(1) and gets itself declared as a Nidhi by the Central Government under section 406, besides being liable for penal consequences as provided in the Act.

8. **Filing of return of statutory compliances [Rule 5(2)]**

Within 90 days from the close of the first financial year after its incorporation and where applicable, the second financial year, Nidhi shall file with the Registrar a return of statutory compliances in Form NDH-1 along with prescribed fees. Such return shall be duly certified by a company secretary in practice or a chartered accountant in practice or a cost accountant in practice.

9. **General restrictions or prohibitions (Rule 6)**

(a) No Nidhi shall carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any body corporate.

(b) No Nidhi shall issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever.

(c) No Nidhi shall open any current account with its members.

(d) No Nidhi shall acquire another company by purchase of securities, or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management, unless it has passed a special resolution in its general meeting and also obtained the previous approval of the Regional Director having jurisdiction over such Nidhi.

(e) No Nidhi shall carry on any business other than the business of borrowing or lending in its own name.

(f) No Nidhi shall accept deposits from or lend to any person, other than its members.

(g) No Nidhi shall pledge any of the assets lodged by its members as security.

(h) No Nidhi shall take deposits from or lend money to any body corporate.

(i) No Nidhi shall enter into any partnership arrangement in its borrowing or lending activities.

(j) No Nidhi shall issue or cause to be issued any advertisement in any form for soliciting deposit.

Private circulation of the details of fixed deposit schemes among the members of the Nidhi carrying the words 'for private circulation to members only' shall not be considered to be an advertisement for soliciting deposits.

(k) No Nidhi shall pay any brokerage or incentive for mobilising deposits from members or for deployment of funds or for granting loans.

A Nidhi which has complied with all the provisions of these rules may provide locker facilities on rent to its members subject to the condition that the rental income from such facilities shall not exceed 20% of the gross income of the Nidhi at any point of time during a financial year.

10. Share capital and allotment (Rule 7)

(a) Every Nidhi shall issue fully paid up equity shares of the nominal value of not less than Rs. 10 each.

This requirement shall not apply to –

(a) a company which had been declared as a Nidhi or Mutual Benefit Society under section 620A of the Companies Act, 1956;

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

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

(c) Every Nidhi shall allot to each deposit holder at least a minimum of 10 equity shares or shares equivalent to Rs. 100.

A savings account holder and a recurring deposit account holder shall hold at least 1 equity share of Rs. 10.

11. Membership (Rule 8)

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

(b) Except as otherwise permitted under these rules, every Nidhi shall ensure that its membership is not reduced to less than 200 members at any time.

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

Deposits may be accepted in the name of a minor, if they are made by the natural or legal guardian who is a member of Nidhi.

12. Net Owned Funds (Rule 9)

Every Nidhi shall maintain Net Owned Funds of not less than Rs. 10 lakh or such higher amount as the Central Government may specify from time to time.

13. Provisions relating to Directors (Rule 17)

(a) The Director shall be a member of Nidhi.

(b) The Director of a Nidhi shall hold office for a term upto 10 consecutive years.

(c) The Director shall be eligible for re-appointment only after the expiration of 2 years of ceasing to be a Director.

(d) Where the tenure of any Director in any case had already been extended by the Central Government, it shall terminate on expiry of such extended tenure.

(e) The provisions of section 152(4) and section 164 shall apply to the Directors of Nidhi.

14. Dividend (Rule 18)

A Nidhi shall not declare dividend exceeding 25%. However, the amount of dividend may exceed 25% if all the following conditions are satisfied:

(a) Such higher amount is specifically approved by the Regional Director for reasons to be recorded in writing.

(b) An equal amount is transferred to the General Reserve.

(c) There has been no default in repayment of matured deposits and interest.

(d) Nidhi has complied with all the rules as are applicable to Nidhis.

15. Auditor (Rule 19)

(a) No Nidhi shall appoint or re-appoint an individual as auditor for more than one term of 5 consecutive years.

(b) No Nidhi shall appoint or re-appoint an audit firm as auditor for more than 2 terms of 5 consecutive years.

An auditor (whether an individual or an audit firm) shall be eligible for subsequent appointment after the expiration of 2 years from the completion of his or its term.

(c) In case of an auditor (whether an individual or audit firm), the period for which he or it has been holding office as auditor prior to the commencement of these rules shall be taken into account in calculating the period of 5 consecutive years or 10 consecutive years, as the case may be.

For the purpose of Rule 19, 'appointment' includes 're-appointment'.

16. Auditor's certificate (Rule 22)

(a) The Auditor of Nidhi shall furnish a certificate every year to the effect that the Nidhi has complied with all the provisions contained in the rules.

(b) Such certificate shall be annexed to the audit report.

(c) In case of non-compliance by Nidhi of any of the provisions of these rules, the auditor shall specifically state the rules which have not been complied with.

17. Penalty for non-compliance (Rule 24)

If a Nidhi contravenes any of the provisions of these rules, the Nidhi and every officer of Nidhi who is in default shall be punishable with fine which may extend to Rs. 5,000, and where the contravention is a continuing one, with a further fine which may extend to Rs. 500 for every day after the first during which the contravention continues.

Practical Problems from CA Examinations

Whether a Nidhi can issue preference shares, declare dividend @ 45%, admit a minor as a member, etc.?

P 13.1A. M/s Kashi Mutual Benefits Nidhi Ltd. is incorporated as a Nidhi Company under the Companies Act, 2013. The Board of directors of the company seeks your advice on the following issues as per the provisions of the Companies Act, 2013 read with rules. Advise

(i) The Board of Directors is planning to issue preference shares.

(ii) The Board of Directors have decided to provide Locker Facilities on rent to its members and have estimated that rental income from such letting will be around 30% of the gross income of the company.

(iii) The Board of Directors of the company is planning to declare dividend for the current year at 45%.

(iv) The Board of Directors of the company have decided to appoint Mr. Prince (a minor) as a member of the company.

[CA (Final) May 2018]

Ans. The given problem relates to section 406 of the Companies Act, 2013 read with Nidhi Rules, 2014, as discussed below:

(i) As per Rule 4, no Nidhi shall issue any preference shares. Also, Rule 6 prohibits a Nidhi from issuing preference shares, debentures or any other debt instrument by any name or in any form whatsoever. Thus, the decision of the Board of directors to issue the preference shares is not valid.

(ii) As per Rule 6, a Nidhi which has complied with all the provisions of the Nidhi Rules, 2014 may provide locker facilities on rent to its members subject to the condition that the rental income from such facilities shall not exceed 20% of the gross income of the Nidhi at any point of time during a financial year. In the given case, the rental income from letting out the lockers is estimated to be 30% of gross income of Nidhi. Since, the estimated rental income will exceed the permitted limit of 20%, the decision of the Board is not valid.

(iii) As per Rule 18, a Nidhi shall not declare dividend exceeding 25%. However, the amount of dividend may exceed 25% if all the following conditions are satisfied:

(a) Such higher amount is specifically approved by the Regional Director for reasons to be recorded in writing.

(b) An equal amount is transferred to the General Reserve.

(c) There has been no default in repayment of matured deposits and interest.

(d) Nidhi has complied with all the rules as applicable to Nidhis.

So, the decision to declare a dividend of 45% shall be valid, if all the above conditions are satisfied.

(iv) As per Rule 8, a minor shall not be admitted as a member of Nidhi. However, a Nidhi may accept deposits in the name of a minor, if such deposits are made by the natural or legal guardian who is a member of Nidhi. So, the decision of the Board to admit Mr. Prince, a minor, as a member of Nidhi is not valid.

Whether a director who has completed a term of 10 consecutive years can be reappointed and whether a Nidhi can pay dividend at the rate of 45%?

P 13.1B. Akri Nidhi Limited proposes:

(i) To reappoint Mr. X, a director who has completed a term of 10 consecutive years as director of the Nidhi.

(ii) To pay dividend at the rate of 45%.

Examine and analyse the validity of the above proposals with reference to Nidhi Rules, 2014 formulated under Companies Act, 2013. [CA (Final) May 2019]

Ans. The given problem relates to section 406 of the Companies Act, 2013 read with Nidhi Rules, 2014, as discussed below:

(i) As per Rule 17, –

(a) a director of a Nidhi shall hold office for a term up to 10 consecutive years; and

(b) the director shall be eligible for re-appointment only after the expiration of 2 years of ceasing to be a director.

Mr. X has completed his tenure of 10 consecutive years as a director of Akri Nidhi Limited. Since the maximum period for which a person can hold office as a director is 10 years, and Mr. X has completed such period, he is not eligible for reappointment as a director for a period of 2 years from the date of cessation of his directorship. *In other words*, Mr. X may be reappointed as a director only after the expiry of 2 years of cessation of his directorship.

(ii) As per Rule 18, a Nidhi shall not declare dividend exceeding 25%. However, the amount of dividend may exceed 25% if all the following conditions are satisfied:

(a) Such higher amount is specifically approved by the Regional Director for reasons to be recorded in writing.

(b) An equal amount is transferred to the General Reserve.

(c) There has been no default in repayment of matured deposits and interest.

(d) Nidhi has complied with all the rules as applicable to Nidhis.

So, the decision of Akri Nidhi Limited to pay a dividend of 45% shall be valid, if all the above conditions are satisfied.

13.2 Special Courts (Sections 435 to 438, and section 440)

1. Establishment of Special Courts (Section 435)

(a) The Central Government may, by notification, establish or designate as many Special Courts as may be necessary.

The purpose of establishing Special Courts is to provide speedy trial of offences punishable under this Act.

(b) A Special Court shall consist of –

(i) a single judge holding office as Session Judge or Additional Session Judge, in case of offences punishable under this Act with imprisonment of 2 years or more; and

(ii) a Metropolitan Magistrate or a Judicial Magistrate of the First Class, in the case of other offences,

who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.

2. Offences triable by Special Courts (Section 436)

(a) All offences punishable under this Act with imprisonment of 2 years or more shall be triable only by the Special Court established for the area in which the registered office of the company is situated. In case there are more Special Courts than one for such area, then, such offence shall be triable by such Special Court as may be specified in this behalf by the High Court.

All such offences as are not triable by the Special Court, shall be tried by a Metropolitan Magistrate or a Judicial Magistrate of the First Class having jurisdiction to try any offence under this Act or under any previous company law.

(b) Where a person accused of, or suspected of the commission of, an offence under this Act is forwarded to a Magistrate, such Magistrate may authorize the detention of such person in such custody as he thinks fit for –

(i) a maximum period of 15 days (in the whole) where such Magistrate is a Judicial Magistrate;

(ii) a maximum period of 7 days (in the whole) where such Magistrate is an Executive Magistrate.

If, such Magistrate considers that the detention of such person upon or before the expiry of the period of detention is unnecessary, he shall order such person to be forwarded to the Special Court having jurisdiction.

(c) The Special Court may exercise, in relation to the person forwarded to it, the same power which a Magistrate having jurisdiction to try a case may exercise under the provisions of the Code of Criminal Procedure, 1973.

(d) A Special Court may, upon perusal of the police report of the facts constituting an offence under this Act, take cognizance of that offence without the accused being committed to it for trial.

The provisions contained in (a) to (d) above shall apply notwithstanding anything contained in the Code of Criminal Procedure, 1973.

(e) When trying an offence under this Act, a Special Court may also try an offence other than an offence under this Act with which the accused may, under the Code of Criminal Procedure, 1973 be charged at the same trial.

(f) The Special Court may, if it thinks fit, try in a summary way any offence under this Act, which is punishable with imprisonment for a term not exceeding 3 years. However, in such a case if the accused is convicted, the period of imprisonment shall not exceed 1 year. Also, if during the course of a summary trial, it appears to the Special Court that the nature of the case is such that an order of imprisonment exceeding 1 year may have to be passed or for any other reason, it is undesirable to try the case summarily, the Special Court shall, after hearing the parties, record an order to that effect and thereafter recall any witnesses who may have been examined and proceed to hear or rehear the case in accordance with the procedure for the regular trial.

3. **Appeal and revision (Section 437)**

The High Court may exercise, so far as may be applicable, all the powers conferred by Chapters XXIX and XXX of the Code of Criminal Procedure, 1973 on a High Court, as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

4. **Application of Code to proceedings before Special Court (Section 438)**

(a) The provisions of the Code of Criminal Procedure, 1973 shall apply to the proceedings before a Special Court.

(b) The Special Court shall be deemed to be a Court of Session or the Court of Metropolitan Magistrate or a Judicial Magistrate of the First Class, as the case may be.

(c) The person conducting a prosecution before a Special Court shall be deemed to be a Public Prosecutor.

Transitional provisions (Section 440)

Any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established, be tried by a Court of Session or the Court of Metropolitan Magistrate or a Judicial Magistrate of the First Class, as the case may be, exercising jurisdiction over the area. However, the High Court shall be empowered to transfer any such case or class of cases in accordance with the provisions of section 407 of the Code of Criminal Procedure, 1973.

Theoretical Questions

Q 13.2A. Excel Ltd. committed an offence under the Companies Act, 2013. The offence falls within the jurisdiction of a special court of Bundi district in which the registered office of Excel Ltd. was situated. However, in that Bundi district, there were two special courts one in X place and other in Y place. Identify the jurisdiction of the special court for trial of offence committed by Excel Ltd.

[CA (Final) Mock Test Paper, March 2018]

13.3 Dissolution of Company Law Board and consequential provisions (Section 466)

The provisions relating to dissolution of the Company Law Board are explained as follows:

1. **Dissolution of the Company Law Board**

The Board of Company Law Administration constituted under the Companies Act, 1956 (hereinafter referred to as the Company Law Board) shall stand dissolved on the constitution of the Tribunal and the Appellate Tribunal.

2. **Certain officers of CLB to continue to function**

Until the Tribunal and the Appellate Tribunal is constituted, the Chairman, Vice-Chairman and Members of the Company Law Board immediately before the constitution of the Tribunal and the Appellate Tribunal, who fulfil the qualifications and requirements provided under this Act regarding appointment as President or Chairperson or Member of the Tribunal or the Appellate Tribunal, shall function as President, Chairperson or Member of the Tribunal or the Appellate Tribunal.

Until the Tribunal and the Appellate Tribunal is constituted, the Chairman, Vice-Chairman and Members of the Company Law Board immediately before the constitution of the Tribunal and the Appellate Tribunal, who do not fulfil the qualifications and requirements provided under this Act regarding appointment as President or Chairperson or Member of the Tribunal or the Appellate Tribunal, shall vacate their respective offices on such constitution, and no such Chairman, Vice- Chairman or Member shall be entitled to claim any compensation for the premature termination of the term of his office or of any contract of service, if any.

3. **Officers and employees appointed on deputation basis to the Company Law Board**

   Every officer or employee, who had been appointed on deputation basis to the Company Law Board, shall, on such dissolution,–

   (i) become officer or employee of the Tribunal or the Appellate Tribunal, if he fulfils the qualifications and requirements under this Act; and

   (ii) stand reverted to his parent cadre, Ministry or Department, in any other case.

4. **Officers and employees of the Company Law Board**

   Every officer and employee of the Company Law Board, employed on regular basis by it, shall become, on and from such dissolution the officer and employee of the Tribunal or the Appellate Tribunal with the same rights and privileges as to pension, gratuity and other like benefits as would have been admissible to him if he had continued to serve that Board and shall continue to do so unless and until his employment in the Tribunal or the Appellate Tribunal is duly terminated or until his remuneration, terms and conditions of employment are duly altered by the Tribunal or the Appellate Tribunal, as the case may be.

   Any such officer or employee shall not be entitled to any compensation under this Act or under any other law for the time being in force and no such claim shall be entertained by any court, tribunal or other authority.

5. **Provident and other funds established by the Company Law Board**

   Where the Company Law Board has established a provident fund, superannuation fund, welfare fund or other fund for the benefit of the officers and other employees employed in the Company Law Board, the monies relatable to the officers and employees who have become officers or employees of the Tribunal or the Appellate Tribunal shall, out of the monies standing to the credit of such provident fund, superannuation fund, welfare fund or other fund, stand transferred to, and vest in, the Tribunal or the Appellate Tribunal, as the case may be, and such monies which stand so transferred shall be dealt with by the Tribunal or the Appellate Tribunal in such manner as may be prescribed.

13.4 Offences to be non cognizable (Section 439)

1. **Offences to be non-cognizable [Section 439(1)]**

   Every offence under this Act except the offences referred to in sub-section (6) of section 212 shall be deemed to be non-cognizable.

   As per section 212(6), the offences covered under section 447 of this Act shall be cognizable. Section 212(6) shall apply notwithstanding anything contained in the Code of Criminal Procedure, 1973.

2. **Cognizance of offences [Section 439(2)]**

   No court shall take cognizance of any offence under this Act, which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing made by –

   (i) the Registrar;

   (ii) a shareholder or a member of the company;

   (iii) a person authorised by the Central Government in that behalf;

   (iv) a person authorized by the Securities and Exchange Board of India, in case of an offence relating to issue and transfer of securities and non-payment of dividend.

   However, this provision shall not apply in case of a prosecution by a company of any of its officers.

   As per Notification No. G.S.R. 463(E) dated 5th June, 2015, in case of a Government company which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the provisions of sub-section (2) of section 439 shall be read as follows:

   No court shall take cognizance of any offence under this Act, which is alleged to have been committed by any company or any officer thereof, unless the complaint in writing is made by–

   (i) a person authorised by the Central Government in that behalf;

   (ii) a person authorized by SEBI, in case of an offence relating to issue and transfer of securities and non-payment of dividend.

   However, this provision shall not apply in case of a prosecution by a company of any of its officers.

3. **Personal presence not required [Section 439(3)]**

Where the complainant is the Registrar or a person authorised by the Central Government, the presence of such officer before the Court trying the offences shall not be necessary unless the Court requires his personal attendance at the trial.

The provisions of section 439 of the Companies Act, 2013 shall apply notwithstanding anything contained in the Code of Criminal Procedure, 1973.

Practical Problems from CA Examinations

Can the Court take cognizance of an offence on the basis of a news published in a newspaper?

P 13.4A. In the annual general meeting of XYZ Ltd, while discussing on the matter of retirement and reappointment of director Mr. X, allegations of fraud and financial irregularities were levelled against him by some members. This resulted into chaos in the meeting. The situation was normal only after the chairman declared about initiating an inquiry against the director. Mr. X, however, could not be re-appointed in the meeting. The matter was published in the newspapers next day. On the basis of such news, whether the court can take cognizance of the matter and take action against the director on its own?

Justify you answer with reference to the provisions of the Companies Act, 2013. [CA (Final) May 2015]

Ans. The given problem relates to section 439 of the Companies Act, 2013.

As per section 439, no court shall take cognizance of any offence under this Act, which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing made by –

(i) the Registrar;

(ii) a shareholder or a member of the company;

(iii) a person authorised by the Central Government in that behalf;

(iv) a person authorized by the Securities and Exchange Board of India, in case of an offence relating to issue and transfer of securities and non-payment of dividend.

In the given case, no person as mentioned in section 439 has filed any complaint with the Court. On the basis of a news published in a newspaper, the Court cannot take cognizance of any offence against any director of the company. In other words, the Court cannot take the cognizance of such offence *suo motu*.

Whether the Court is bound to take cognizance of an offence where a complaint is filed by a member of the company?

P 13.4B. Mr. Joseph, a member of Armaments Ltd., is aggrieved due to failure of the company to make payment of dividend declared in the AGM held in August, 2015. He makes a complaint, in writing, before the court of competent jurisdiction within the prescribed period of limitation, but the court refused to take cognizance of the alleged offence. Explain the legal position in this regard under the Companies Act, 2013. [CA (Final) Revision Test Paper, May 2016]

Ans. The given problem relates to section 439 of the Companies Act, 2013.

As per section 439, no court shall take cognizance of any offence under this Act, which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing made by –

(i) the Registrar;

(ii) a shareholder or a member of the company;

(iii) a person authorised by the Central Government in that behalf;

(iv) a person authorized by the Securities and Exchange Board of India, in case of an offence relating to issue and transfer of securities and non-payment of dividend.

In the given case, a complaint has been filed with the Court by a member of the company (viz. Mr. Joseph). As per section 439, Mr. Joseph is authorised to make such a complaint. So, the Court is bound to take cognizance of the alleged offence. Accordingly, the refusal of the Court to take cognizance of the alleged offence is not valid.

Whether all offences covered under the Act are non-cognizable?

P 13.4C. All offences under the Companies Act, 2013 are non-cognizable except offences of fraud covered under Section 447 of the Act. Explain the validity of the statement. [CA (Final) May 2018]

Ans. As per section 439, every offence under this Act except the offences referred to in sub-section (6) of section 212 shall be deemed to be non-cognizable.

As per section 212(6), the offences covered under section 447 of this Act shall be cognizable. Section 212(6) shall apply notwithstanding anything contained in the Code of Criminal Procedure, 1973.

To conclude, all the offences covered under the Companies Act, 2013 shall be non-cognizable. However, there is one exception to this, *i.e.* the offences relating to fraud which are covered under section 447 shall be cognizable.

Thus, the given statement is correct.

13.5 Mediation and Conciliation Panel (Section 442)

1. Constitution of Mediation and Conciliation Panel

(a) The Central Government shall maintain a panel of experts to be called as the Mediation and Conciliation Panel.

(b) The Mediation and Conciliation Panel shall consist of such number of experts having such qualifications as may be prescribed.

(c) The fee and other terms and conditions of experts of the Mediation and Conciliation Panel shall be such as may be prescribed.

2. Which proceedings may be referred to the Mediation and Conciliation Panel?

Any proceedings may be referred to the Mediation and Conciliation Panel for mediation between the parties, if such proceedings are pending before –

(i) the Central Government; or

(ii) the Tribunal; or

(iii) the Appellate Tribunal.

3. Who can refer the proceedings to the Mediation and Conciliation Panel?

(a) Application by the parties. Any of the parties to the proceedings may make an application for referring the proceedings to the Mediation and Conciliation Panel.

(a) Such application may be made at any time when the proceedings are pending before the Central Government or the Tribunal or the Appellate Tribunal.

(b) The application shall be made to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, before whom the proceedings are pending.

(c) The application shall be made in such form along with such fees as may be prescribed.

(d) When such an application is made, the Central Government or Tribunal or the Appellate Tribunal, as the case may be, shall appoint one or more experts from the Mediation and Conciliation Panel.

(b) Application by the Central Government or the Tribunal or the Appellate Tribunal. The Central Government or the Tribunal or the Appellate Tribunal may, *suo motu*, refer any pending proceedings to such number of experts from the Mediation and Conciliation Panel as the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, deems fit.

4. Procedure to be followed by the Mediation and Conciliation Panel

(a) The Mediation and Conciliation Panel shall follow such procedure as may be prescribed.

(b) It shall dispose of the matter referred to it within 3 months.

(c) It shall forward its recommendations to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

5. Right of aggrieved party to file objections

Any party aggrieved by the recommendations of the Mediation and Conciliation Panel may file objections to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

The objective of constitution of Mediation and Conciliation Panel is to provide an alternative dispute resolution mechanism. The mediator or conciliator facilitates voluntary resolution of the dispute between the parties. He communicates the views of each party to the other, assists the parties in identifying issues to the dispute, reduces misunderstandings between the parties, clarifies the priorities, explores areas of compromise and generates alternative solutions in an attempt to resolve the dispute. The mediator or conciliator has no authority to impose any terms of settlement on the parties without the consent of all the parties.

Simply speaking, mediation and conciliation requires involvement of a third party in a dispute with the objective of resolving the dispute. It is friendly settlement of a dispute between the parties to the dispute without resorting to judicial means.

Theoretical Questions from CA Examinations

Q 13.5A. What do you understand by the terms 'Mediation' and 'Conciliation'? Mention the provisions regarding Mediation and Conciliation Panel under the Companies Act, 2013. [CA (Final) Nov. 2017]

13.6 Power of the Central Government to appoint Company Prosecutors (Section 443)

1. The Central Government may appoint one or more persons, as Company Prosecutors.
2. The Company Prosecutor(s) may be appointed generally, or for any case, or for any specified class of cases.
3. The Company Prosecutor(s) shall be appointed to conduct prosecutions arising out of this Act.
4. A Company Prosecutor shall have all the powers and privileges conferred on Public Prosecutors appointed under section 24 of the Code of Criminal Procedure, 1973.

Theoretical Questions from CA Examinations

Q 13.6A. The Central Government wants to appoint Mr. Honest as Company Prosecutor. Can it do so? Mention the provisions regarding the power of Central Government to appoint Company Prosecutors along with their powers and privileges under the Companies Act, 2013. [CA (Final) Nov. 2018]

13.7 Appeal against acquittal (Section 444)

1. The Central Government may direct any Company Prosecutor or any other person (by name or by virtue of his office) to present an appeal from an order of acquittal passed by any Court, other than a High Court.
2. An appeal so presented shall be deemed to be validly presented.

Theoretical Questions from CA Examinations.

Q 13.7A. What are the powers of the Central Government under the Companies Act, 2013 regarding appeal against acquittal? [CA (Final) Nov. 2018]

13.8 Compensation for accusation without reasonable cause (Section 445)

Where compensation is to be determined by the Special Court or the Court of Session for accusation without reasonable cause, such compensation shall be determined, *mutatis mutandis*, as per Section 250 of the Code of Criminal Procedure, 1973.

13.9 Utilisation of fines (Section 446)

Where any fine is imposed by the Court on any person under the Act, the Court imposing the fine may direct that the whole or any part of fine shall be utilised for –

(a) payment of the costs of the proceedings; or

(b) payment of a reward to the person on whose information the proceedings were instituted.

13.10 Factors for determining level of punishment (Section 446A)

The court or the Special Court, while deciding the amount of fine or imprisonment under this Act, shall have due regard to the following factors:

(a) Size of the company

(b) Nature of business carried on by the company

(c) Injury to public interest

(d) Nature of the default

(e) Repetition of the default.

13.11 Lesser penalties for One Person Companies or small companies (Section 446B)

1. **Applicability of section 446B**

   Section 446B applies where a One Person Company or a small company fails to comply with the provisions of –

   (a) sub-section (5) of section 92 (*i.e.* Punishment for failure to file the annual return within the time specified in section 92); or

   (b) sub-section (2) of section 117 (*i.e.* Punishment for failure to file any agreement or resolution required to be filed under section 117 within 30 days); or

   (c) sub-section (3) of section 137 (*i.e.* Punishment for failure to file the financial statements within the time specified in section 137).

2. **Quantum of punishment**

   The One Person Company or the small company and officer in default of such company shall be liable to a penalty which shall not be more than one half (i.e. 50%) of the penalty specified in such sections.

The provisions of section 446B shall apply notwithstanding anything contained in this Act.

13.12 Punishment for fraud (Section 447)

1. Where any person is found guilty of fraud involving an amount of at least Rs. 10 lakh or 1% of the turnover of the company, whichever is lower, he shall be punishable as follows:

	Fraud involves public interest	***Any other case***
Minimum Imprisonment	3 years	6 months
Maximum Imprisonment	10 years	
Minimum Fine	Amount involved in the fraud	
Maximum Fine	3 times the amount involved in the fraud	

2. Where any person is found guilty of fraud involving an amount less than Rs. 10 lakh or 1% of the turnover of the company, whichever is lower, and the fraud does not involve public interest, any person guilty of such fraud shall be punishable with –

   (a) imprisonment upto 5 years; or

   (b) fine upto Rs. 50 lakh; or

   (c) both.

3. The person liable under section 447 shall continue to be liable for any other liability under this Act or any other law for the time being in force (including repayment of any debt).

Meaning of certain terms

1. 'Fraud' includes any act, omission, concealment of any fact or abuse of position with intent to deceive, to gain undue advantage from, or to injure the interests of, any other person, whether or not there is any wrongful gain or wrongful loss.
2. 'Wrongful gain' means the gain by unlawful means of property to which the person gaining is not legally entitled.
3. 'Wrongful loss' means the loss by unlawful means of property to which the person losing is legally entitled.

13.13 Punishment where no specific penalty or punishment is provided (Section 450)

Meaning of 'offence'

The term offence has not been defined under the Companies Act, 2013. 'Offence' refers to any act or omission made punishable under the law for the time being in force.

Residuary penalty section

Penal provisions under the Act are scattered throughout the Companies Act, 2013. However, a general provision has been incorporated under section 450 of the Companies Act, 2013 which specifies penalty where no specific penalty or punishment is provided elsewhere in the Act. Accordingly, contravention of any provision of the Act (for which no penalty or punishment has been specified in the Act) shall result in a fine upto Rs. 10,000 plus a fine upto Rs. 1,000 per day where the offence is of continuing nature.

13.14 Adjudication of penalties (Section 454)

1. **Appointment of adjudicating officers**
   (a) The Central Government may appoint the adjudicating officers.
   (b) The adjudicating officers shall have the power to adjudge the penalties under the provisions of this Act.
   (c) The adjudicating officers shall adjudge the penalties in such manner as may be prescribed.
   (d) Such number of adjudicating officers may be appointed as the Central Government may deem fit.
   (e) The appointment of adjudicating officers shall be made by publishing an order in the Official Gazette.
   (f) Any officer of the Central Government, not below the rank of Registrar, may be appointed as the adjudicating officer.
2. **Jurisdiction of adjudicating officers**
   While appointing the adjudicating officers, the Central Government shall specify their respective jurisdiction.
3. **Orders of the adjudicating officer**
   The adjudicating officer is empowered to pass the following orders:
   (a) Impose the penalty on the company, the officer who is in default, or any other person.
      1. The order of the adjudicating officer shall state the non-compliance or default under the relevant provisions of this Act.
      2. Before imposing any penalty, the adjudicating officer shall give a reasonable opportunity of being heard to such company, the officer who is in default or any other person.
   (b) Direct such company, or officer who is in default, or any other person to rectify the default.
4. **Appeal against the order of the adjudicating officer**
   (a) Any person aggrieved by an order made by the adjudicating officer may prefer an appeal to the Regional Director having jurisdiction in the matter.
   (b) Such appeal shall be filed within 60 days from the date on which the copy of the order made by the adjudicating officer is received by the aggrieved person. The appeal shall be in such form and manner and shall be accompanied by such fees as may be prescribed.
5. **Order of the Regional Director**
   (a) The Regional Director may pass such order as he may think fit.
   (b) The Regional Director may confirm, modify or set aside the order appealed against.
   (c) Before passing any order, the Regional Director shall give a reasonable opportunity of being heard to the parties to the appeal.
6. **Consequences of failure to comply with the orders of the adjudicating officer or Regional Director**
   (a) If a company fails to comply with any order passed under this section by the adjudicating officer or the Regional Director within 90 days from the date of receipt of the copy of such order, it shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5 lakh.
   (b) If any officer of a company or any other person fails to comply with any order passed under this section by the adjudicating officer or the Regional Director within 90 days from the date of receipt of the copy of such order, he shall be punishable with imprisonment which may extend to 6 months or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 1 lakh, or with both.

13.15 Penalty for repeated default (Section 454A)

1. **Applicability of section 454A**

   Section 454A applies where a company or an officer of a company or any other person having already been subjected to penalty for default, again commits the same default within a period of 3 years from the date of order imposing such penalty passed by the adjudicating officer or the Regional Director, as the case may be.

2. **Quantum of punishment**

   Such company or such officer of the company shall be liable for the second or subsequent defaults for an amount equal to twice the amount of penalty provided for such default under the relevant provisions of this Act.

13.16 Dormant company (Section 455)

1. **Application by a company to the registrar for obtaining the status of dormant company**

   (a) A company may make an application to the Registrar so as to obtain the status of a dormant company in the following cases:

   (i) It was formed and registered under the Companies Act, 2013 for a future project or to hold an asset or intellectual property and it has no significant accounting transaction.

   (ii) It is an inactive company.

   (b) The application shall be made to the Registrar in such manner as may be prescribed.

   Provisions contained in Rule 3 of the Companies (Miscellaneous) Rules, 2014

   (a) The application shall be made to the Registrar in Form MSC-1.

   (b) The application may be made, only if –

   (i) a special resolution to this effect is passed in the general meeting of the company; or

   (ii) a notice is issued to all the shareholders of the company for this purpose and consent of at least 3/4th shareholders (in value) is obtained.

2. **Meaning of 'inactive company'**

   'Inactive company' means–

   (a) a company which has not been carrying on any business or operation; or

   (b) a company which has not made any significant accounting transaction during the last 2 financial years; or

   (c) a company which has not filed financial statements and annual returns during the last 2 financial years.

3. **Meaning of 'significant accounting transaction'**

   'Significant accounting transaction' means any transaction other than –

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

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

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

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

4. **Cases in which application cannot be made for obtaining the status of a dormant company**

   As per Rule 3 of the Companies (Miscellaneous) Rules, 2014, a company shall be eligible to apply only if –

   (i) no inspection, inquiry or investigation has been ordered or taken up or carried out against the company;

   (ii) no prosecution has been initiated and pending against the company under any law;

   (iii) the company is neither having any public deposits which are outstanding nor the company is in default in payment thereof or interest thereon;

   (iv) the company is not having any outstanding loan, whether secured or unsecured;

   However, if there is any outstanding unsecured loan, the company may make an application for obtaining the status of a dormant company after obtaining concurrence of the lender and enclosing the same with the application made to the Registrar.

   (v) there is no dispute in the management or ownership of the company and a certificate in this regard is enclosed with the application made to the registrar;

(vi) the company does not have any outstanding statutory taxes, dues, duties etc. payable to the Central Government or any State Government or local authorities, etc.;

(vii) the company has not defaulted in the payment of workmen's dues;

(viii) the securities of the company are not listed on any stock exchange within or outside India.

5. **Grant of status of dormant company by the Registrar**

(a) After considering the application made by the company, the Registrar shall allow the status of a dormant company to the applicant company.

(b) The Registrar shall issue a certificate in the prescribed form. As per Rule 4 of the Companies (Miscellaneous) Rules, 2014, the Registrar shall, after considering the application, issue a certificate in Form MSC-2 allowing the status of a Dormant Company to the applicant.

6. **Register of dormant companies to be maintained by the Registrar**

(a) The Registrar shall maintain a register of dormant companies.

(b) The register shall be maintained in the prescribed form.

7. **Compliance requirements for a dormant company**

(a) To retain its dormant status, a dormant company shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed.

Provisions contained in Rule 6 of the Companies (Miscellaneous) Rules, 2014

1. A dormant company shall have a minimum number of 3 directors in case of a public company, 2 directors in case of a private company and 1 director in case of a One Person Company.
2. The provisions with respect to rotation of auditors shall not apply to a dormant company.

(b) If a dormant company fails to comply with these requirements, the Registrar shall strike off its name from the register of dormant companies.

8. **Option of dormant company to become an active company**

(a) A dormant company may become an active company by making an application to the Registrar in this behalf.

(b) The application shall be accompanied by such documents and such fees as may be prescribed.

If a company does not file financial statements or annual returns for 2 consecutive financial years, the Registrar shall issue a notice to that company and enter the name of such company in the register maintained for dormant companies.

Theoretical Questions from CA Examinations

Q 13.16A. JKL Research Development Limited is a registered Public Limited Company. The company has a unique business idea emerging from research and development in a new area. However, it is a future project and the company has no significant accounting transactions and business activities at present. The company desires to obtain the status of a 'Dormant Company'. Advise the company regarding the provisions of the Companies Act, 2013 in this regard and the procedure to be followed in this regard. [CA (Final) May 2015]

Practical Problems from CA Examinations

Various issues with respect to obtaining status of a dormant company

P 13.16A. Gulmohar Ltd. is a company registered in India for last 5 years. Since last 2 financial years, it has not been carrying on any business or operations and has not filed financial statements and annual returns saying that it has not made any significant accounting transaction during the last two financial years. Considering the current situation, directors of the company are contemplating to apply to Registrar of Companies to obtain the status of dormant or inactive company.

Advise them on:

(i) Whether Gulmohar Ltd. is eligible to apply to Registrar of Companies to obtain dormant status for the company?

(ii) Will your answer be different if Gulmohar Ltd. is continuing payment of fees to Registrar of Companies and payment of rentals for its office and accounting records for last two financials years?

(iii) Is special resolution in general meeting a pre-requisite to make an application to Registrar of Companies for obtaining the status of dormant company?

(iv) What will be your answer if it is found after making an application of dormant company to Registrar of Companies that an investigation is pending against the company which was ordered 6 months ago? [CA (Final) May 2019]

Ans. The given problem relates to section 455 of the Companies Act, 2013.

(i) Whether Gulmohar Ltd. is eligible to apply to Registrar of Companies to obtain dormant status for the company?

If a company is an inactive company, it may make an application to the Registrar for obtaining the status of a dormant company.

An 'inactive company' means –

(a) a company which has not been carrying on any business or operation; or

(b) a company which has not made any significant accounting transaction during the last 2 financial years; or

(c) a company which has not filed financial statements and annual returns during the last 2 financial years.

Gulmohar Ltd. has not filed its financial statements and annual returns during the last 2 financial years. Also, it had not made any significant accounting transaction during the last 2 financial years. Therefore, Gulmohar Ltd. is an inactive company and so it is eligible to make an application to the Registrar for obtaining the status of a dormant company.

(ii) Whether application can be made by Gulmohar Ltd. if it had been continuously making payment of fees to Registrar and payment of rent for its office and accounting records for last 2 financials years?

'Significant accounting transaction' means any transaction other than –

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

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

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

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

Even if Gulmohar Ltd. has been making payment of fees to Registrar and payment of rent for its office and payments for maintenance of accounting records for last 2 financials years, none of such payments shall not amount to 'significant accounting transaction'. So, despite the fact that Gulmohar Ltd. has made any of such payments, it shall remain an inactive company, and so it shall be eligible to make an application to the Registrar for obtaining the status of a dormant company.

(iii) Whether passing of a special resolution in general meeting is a pre-requisite to make an application to Registrar for obtaining the status of dormant company?

As per Rule 3 of the Companies (Miscellaneous) Rules, 2014, an application for obtaining the status of a dormant company may be made only if –

(a) a special resolution to this effect is passed in the general meeting of the company; or

(b) a notice is issued to all the shareholders of the company for this purpose and consent of at least 3/4th shareholders (in value) is obtained.

Thus, either a special resolution is required or consent of at least 3/4th shareholders in value is required for making an application for the status of a dormant company.

(iv) Whether application can be made by Gulmohar Ltd. if an investigation is pending against it?

As per Rule 3 of the Companies (Miscellaneous) Rules, 2014, a company shall be eligible to apply only if no inspection, inquiry or investigation has been ordered or taken up or carried out against the company.

Therefore, if, after an application for obtaining the status of a dormant company is made by Gulmohar Ltd., it is revealed that an investigation was pending against it, the application made by Gulmohar Ltd. for obtaining the status of a dormant company shall be rejected.

13.17 Process and relevance of back office of MCA

The process of back office in MCA-21 program encompasses the following:

- Dynamic routing of documents that have been electronically filed to the concerned official within MCA, based on the type of service request.
- Electronic workflow systems to support speed and certainty in service delivery.
- Supporting all routine tasks such as registrations and approvals.
- Storing of all approved documents of companies as part of electronic records, including provision of access to electronic records for the stakeholders.
- Enhancing identification of defaulters.
- Increasing efficiency of Technical Scrutiny.
- Ensuring close follow-up on matters related to compliance management including prosecutions.
- Enabling quicker responses to investor grievances.

- Providing alerts when the tasks are not carried out within stipulated period.

Following points may be referred to understand the relevance of back office in MCA-21 program:

- Expeditious incorporation of companies.
- Simplified and ease of convenience in filing of Forms/ Returns.
- Better compliance management.
- Total transparency through e-Governance.
- Customer centric approach.
- Increased usage of professional certificate for ensuring authenticity and reliability of the Forms / Returns.
- Building up a centralised database repository of corporate operating.
- Enhanced service level fulfilment.
- Inspection of public documents of companies anytime from anywhere.
- Registration as well as verification of charges anytime from anywhere.
- Timely redressal of investor grievances.
- Availability of more time for MCA employees for monitoring and supervision.

Theoretical Questions from CA Examinations

Q 13.17A. Explain the process and relevance of back office in MCA-21 program of the Ministry of Corporate Affairs.

[CA (Final) Nov. 2017]

13.18 Condonation of Delay Scheme, 2018

- Condonation of Delay Scheme, 2018 (CODS-2018) was introduced by the Central Government with a view to giving an opportunity to the non-compliant, defaulting companies to rectify the default of section 164(2) of the Companies Act, 2013 read with Rule 14 of the Companies (Appointment and Qualification of Directors) Rules, 2014.
- This scheme is applicable to all defaulting companies (other than the companies which have been stuck off/ whose names have been removed from the register of companies under section 248(5) of the Act). As per this Scheme, a defaulting company is permitted to file its overdue documents which were due for filing till 30.06.2017 in accordance with the provisions contained in the Scheme.
- In the case of defaulting companies whose names have not been removed from register of companies, the procedure to be followed to avail the benefit of the scheme is as under:
  (i) The DINs of the disqualified directors de-activated at present shall be temporarily activated during the validity of the scheme to enable them to file the overdue documents.
  (ii) The defaulting company shall file the overdue documents in the respectively prescribed e-Forms paying the statutory filing fee and the additional fee payable as per section 403 of the Companies Act, 2013 read with Companies (Registration Offices and fee) Rules, 2014 for filing these overdue documents.
  (iii) The defaulting company, after filing documents under this scheme, shall seek condonation of delay by filing form e-CODS 2018 attached to this scheme along with a fee of Rs. 30,000/- as prescribed by the Companies (Registration Offices and Fee) Rules, 2014 well before the last date of the scheme.
  (iv) The DINs of the Directors associated with the defaulting companies that have not filed their overdue documents and the e-form CODS, and these are not taken on record in the MCA21 registry and are still found to be disqualified on the conclusion of the scheme in terms of section 164(2)(a) read with section 167(1)(a) of the Companies Act, 2013 shall be liable to be deactivated on expiry of the scheme period.
  (v) The Registrar concerned shall withdraw the prosecution(s) pending if any before the concerned Court(s) for all documents filed under the scheme.

- This scheme shall not apply to the filing of documents other than the following overdue documents:
  - (i) Form No. 20B / Form No. MGT-7 (Form for filing Annual Return by a company having share capital)
  - (ii) Form No. 21A / Form No. MGT-7 (Form for filing Annual Return by a company not having share capital)
  - (iii) Form No. 23AC, Form No. 23ACA, Form No. 23AC-XBRL, Form No. 23ACA-XBRL, Form No. AOC-4, Form No. AOC-4CFS, Form No. AOC (XBRL) and Form No. AOC-4(non-XBRL) (Forms for filing Balance Sheet and Profit and Loss Account / Financial Statement)
  - (iv) Form No. 66 (Form for submission of Compliance Certificate with the Registrar)
  - (v) Form No. 23B / ADT-1 (Form for intimation for Appointment of Auditors)
- At the conclusion of the Scheme, the Registrar shall take necessary actions under the Companies Act, 1956 or the Companies Act, 2013 against the companies which have not availed the benefit of this Scheme and continue to be in default in filing the overdue documents.
- The scheme is not applicable for those directors who are associated with a company whose name was struck off under section 248 of the Companies Act, 2013 and DINs for such individuals shall be re-activated only upon receipt of orders for the said company in accordance with the procedure laid down under section 252 of the Companies Act, 2013.

Condonation of Delay Scheme, 2018 (CODS-2018) came into force with effect from 01.01.2018 and was to remain in force till 31.03.2018. However, it was extended till 30.04.2018.

Miscellaneous Practical Problems from CA Examinations

Whether a company can be granted approval to change its financial year from 1st April to 31st April to 1st January to 31st December for the purpose of consolidation of financial statements with a company incorporated outside India

P 13.18A. M/s EVA Optical Networking India Private Limited having its registered office situated in the city of Gurugram, Haryana State, falling within the jurisdiction of Registrar of Companies, NCT, Delhi & Haryana has filed a petition before the Central Government under the Companies Act, 2013 seeking an exemption be granted to the petitioner company to change the financial year of the company from 1st April to 31st March presently adopted by following the financial year in below manner:-

(i) For the next financial year: From 1st April, 2018 to 31st December, 2018 both days inclusive.

(ii) For the subsequent financial year: Be changed to a period of one calendar year beginning 1st January of one year and concluding on 31st December of the same year.

The petitioner company in its petition avers that it is a part of EVA Optical Networking Singapore Pvt. Ltd., a company incorporated in Singapore (being the parent company) holding 99% of the Equity Share Capital of the petitioner and the remaining 1% of the equity share capital is held by EVA Optical Networking SE, a company incorporated in Germany, which is represented to be the ultimate holding company. The parent company as well as the ultimate holding company follows their financial year as 1st January to 31st December of the same year for the purpose of consolidation of accounts and hence in order to streamline the preparation of the consolidated financials of the parent company, the petitioner company is required to align with it. Advise whether the petition will stand before the Central Government as per the provisions of the Companies Act, 2013. What would be your answer if M/s EVA Optical Networking India Private Limited was registered as a Specified International Financial Services Centre (IFSC) private company? [CA (Final) May 2018 (Modified)]

Ans. The given problem relates to section 2(41) of the Companies Act, 2013, as discussed below:

The legal position

1. The term 'financial year' has been defined under Clause (41) of section 2, as follows:

   'Financial year', in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

   Provided that where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year:

   Provided further that any application pending before the Tribunal as on the date of commencement of the Companies (Amendment) Act, 2019, shall be disposed of by the Tribunal in accordance with the provisions applicable to it before such commencement:

Provided also that a company or body corporate, existing on the commencement of this Act, shall, within a period of 2 years from such commencement, align its financial year as per the provisions of this clause.

2. Specified IFSC private companies have been granted the following exemption by the Central Government vide Notification No. G.S.R. 9(E) dated 4th January, 2017:

   In case of a Specified IFSC private company, which is a subsidiary of a foreign company, the financial year of the subsidiary may be same as the financial year of its holding company and approval of the Central Government shall not be required.

The given case and analysis of the case

3. M/s EVA Optical Networking India Private Limited is a subsidiary of EVA Optical Networking Singapore Pvt. Ltd. (hereinafter referred to as 'parent company'), a company incorporated in Singapore, and EVA Optical Networking Singapore Pvt. Ltd. is a subsidiary of EVA Optical Networking SE (hereinafter referred to as 'ultimate holding company'), a company incorporated in Germany. The period of financial year of the parent company as well as of the ultimate holding company is 1st January to 31st December of the same year.

4. M/s EVA Optical Networking India Private Limited has filed an application before the Central Government seeking permission to change its financial year from 1st April to 31st March presently adopted by it to 1st April, 2018 to 31st December, 2018 for the next financial year, and the period starting on 1st January to 31st December of the same year for all subsequent financial years.

5. The application made by M/s EVA Optical Networking India Private Limited to the Central Government states that such alignment of financial year is required so as to streamline the preparation of the consolidated financial statements of the parent company with M/s EVA Optical Networking India Private Limited.

6. Section 2(41) empowers the Central Government to make an order that a company incorporated in India shall be allowed to follow a different period as its financial year (*i.e.* different from 1st April to 31st March of the following year), whether such different period is a year or not. However, the Central Government may make such an order if it is satisfied that –

   (a) the company incorporated in India is a holding company or a subsidiary company or an associate company of a company incorporated outside India; and

   (b) for the purpose of consolidation of accounts with a company incorporated outside India, the company incorporated in India is required to follow a different financial year (*i.e.* different from 1st April to 31st March of the following year).

Conclusion

7. Both the conditions as discussed in Point (6) above have been satisfied by M/s EVA Optical Networking India Private Limited, and so M/s EVA Optical Networking India Private Limited can rightfully make an application to the Central Government seeking an order of change in financial year, and the Central Government is empowered to make an order that M/s EVA Optical Networking India Private Limited shall be allowed to follow the financial year(s) as requested.

8. Had M/s EVA Optical Networking India Private Limited been an IFSC private company, it would have the power to change its financial year as desired by it, without making any application to the Central Government, in terms of Notification No. G.S.R. 9(E) dated 4th January, 2017.

Alphanumeric numbering of e-forms under the Companies Act, 2013

P 13.18B. The e-forms rolled out by the Ministry of Corporate Affairs (MCA) under the provisions of the Companies Act, 2013 and rules framed thereunder are mandatorily numbered alphanumeric. Explain this concept. What is the chapter-wise nomenclature of e-forms provided by MCA in respect of –

1. Acceptance of Deposits by Companies & 2. Management and Administration? [CA (Final) May 2018]

Ans. In order to facilitate easy understanding of the e-forms rolled out under the provisions of Companies Act, 2013 and Rules made thereunder, the forms under the Companies Act, 2013 are mandatorily numbered alpha-numeric. Each e-form starts with 2 or 3 alphabets based on the subject of the Chapter, followed by serial number of the form. By referring to the alphanumeric numbering of any e-form, it becomes possible to identify the relevant Chapter of the Companies Act, 2013 to which the form pertains and the nature of the e-form.

Chapter-wise nomenclature of e-forms issued by MCA in respect of '1. Acceptance of Deposits by Companies' & '2. Management and Administration' are as follows:

Chapter No.	Name of the Chapter	Nomenclature of e-form	Example
V	Acceptance of Deposits by Companies	DPT	Form No. DPT-4 (Statement regarding deposits existing on the commencement of the Act)
VI	Management and Administration	MGT	Form No. MGT-14 (Filing of Resolutions and agreements with the Registrar)

Users of Digital Signature Certificate and e-forms used for filing particulars of satisfaction of charge and for filing profit and loss account

P 13.18C. "The e-forms are required to be authenticated by the authorised signatories using digital signatures." With reference to e-filing of documents with the Registrar of Companies, identify the users of digital signature who are required to obtain Digital Signature Certificate (DSC) and name the e-forms required to be filed for the following:

(i) Particulars for satisfaction of charge.

(ii) For filing profit and loss account and other documents with the Registrar. **[CA (Final) Nov. 2019]**

Ans. Following are the users of Digital Signature Certificate with respect to e-filing of documents with the Registrar of Companies:

1. Employees of Ministry of Corporate Affairs (MCA) (for authenticating the e-forms filed by the users in token of their acceptance by the MCA System)
2. Professionals, *e.g.* Chartered Accountants, Company Secretaries, Cost Accountants and Advocates (for digitally certifying the e-forms which are required to be certified by a professional in accordance with the provisions contained in the Companies Act, 2013 or Rules prescribed under the Companies Act, 2013)
3. Authorised signatories of the company, *e.g.* managing director, director, manager and secretary (for digitally signing the e-forms which are required to be signed by them in accordance with the provisions contained in the Companies Act, 2013 or Rules prescribed under the Companies Act, 2013)
4. Representatives of Banks and Financial Institutions (for digitally signing various e-forms where a charge is created by a company in favour of a Bank or Financial Institution).

The e-forms required to be filed for filing –

(i) particulars of satisfaction of charge is CHG-4 (As per Rule 8 of the Companies (Registration of Charges) Rules, 2014); and

(ii) profit and loss account and other documents (*i.e.* financial statements) is AOC-4 and AOC-4 CFS (for filing the consolidated financial statements) (As per Rule 12 of the Companies (Accounts) Rules, 2014).

Appendix 1

Definitions contained in section 2 of the Companies Act, 2013 *

'Abridged prospectus' [Section 2(1)]

'Abridged prospectus' means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf.

'Accounting standards'[Section 2(2)]

'Accounting standards' means the standards of accounting or any addendum thereto for companies or class of companies referred to in section 133.

'Alter' or 'alteration'[Section 2(3)]

'Alter' or 'alteration' includes the making of additions, omissions and substitutions.

'Appellate Tribunal' [Section 2(4)]

'Appellate Tribunal' means the National Company Law Appellate Tribunal constituted under section 410.

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* In the Companies Act, 2013, the definitions are contained in various clauses of section 2. For example, the definition of 'abridged prospectus' is contained in section 2(1), which is to be read / written as 'Clause (1) of section 2'; reading / writing it as 'sub-section (1) of section 2' is incorrect.

'Articles' [Section 2(5)]

'Articles' means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act.

'Associate company' [Section 2(6)]

'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.

Explanation. For the purpose of this clause, –

(a) the expression 'significant influence' means control of at least 20% of total voting power, or control of or participation in business decisions under an agreement;

(b) the expression 'joint venture' means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

'Auditing standards'[Section 2(7)]

'Auditing standards' means the standards of auditing or any addendum thereto for companies or class of companies referred to in sub-section (10) of section 143.

'Authorised capital' or 'nominal capital' [Section 2(8)]

'Authorised capital' or 'nominal capital' means such capital as is authorized by the memorandum of a company to be the maximum amount of share capital of the company.

'Banking company' [Section 2(9)]

'Banking company' means a banking company as defined in clause (*c*) of section 5 of the Banking Regulation Act, 1949.

'Board of Directors' or 'Board' [Section 2(10)]

'Board of Directors' or 'Board', in relation to a company, means the collective body of the directors of the company.

'Body corporate' or 'corporation' [Section 2(11)]

'Body corporate' or 'corporation' includes a company incorporated outside India, but does not include –

(i) a co-operative society registered under any law relating to co-operative societies; and

(ii) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf.

'Book and paper' and 'book or paper' [Section 2(12)]

'Book and paper' and 'book or paper' include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.

'Books of account' [Section 2(13)]

'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 the 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

(iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

'Branch office' [Section 2(14)]

'Branch office', in relation to a company, means any establishment described as such by the company.

'Called-up capital' [Section 2(15)]

'Called-up capital' means such part of the capital, which has been called for payment.

'Charge' [Section 2(16)]

'Charge' means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

'Chartered accountant' [Section 2(17)]

'Chartered accountant' means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 who holds a valid certificate of practice under sub-section (1) of section 6 of that Act.

'Chief Executive Officer' [Section 2(18)]

'Chief Executive Officer' means an officer of a company, who has been designated as such by it.

'Chief Financial Officer' [Section 2(19)]

'Chief Financial Officer' means a person appointed as the Chief Financial Officer of a company.

'Company' [Section 2(20)]

'Company' means a company incorporated under this Act or under any previous company law.

'Company limited by guarantee' [Section 2(21)]

'Company limited by guarantee' means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

'Company limited by shares' [Section 2(22)]

'Company limited by shares' means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.

'Company liquidator' [Section 2(23)]

'Company Liquidator' means a person appointed by the Tribunal as the Company Liquidator in accordance with the provisions of section 275 for the winding up of a company under this Act.

'Company secretary' or 'secretary' [Section 2(24)]

'Company secretary' or 'secretary' means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act.

As per section 2(1)(c) of the Company Secretaries Act, 1980, company secretary means a person who is a member of the Institute of Company Secretaries of India (ICSI). The combined effect of the above two definitional clauses is that a person can be appointed as a company secretary under the Companies Act, 2013 only if he is a member of ICSI.

In case of a company licenced under section 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the provisions of clause (24) of section 2 shall not apply [Notification No. G.S.R. 466(E) dated 5th June, 2015]. The implications of this Notification is that any person may be appointed as a company secretary of a company licenced under section 8, whether or not he is a member of ICSI, if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

'Company secretary in practice' [Section 2(25)]

'Company secretary in practice' means a company secretary who is deemed to be in practice under sub-section (2) of section 2 of the Company Secretaries Act, 1980.

'Contributory' [Section 2(26)]

'Contributory' means a person liable to contribute towards the assets of the company in the event of its being wound up.

A person holding fully paid-up shares in a company shall be considered as a contributory but shall have no liabilities of a contributory under the Act whilst retaining rights of such a contributory.

'Control' [Section 2(27)]

'Control' shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

'Cost accountant' [Section 2(28)]

'Cost Accountant' means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 and who holds a valid certificate of practice under sub-section (1) of section 6 of that Act.

'Court' [Section 2(29)]

'Court' means –

(i) the High Court having jurisdiction in relation to the place at which the registered office of the company concerned is situated, except to the extent to which jurisdiction has been conferred on any district court or district courts subordinate to that High Court under sub-clause (ii);

(ii) the district court, in cases where the Central Government has, by notification, empowered any district court to exercise all or any of the jurisdictions conferred upon the High Court, within the scope of its jurisdiction in respect of a company whose registered office is situated in the district;

(iii) the Court of Session having jurisdiction to try any offence under this Act or under any previous company law;

(iv) the Special Court established under section 435;

(v) any Metropolitan Magistrate or a Judicial Magistrate of the First Class having jurisdiction to try any offence under this Act or under any previous company law.

'Debenture' [Section 2(30)]

'Debenture' includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not:

Provided that –

(a) the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; and

(b) such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company, shall not be treated as debenture.

'Deposit' [Section 2(31)]

'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.

'Depository' [Section 2(32)]

'Depository' means a depository as defined in clause (*e*) of sub-section (*1*) of section 2 of the Depositories Act, 1996.

'Derivative' [Section 2(33)]

'Derivative' means the derivative as defined in clause (*ac*) of section 2 of the Securities Contracts (Regulation) Act, 1956.

'Director' [Section 2(34)]

'Director' means a director appointed to the Board of a company.

'Dividend' [Section 2(35)]

'Dividend' includes any interim dividend.

'Document' [Section 2(36)]

'Document' includes summons, notice, requisition, order, declaration, form and register, whether issued, sent or kept in pursuance of this Act or under any other law for the time being in force or otherwise, maintained on paper or in electronic form.

'Employees' stock option' [Section 2(37)]

'Employees' stock option' means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

'Expert' [Section 2(38)]

'Expert' includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force.

'Financial institution' [Section 2(39)]

'Financial institution' includes a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934.

'Financial statement' [Section 2(40)]

'Financial statement' in relation to a company, includes –

(i) a balance sheet as at the end of the financial year;

(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

(iii) cash flow statement for the financial year;

(iv) a statement of changes in equity, if applicable; and

(v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv).

Provided that the financial statement, with respect to one person company, small company, dormant company and private company (if such private company is a start-up) may not include the cash flow statement if such company has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92.

Explanation. For the purposes of this Act, the term "start-up" or "start-up company" means a private company incorporated under the Companies Act, 2013 (18 of 2013) or the Companies Act, 1956 (1 of 1956) and recognised as start-up in accordance with the notification issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry [Notification No. G.S.R. 364(E) dated 5th June, 2015 as amended by Notification No. G.S.R. 583(E) dated 13th June, 2017].

'Financial year' [Section 2(41)]

'Financial year', in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

Provided that where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year:

Provided further that any application pending before the Tribunal as on the date of commencement of the Companies (Amendment) Act, 2019, shall be disposed of by the Tribunal in accordance with the provisions applicable to it before such commencement:

Provided also that a company or body corporate, existing on the commencement of this Act, shall, within a period of 2 years from such commencement, align its financial year as per the provisions of this clause.

'Foreign company' [Section 2(42)]

'Foreign company' means any company or body corporate incorporated outside India which –

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

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

'Free reserves' [Section 2(43)]

'Free reserves' means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend.

Provided that –

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

shall not be treated as free reserves.

'Global Depository Receipt' [Section 2(44)]

'Global Depository Receipt' means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipts.

'Government company' [Section 2(45)]

'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.

Explanation: For the purposes of section 2(45), the term "paid-up share capital" shall be construed as "total voting power", where shares with differential voting rights have been issued.

'Holding company' [Section 2(46)]

'Holding company', in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Explanation. For the purposes of this clause, the expression 'company' includes any body corporate.

'Independent director' [Section 2(47)]

'Independent director' means an independent director referred to in sub-section (5) of section 149.

'Indian Depository Receipt' [Section 2(48)]

'Indian Depository Receipt' means any instrument in the form of a depository receipt created by a domestic depository in India and authorised by a company incorporated outside India making an issue of such depository receipts.

'Interested director' [Section 2(49)]

Omitted by the Companies (Amendment) Act, 2017.

'Issued capital' [Section 2(50)]

'Issued capital' means such capital as the company issues from time to time for subscription.

'Key managerial personnel' [Section 2(51)]

'Key managerial personnel', in relation to company, means –

(i) the Chief Executive Officer or the managing director or the manager;

(ii) the company secretary;

(iii) the whole-time director;

(iv) the Chief Financial Officer; and

(v) such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and

(vi) such other officer as may be prescribed.

'Listed company' [Section 2(52)]

'Listed company' means a company which has any of its securities listed on any recognised stock exchange.

'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.

'Managing director' [Section 2(54)]

'Managing director' means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

Explanation. For the purposes of this clause, the power to do administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, shall not be deemed to be included within the substantial powers of management.

'Member' [Section 2(55)]

'Member', in relation to a company, means –

(i) the subscriber to the memorandum of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members;

(ii) every other person who agrees in writing to become a member of the company and whose name is entered in the register of members of the company;

(iii) every person holding shares of the company and whose name is entered as a beneficial owner in the records of a depository.

'Memorandum' [Section 2(56)]

'Memorandum' means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act.

'Net worth' [Section 2(57)]

'Net worth' means the aggregate value of the paid-up share capital and all reserves created out of the profits, securities premium account and debit or credit balance of profit and loss account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

'Notification' [Section 2(58)]

'Notification' means a notification published in the Official Gazette and the expression "notify" shall be construed accordingly.

'Officer' [Section 2(59)]

'Officer' includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act.

'Officer who is in default' [Section 2(60)]

'Officer who is in default', for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely:

(i) whole-time director;

(ii) key managerial personnel;

(iii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;

(iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;

(v) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity;

(vi) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance;

(vii) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer.

'Official Liquidator' [Section 2(61)]

'Official Liquidator' means an Official Liquidator appointed under sub-section (1) of section 359.

'One Person Company' [Section 2(62)]

'One Person Company' means a company which has only one person as a member.

'Ordinary or special resolution' [Section 2(63)]

'Ordinary or special resolution' means an ordinary resolution, or as the case may be, special resolution referred to in section 114.

'Paid-up share capital' or 'share capital paid-up' [Section 2(64)]

'Paid-up share capital' or 'share capital paid-up' means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.

'Postal ballot' [Section 2(65)]

'Postal ballot' means voting by post or through any electronic mode.

'Prescribed' [Section 2(66)]

'Prescribed' means prescribed by rules made under this Act.

'Previous company law' [Section 2(67)]

'Previous company law' means any of the laws specified below:

(i) Acts relating to companies in force before the Indian Companies Act, 1866;

(ii) the Indian Companies Act, 1866;

(iii) the Indian Companies Act, 1882;

(iv) the Indian Companies Act, 1913;

(v) the Registration of Transferred Companies Ordinance, 1942;

(vi) the Companies Act, 1956; and

(vii) any law corresponding to any of the aforesaid Acts or the Ordinances and in force —

  (A) in the merged territories or in a Part B State (other than the State of Jammu and Kashmir), or any part thereof, before the extension thereto of the Indian Companies Act, 1913; or

  (B) in the State of Jammu and Kashmir, or any part thereof, before the commencement of the Jammu and Kashmir (Extension of Laws) Act, 1956, in so far as banking, insurance and financial corporations are concerned, and before the commencement of the Central Laws (Extension to Jammu and Kashmir) Act, 1968, in so far as other corporations are concerned;

(viii) the Portuguese Commercial Code, in so far as it relates to sociedades anonimas; and

(ix) the Registration of Companies (Sikkim) Act, 1961.

'Private company' [Section 2(68)]

'Private company' means a company having a minimum paid-up share capital as may be prescribed, and which by its articles, –

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to 200:

  Provided that where 2 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

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

In case of a company licenced under section 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the requirement of having minimum paid-up share capital shall not apply [Notification No. G.S.R. 466(E) dated 5th June, 2015].

'Promoter' [Section 2(69)]

'Promoter' means a person –

(a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or

(b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

(c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity.

'Prospectus' [Section 2(70)]

'Prospectus' means any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

'Public company' [Section 2(71)]

'Public company' means a company which –

(a) is not a private company; and

(b) has a minimum paid-up share capital as may be prescribed.

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.

In case of a company licenced under section 8 which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, the requirement of having minimum paid-up share capital shall not apply [Notification No. G.S.R. 466(E) dated 5th June, 2015].

'Public financial institution' [Section 2(72)]

'Public financial institution' means –

(i) the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956;

(ii) the Infrastructure Development Finance Company Limited, referred to in clause (vi) of sub-section (1) of section 4A of the Companies Act, 1956 so repealed under section 465 of this Act;

(iii) speeified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;

(iv) institutions notified by the Central Government under sub-section (2) of section 4A of the Companies Act, 1956 so repealed under section 465 of this Act;

(v) 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 other than this Act or the previous company law; 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.

'Recognised stock exchange' [Section 2(73)]

'Recognised stock exchange' means a recognised stock exchange as defined in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956.

'Register of companies' [Section 2(74)]

'Register of companies' means the register of companies maintained by the Registrar on paper or in any electronic mode under this Act.

'Registrar' [Section 2(75)]

'Registrar' means a Registrar, an Additional Registrar, a Joint Registrar, a Deputy Registrar or an Assistant Registrar, having the duty of registering companies and discharging various functions under this Act.

'Related party' [Section 2(76)]

'Related party', with reference to a company, means –

(i) a director or his relative;

(ii) a key managerial personnel or his relative;

(iii) a firm, in which a director, manager or his relative is a partner;

(iv) a private company in which a director or manager or his relative is a member or director;

(v) a public company in which a director or manager is a director and holds along with his relatives, more than 2% of its paid-up share capital;

(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act;

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

(viii) any body corporate which is –

(A) a holding, subsidiary or an associate company of such company;

(B) a subsidiary of a holding company to which it is also a subsidiary; or

(C) an investing company or the venturer of the company;

Explanation. For the purpose of this clause, 'the investing company or the venturer of a company' means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

In case of a private company which has not committed any default in filing with the Registrar its financial statements under section 137 or annual return under section 92, sub-clause (viii) of clause (76) of section 2 shall not apply with respect to section 188 [Notification No. G.S.R. 464(E) dated 5th June, 2015].

(ix) such other person as may be prescribed.

For the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director other than an independent director or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party [Rule 3 of the Companies (Specification of definitions details) Rules, 2014].

'Relative' [Section 2(77)]

'Relative', with reference to any person, means any one who is related to another, if –

(i) they are members of a Hindu Undivided Family;

(ii) they are husband and wife; or

(iii) one person is related to the other in such manner as may be prescribed.

As per Rule 4 of the Companies (Specification of definitions details) Rules, 2014, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely:

(1) Father (including step-father)

(2) Mother (including step-mother)

(3) Son (including step-son)

(4) Son's wife

(5) Daughter

(6) Daughter's husband

(7) Brother (including step-brother)

(8) Sister (includes step-sister)

'Remuneration' [Section 2(78)]

'Remuneration' means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961.

'Schedule' [Section 2(79)]

'Schedule' means a Schedule annexed to this Act.

'Scheduled bank' [Section 2(80)]

'Scheduled bank' means the scheduled bank as defined in clause (e) of Section 2 of the Reserve Bank of India Act, 1934.

'Securities' [Section 2(81)]

'Securities' means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

'Securities and Exchange Board' [Section 2(82)]

'Securities and Exchange Board' means the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992;

'Serious Fraud Investigation Office' [Section 2(83)]

'Serious Fraud Investigation Office' means the office referred to in section 211.

'Share' [Section 2(84)]

'Share' means a share in the share capital of a company and includes stock.

'Small company' [Section 2(85)]

'Small company' means a company, other than a public company, –

(i) paid-up share capital of which does not exceed Rs. 50 lakh or such higher amount as may be prescribed which shall not be more than Rs. 10 crore; and

(ii) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed Rs. 2 crore or such higher amount as may be prescribed which shall not be more than Rs. 100 crore:

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.

'Subscribed capital' [Section 2(86)]

'Subscribed capital' means such part of the capital which is for the time being subscribed by the members of a company.

'Subsidiary company' or 'subsidiary' [Section 2(87)]

'Subsidiary company' or 'subsidiary', in relation to any other company (that is to say the holding company), means a company in which the holding company –

(i) controls the composition of the Board of Directors; or

(ii) 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.

Explanation. For the purposes of this clause, –

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression "company" includes any body corporate;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries.

MCA has vide General Circular No. 20/2013 dated 27.12.2013, clarified that the shares held by a company or power exercisable by it in another company in a 'fiduciary capacity' shall not be counted for the purpose of determining the holding-subsidiary relationship in terms of the provision of section 2(87) of the Companies Act, 2013.

'Sweat equity shares' [Section 2(88)]

'Sweat equity shares' means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

'Total voting power' [Section 2(89)]

'Total voting power', in relation to any matter, means the total number of votes which may be cast in regard to that matter on a poll at a meeting of a company if all the members thereof or their proxies having a right to vote on that matter are present at the meeting and cast their votes.

'Tribunal' [Section 2(90)]

'Tribunal' means the National Company Law Tribunal constituted under section 408.

'Turnover' [Section 2(91)]

'Turnover' means the gross amount of revenue recognised in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year.

'Unlimited company' [Section 2(92)]

'Unlimited company' means a company not having any limit on the liability of its members.

'Voting right' [Section 2(93)]

'Voting right' means the right of a member of a company to vote in any meeting of the company or by means of postal ballot.

'Whole-time director' [Section 2(94)]

'Whole-time director' includes a director in the whole-time employment of the company.

'Winding up' [Section 2(94A)]

'Winding up' means winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable.

Miscellaneous [Section 2(95)]

Words and expressions used and not defined in this Act but defined in the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 shall have the meanings respectively assigned to them in those Acts.

Appendix 2

The Companies (Restriction on Number of Layers) Rules, 2017

MINISTRY OF CORPORATE AFFAIRS

NOTIFICATION

New Delhi, the 20th September, 2017

G.S.R. 1176 (E).— In exercise of the powers conferred under proviso to clause (87) of section 2, section 450 read with sub-sections (1) and (2) of section 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the following rules, namely:

1. **Short title and Commencement.-**
   (1) These rules may be called the Companies (Restriction on number of layers) Rules, 2017.
   (2) They shall come into force on the date of their publication in the Official Gazette.
2. **Restriction on number of layers for certain classes of holding companies.-**
   (1) On and from the date of commencement of these rules, no company, other than a company belonging to a class specified in sub-rule (2), shall have more than two layers of subsidiaries:

   Provided that the provisions of this sub-rule shall not affect a company from acquiring a company incorporated outside India with subsidiaries beyond two layers as per the laws of such country:

   Provided further that for computing the number of layers under this rule, one layer which consists of one or more wholly owned subsidiary or subsidiaries shall not taken into account.

   (2) The provisions of this rule shall not apply to the following classes of companies, namely:-
   (a) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
   (b) a non-banking financial company as defined in clause (f) of Section 45-I of the Reserve Bank of India Act, 1934 which is registered with the Reserve Bank of India and considered as systematically important non-banking financial company by the Reserve Bank of India;

(c) an insurance company being a company which carries on the business of insurance in accordance with provisions of the Insurance Act, 1938 (4 of 1938) and the Insurance Regulatory Development Authority Act, 1999 (41 of 1999);

(d) a government company referred to in clause (45) of section 2 of the Act.

(3) The provisions of this rule shall not be in derogation of the proviso to sub-section (1) of section 186 of the Act.

(4) Every company, other than a company referred to in sub-rule (2), existing on or before the commencement of these rules, which has number of layers of subsidiaries in excess of the layers specified in sub-rule (1) –

(i) shall file, with the Registrar a return in Form CRL-1 disclosing the details specified therein, within a period of one hundred and fifty days from the date of publication of these rules in the Official Gazette;

(ii) shall not, after the date of commencement of these rules, have any additional layer of subsidiaries over and above the layers existing on such date; and

(iii) shall not, in case one or more layers are reduced by it subsequent to the commencement of these rules, have the numbers of layers beyond the number of layers it has after such reduction or maximum layers allowed in sub-rule (1), whichever is more.

(5) If any company contravenes any provision of these rules the company and every officer of the company who is in default shall be punishable with fine which may extend to ten thousand rupees and where the contravention is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which such contravention continues.

Appendix 3

The Companies (Mediation and Conciliation) Rules, 2016

MINISTRY OF CORPORATE AFFAIRS

NOTIFICATION

New Delhi, the 9th September, 2016

G.S.R. 877 (E).—In exercise of the powers conferred under section 442 read with section 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the following rules, namely:

1. Short Title and Commencement

(1) These rules may be called the Companies (Mediation and Conciliation) Rules, 2016.

(2) They shall come into force on the date of their publication in the Official Gazette.

2. Definitions

(1) In these rules, unless the context otherwise requires,—

(a) "Act" means the Companies Act, 2013 (18 of 2013);

(b) "Regional Director" means the person appointed by the Central Government in the Ministry of Corporate Affairs as a Regional Director;

(c) "Annexure" means the annexure attached to these rules;

(d) "Form" or "e-Form" means a form set forth in the Annexure which shall be used for the matter to which it relates;

(e) "Panel" means the Mediation and Conciliation Panel.

(2) The words and expressions used in these rules but not defined and defined in the Act or in the Companies (Specification of Definitions Details) Rules, 2014 shall have the meanings respectively assigned to them in the Act or the rules.

3. Panel of mediators or conciliators

(1) Regional Director shall prepare a panel of experts willing and eligible to be appointed as mediators or conciliators in the respective regions and such panel shall be placed on the website of the Ministry of Corporate Affairs or on any other websi s may be notified by the Central Government.

(2) The Regional Director may invite applications from persons interested in getting empanelled as mediator or conciliator and possessing the requisite qualifications specified in Rule 4.

(3) A person who intends to get empanelled as mediator or conciliator and possesses the requisite qualifications shall apply to the Regional Director in Form MDC-1.

(4) Application received under sub-rule (3), if rejected by the Regional Director, the Regional Director shall record the reasons in writing for the same.

(5) The Regional Director shall invite applications from persons interested in getting empanelled as mediator or conciliator every year during the month of February and update the Panel which shall be effective from 1st of April of every year:

Provided that for Financial Year 2016-17, the Regional Director may call for applications from the persons interested in getting empanelled as mediator or conciliator, within 60 days from the date of publication of these rules and prepare the panel for the current financial year within a period of 30 days.

4. Qualifications for empanelment

A person shall not be qualified for being empanelled as mediator or conciliator unless he —

(a) has been a Judge of the Supreme Court of India; or

(b) has been a Judge of a High Court; or

(c) has been a District and Sessions Judge; or

(d) has been a Member or Registrar of a Tribunal constituted at the National level under any law for the time being in force; or

(e) has been an officer in the Indian Corporate Law Service or Indian Legal Service with 15 years experience; or

(f) is a qualified legal practitioner for not less than 10 years; or

(g) is or has been a professional for at least 15 years of continuous practice as Chartered Accountant or Cost Accountant or Company Secretary; or

(h) has been a Member or President of any State Consumer Forum; or

(i) is an expert in mediation or conciliation who has successfully undergone training in mediation or conciliation.

5. Disqualifications for empanelment

A person shall be disqualified for being empanelled as mediator or conciliator, if he —

(a) is an undischarged insolvent or has applied to be adjudicated as an insolvent and his application is pending;

(b) has been convicted for an offence which, in the opinion of the Central Government, involves moral turpitude;

(c) has been removed or dismissed from the service of the Government or the Corporation owned or controlled by the Government;

(d) has been punished in any disciplinary proceeding, by the appropriate disciplinary authority; or

(e) has, in the opinion of the Central Government, such financial or other interest in the subject matter of dispute or is related to any of the parties, as is likely to affect prejudicially the discharge by him of his functions as a mediator or conciliator.

6. Application for appointment of Mediator or Conciliator and his appointment

(1) (a) Parties concern may agree on the name of the sole mediator or conciliator for mediation or conciliation between them;

(b) Where, there are two or more sets of parties and are unable to agree on a sole mediator or conciliator, the Central Government or the Tribunal or the Appellate Tribunal may ask each party to nominate the mediator or conciliator or the Central Government or the Tribunal or the Appellate Tribunal may appoint the mediator or conciliator, as may be deemed necessary for mediation or conciliation between the parties.

(2) The application to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, for referring the matter pertaining to any proceeding pending before it for mediation or conciliation shall be in Form MDC-2 and shall be accompanied with a fee of one thousand rupees.

(3) On receipt of an application under sub-rule (2), the Central Government or the Tribunal or the Appellate Tribunal shall appoint one or more experts from the panel.

(4) The Central Government or the Tribunal or the Appellate Tribunal, as the case may be, before which any proceeding is pending may, *suo motu*, refer any matter pertaining to such proceeding to such number of experts from the Mediation and Conciliation Panel, if it deems fit in the interest of parties.

7. Deletion from the Panel

The Regional Director may by recording reasons in writing and after giving him an opportunity of being heard, remove any person from the Panel.

8. Withdrawing name from Panel

Any person who intends to withdraw his name from the Mediation and Conciliation Panel may make an application to the Regional Director indicating the reasons for such withdrawal and the Regional Director shall take a decision on such application within 15 days of receipt of such application and update the Panel accordingly.

9. Duty of mediator or conciliator to disclose certain facts

(1) It shall be the duty of a mediator or conciliator to disclose to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, about any circumstances which may give rise to a reasonable doubt as to his independence or impartiality in carrying out his functions.

(2) Every mediator or conciliator shall from the time of his appointment and throughout continuance of the mediation or conciliation proceedings, without any delay, disclose to the parties about existence of any circumstance referred to in sub-rule (1).

10. Withdrawal of appointment

The Central Government or the Tribunal or the Appellate Tribunal as the case may be, upon receiving any disclosure furnished by the mediator or conciliator under rule 9, or after receiving any other information from a party or other person in any proceeding which is pending and on being satisfied that such disclosures or information has raised a reasonable doubt as to the independence or impartiality of such mediator or conciliator, may withdraw his appointment and in his place, appoint any other mediator or conciliator in that proceeding:

Provided that the mediator or conciliator may, offer to withdraw himself from such proceeding and request the Central Government or the Tribunal or the Appellate Tribunal as the case may be to appoint any other mediator or conciliator.

11. Procedure for disposal of matters

(1) For the purposes of mediation and conciliation, the mediator or conciliator shall follow the following procedure, namely:

(i) he shall fix, in consultation with the parties, the dates and the time of each mediation or conciliation session, where all parties have to be present;

(ii) he shall hold the mediation or conciliation at the place decided by the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, or such other place where the parties and the mediator or conciliator jointly agree;

(iii) he may conduct joint or separate meetings with the parties;

(iv) each party shall, 10 days before a session, provide to the mediator or conciliator a brief memorandum setting forth the issues, which need to be resolved, and his position in respect of those issues and all information reasonably required for the mediator or conciliator to understand the issue and a copy of such memorandum shall also be given to the opposite party or parties:

Provided that in suitable or appropriate cases, the above mentioned period may be reduced at the discretion of the mediator or conciliator;

(v) each party shall furnish to the mediator or conciliator such other information as may be required by him in connection with the issues to be resolved.

(2) Where there is more than one mediator or conciliator, the mediator or conciliators may first concur with the party that agreed to nominate him and thereafter interact with the other mediator or conciliator, with a view to resolve the dispute.

12. Mediator or Conciliator not bound by the Indian Evidence Act, 1872 or the Code of Civil Procedure, 1908

The mediator or conciliator shall not be bound by the Indian Evidence Act, 1872 or the Code of Civil Procedure, 1908 while disposing the matter, but shall be guided by the principles of fairness and natural justice, having regard to the rights and obligations of the parties, usages of trade, if any, and the circumstances of the dispute.

13. Representation of parties

The parties shall ordinarily be present personally or through an authorised attorney at the sessions or meetings notified by the mediator or conciliator:

Provided that the parties may be represented by an authorised person or counsel with the permission of the mediator or conciliator in such sessions or meetings and the mediator or conciliator or the Central Government or the Tribunal or the Appellate Tribunal as the case may be, shall be entitled to direct or ensure the presence of any party to appear in person:

Provided further that the party not residing in India may, with the permission of the mediator or conciliator, be represented by his or her authorised representative at the sessions or meetings.

14. Consequences of non-attendance of parties at sessions or meetings on due dates

If a party fails to attend a session or a meeting fixed by the mediator or conciliator deliberately or wilfully for 2 consecutive times, the mediation or conciliation shall be deemed to have failed and mediator or conciliator shall report the matter to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

15. Administrative assistance

In order to facilitate the conduct of mediation or conciliation proceedings, the mediator or conciliator with the consent of the parties, may arrange for administrative assistance by a suitable institution or person.

16. Offer of settlement by parties

(1) Any party to the proceeding may, "without prejudice" offer a settlement to the other party at any stage of the proceedings, with a notice to the mediator or conciliator.

(2) Any party to the proceeding may make a "with prejudice" offer to the other party at any stage of the proceedings with a notice to the mediator or conciliator.

17. Role of Mediator or Conciliator

The mediator or conciliator shall attempt to facilitate voluntary resolution of the dispute by the parties, and communicate the view of each party to the other, assist them in identifying issues, reducing misunderstandings, clarifying priorities, exploring areas of compromise and generating options in an attempt to resolve the dispute, emphasising that it is the responsibility of the parties to take decision which affect them and he shall not impose any terms of settlement on the parties:

Provided that on consent of both the parties, the mediator or conciliator may impose such terms and conditions on the parties for early settlement of the dispute as he may deem fit.

18. Parties alone responsible for taking decision

The parties shall be made to understand that the mediator or conciliator facilitates in arriving a decision to resolve the dispute and that he shall not and cannot impose any settlement nor the mediator or conciliator give any assurance that the mediation or conciliation shall result in a settlement and the mediator or conciliator shall not impose any decision on the parties.

19. Time limit for completion of mediation or conciliation

(1) The process for any mediation or conciliation under these rules shall be completed within a period of 3 months from the date of appointment of expert or experts from the Panel.

(2) On the expiry of 3 months from the date of appointment of expert from the Panel, the mediation or conciliation process shall stand terminated.

(3) In case of mediation or conciliation in relation to any proceeding before Tribunal or Appellate Tribunal which could not be completed within 3 months, the Tribunal or as the case may be, the Appellate Tribunal, may on the application of mediator or conciliator or any of the party to the proceedings, extend the period for mediation or conciliation by such period not exceeding 3 months.

20. Parties to act in good faith

All the parties shall commit to participate in the proceedings in good faith with the intention to settle the dispute.

21. Confidentiality, disclosure and inadmissibility of information

(1) When a mediator or conciliator receives factual information concerning the dispute from any party, he shall disclose the substance of that information to the other party, so that the other party may have an opportunity to present such explanation as it may consider appropriate:

Provided that when a party gives information to the mediator or conciliator subject to a specific condition that the information may be kept confidential, the mediator or conciliator shall not disclose that information to the other party.

(2) The receipt or perusal, or preparation of records, reports or other documents by the mediator or conciliator, while serving in that capacity shall be confidential and the mediator or conciliator shall not be compelled to divulge information regarding those documents nor as to what transpired during the mediation or conciliation before the Central Government or the Tribunal or the Appellate Tribunal or as the case may be, or any other authority or any person or group of persons.

(3) The parties shall maintain confidentiality in respect of events that transpired during the mediation and conciliation and shall not rely on or introduce the said information in other proceedings as to —

(i) views expressed by a party in the course of the mediation or conciliation proceedings;

(ii) documents obtained during the mediation or conciliation which were expressly required to be treated as confidential or other notes, drafts or information given by the parties or the mediator or conciliator.

(iii) proposals made or views expressed by the mediator or conciliator;

(iv) admission made by a party in the course of mediation or conciliation proceedings.

(4) There shall be no audio or video recording of the mediation or conciliation proceedings.

(5) No statement of parties or the witnesses shall be recorded by the mediator or conciliator.

22. Privacy

The mediation or conciliation sessions or meetings shall be conducted in privacy where the persons as mentioned in rule 13 shall be entitled to represent parties but other persons may attend only with the permission of the parties and with the consent of the mediator or conciliator.

23. Protection of action taken in good faith

No mediator or conciliator shall be held liable for anything, which is done or omitted to be done by him, in good faith during the mediation or conciliation proceedings for civil or criminal action nor shall be summoned by any party to the suit or proceeding to appear before the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, to testify regarding information received by him or action taken by him or in respect of drafts or records prepared by him or shown to him during the mediation or conciliation proceedings.

24. Communication between mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal

In order to preserve the confidence of parties in the Central Government or the Tribunal or the Appellate Tribunal as the case may be and the neutrality of the mediator or conciliator, there shall be no communication between the mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in the subject matter:

Provided that, if any communication between the mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, is necessary, it shall be in writing and copies of the same shall be given to the parties or the authorised representative:

Provided further that communication between the mediator or conciliator and the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, shall be limited to communication by the mediator or conciliator:

(i) about the failure of the party to attend;

(ii) about the consent of the parties;

(iii) about his assessment that the case is not suited for settlement through the mediation or conciliation;

(iv) about settlement of dispute between the parties.

25. Settlement agreement

(1) Where an agreement is reached between the parties in regard to all the issues or some of the issues in the proceeding, the same shall be reduced to writing and signed by the parties and if any counsel has represented the parties, the conciliator or mediator may also obtain the signature of such counsel on the settlement agreement.

(2) The agreement of the parties so signed shall be submitted to the mediator or conciliator who shall, with a covering letter signed by him, forward the same to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

(3) Where no agreement is reached at between the parties, before the time limit specified in rule 19, or where the mediator or conciliator is of the view that no settlement is possible, he shall report the same to the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, in writing.

26. Fixing date for recording settlement and passing order

(1) The Central Government or the Tribunal or the Appellate Tribunal as the case may be, shall fix a date of hearing normally within 14 days from the date of receipt of the report of the mediator or conciliator under rule 25 and on such date of hearing, if the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, is satisfied that the parties have settled their dispute, it shall pass an order in accordance with terms thereof.

(2) If the settlement disposes of only certain issues arising in the proceeding, on the basis of which any order is passed as stated in sub-rule (1), the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, shall proceed further to decide the remaining issues.

27. Expenses of the mediation and conciliation

(1) At the time of referring the matter to the mediation or conciliation, the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, may fix the fee of the mediator or conciliator and as far as possible, a consolidated sum may be fixed rather than for each session or meeting.

(2) The expense of the mediation or conciliation including the fee of the mediator or conciliator, costs of administrative assistance and other ancillary expenses concerned, shall be borne equally by the various contesting parties or as may be otherwise directed by the Central Government or the Tribunal or the Appellate Tribunal, as the case may be.

(3) Each party shall bear the costs for production of witnesses on his side including experts or for production of documents.

(4) The mediator or conciliator may, before the commencement of the mediation or conciliation, direct the parties to deposit equal share of the probable costs of the mediation or conciliation including the fees to be paid to the mediator or conciliator.

(5) If any party or parties do not pay the amount referred to sub-rule (4), the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, shall on the application of the mediator or conciliator, or any party, issue appropriate directions to the concerned parties.

(6) The mediation or conciliation shall commence only on the deposit of amount referred to in sub-rule (4) and in case amount is not paid before such commencement, the mediation or conciliation shall be deemed to have terminated.

28. Ethics to be followed by Mediator or Conciliator

The mediator or conciliator shall—

(a) follow and observe the rules strictly and with due diligence;

(b) not carry on any activity or conduct which shall reasonably be considered as conduct unbecoming of a mediator or conciliator;

(c) uphold the integrity and fairness of the mediation or conciliation process;

(d) ensure that the parties involved in the mediation or conciliation are fairly informed and have an adequate understanding of the procedural aspects of the process;

(e) satisfy himself or herself that he or she is qualified to undertake and complete the assignment in a professional manner;

(f) disclose any interest or relationship likely to affect impartiality or which might seek an appearance of partiality or bias;

(g) avoid, while communicating with the parties, any impropriety or appearance of impropriety;

(h) be faithful to the relationship of trust and confidentiality imposed in the office of mediator or conciliator;

(i) conduct all proceedings related to the resolutions of a dispute, in accordance with the relevant applicable law;

(j) recognise that the mediation or conciliation is based on principles of self-determination by the parties and that the mediation or conciliation process relies upon the ability of parties to reach a voluntary, undisclosed agreement; and

(k) maintain the reasonable expectations of the parties as to confidentiality and refrain from promises or guarantees of results.

Provided that if any party finds conduct of mediator or conciliator violative of ethics laid down in this rule, the party may immediately bring it to the notice of the Regional Director.

29. Resort to arbitral or judicial proceedings

The parties shall not initiate, during the mediation or conciliation under these rules, any arbitral or judicial proceedings in respect of a matter that is the subject-matter of the mediation or conciliation, except that a party may initiate arbitral or Judicial proceedings, where, in his, opinion, such proceedings are necessary for protecting his rights.

30. Matters not to be referred to the mediation or conciliation

The following matters shall not be referred to mediation or conciliation, namely:—

(a) the matters relating to proceedings in respect of inspection or investigation under Chapter XIV of the Act; or the matters which relate to defaults or offences for which applications for compounding have been made by one or more parties.

(b) cases involving serious and specific allegations of fraud, fabrication of documents forgery, impersonation, coercion etc.

(c) cases involving prosecution for criminal and non-compoundable offences.

(d) cases which involve public interest or interest of numerous persons who are not parties before the Central Government or the Tribunal or the Appellate Tribunal as the case may be.

Appendix 4

The Companies (Adjudication of Penalties) Rules, 2014

MINISTRY OF CORPORATE AFFAIRS

NOTIFICATION

New Delhi, the 31st March, 2014

G.S.R. 253 (E).— In exercise of the powers conferred by section 454 read with section 469 of the Companies Act, 2013, the Central Government hereby makes the following rules, namely:-

1. Short title and commencement. –

(1) These rules may be called the Companies (Adjudication of Penalties) Rules, 2014.

(2) They shall come into force on the date of their publication in the Official Gazette.

2. Definitions.

(1) In these rules, unless the context otherwise requires,-

(a) "Act" means the Companies Act, 2013 (18 of 2013);

(b) "Annexure" means the Annexure enclosed to these Rules;

(c) "Fees" means fees as prescribed in the Companies (Registration Offices and Fees) Rules, 2014;

(d) "Form" or 'e-Form" means a form set forth in Annexure to these rules which shall be used for the matter to which it relates;

(e) "Regional Director" means the person appointed by the Central Government in the Ministry of Corporate Affairs as a Regional Director;

(f) "section" means section of the Act;

(2) Words and expressions used in these rules but not defined, and defined in the Act or in the Companies (Specification of definitions details) Rules, 2014 shall have the meanings respectively assigned to them in the Act or in the said Rules.

3. Adjudication of Penalties.

(1) The Central Government may appoint any of its officers, not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of the Act.

(2) Before adjudging penalty, the adjudicating officer shall issue a written notice in the specified manner, to the company, the officer who is in default or any other person, as the case may be, to show cause, within such period as may be specified in the notice (not being less than 15 days and more than 30 days from the date of service thereon), why the penalty should not be imposed on it or him.

(3) Every notice issued under sub-rule (2), shall clearly indicate the nature of non-compliance or default under the Act alleged to have been committed or made by such company, officer in default, or any other person, as the case may be and also draw attention to the relevant penal provisions of the Act and the maximum penalty which can be imposed on the company, and each of the officers in default, or the other person.

(4) The reply to such notice shall be filed in electronic mode only within the period as specified in the notice:

Provided that the adjudicating officer may, for reasons to be recorded in writing, extend the period referred to above by a further period not exceeding 15 days, if the company or officer in default or any person as the case may be, satisfies the adjudicating officer that it or he has sufficient cause for not responding to the notice within the stipulated period or the adjudicating officer has reason to believe that the company or the officer or the person has received a shorter notice and did not have reasonable time to give reply.

(5) If, after considering the reply submitted by such company, its officer, or any other person, as the case may be, the adjudicating officer is of the opinion that physical appearance is required, he shall issue a notice, within a period of 10 working days from the date of receipt of reply fixing a date for the appearance of such company, through its authorised representative, or officer of such company, or any other person, whether personally or through his authorised representative:

Provided that if any person, to whom a notice is issued under sub-rule (2), desires to make an oral representation, whether personally or through his authorised representative and has indicated the same while submitting his reply in electronic mode, the adjudicating officer shall allow such person to make such representation after fixing a date of appearance.

(6) On the date fixed for hearing and after giving a reasonable opportunity of being heard to the person concerned, the adjudicating officer may, subject to reasons to be recorded in writing, pass any order in writing as he thinks fit including an order for adjournment :

Provided that after hearing, adjudicating officer may require the concerned person to submit his reply in writing on certain other issues related to the notice under sub-rule (2), relevant for determination of the default.

(7) The adjudicating officer shall pass an order,-

(a) within 30 days of the expiry of the period referred in sub-rule (2) or of such extended period as referred therein, where physical appearance was not required under sub-rule (5);

(b) within 90 days of the date of issue of notice under sub-rule (2), where any person appeared before the adjudicating officer under sub-rule (5):

Provided that in case an order is passed after the aforementioned duration, the reasons of the delay shall be recorded by the adjudicating officer and no such order shall be invalid merely because of its passing after the expiry of such 30 days or 90 days as the case may be.

(8) Every order of the adjudicating officer shall be duly dated and signed by him and shall clearly state the reasons for requiring the physical appearance under sub-rule (5).

(9) The adjudicating officer shall send a copy of the order passed by him to the concerned company, officer who is in default or any other person or all of them and to the Central Government and a copy of the order shall also be uploaded on the website.

(10) For the purposes of this rule, the adjudicating officer shall exercise the following powers, namely:-

(a) to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case after recording reasons in writing;

(b) to order for evidence or to produce any document, which in the opinion of the adjudicating officer, may be relevant to the subject matter.

(11) If any person fails to reply or neglects or refuses to appear as required under sub-rule (5) or sub- rule (10) before the adjudicating officer, the adjudicating officer may pass an order imposing the penalty, in the absence of such person after recording the reasons for doing so.

(12) While adjudging quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely:-

(a) size of the company;

(b) nature of business carried on by the company;

(c) injury to public interest;

(d) nature of the default;

(e) repetition of the default;

(f) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default; and

(g) the amount of loss caused to an investor or group of investors or creditors as a result of the default:

Provided that, in no case, the penalty imposed shall be less than the minimum penalty prescribed, if any, under the relevant section of the Act.

(13) In case a fixed sum of penalty is provided for default of a provision, the adjudicating officer shall impose that fixed sum, in case of any default therein.

(14) Penalty shall be paid through Ministry of Corporate Affairs portal only.

(15) All sums realised by way of penalties under the Act shall be credited to the Consolidated Fund of India.

Explanation 1.- For the purposes of this rule, the term "specified manner" shall mean service of documents as specified under section 20 of the Act and rules made thereunder and details in respect of address (including electronic mail ID) provided in the KYC documents filed in the registry shall be used for communication under this rule.

Explanation 2.- For the purposes of this rule, it is hereby clarified that the requirement of submission of replies in electronic mode shall become mandatory after the creation of the e-adjudication platform.

4. Appeal against the order of adjudicating officer. –

(1) Every appeal against the order of the adjudicating officer shall be filed in writing with the Regional Director having jurisdiction in the matter within a period of 60 days from the date of receipt of the order of adjudicating officer by the aggrieved party, in Form ADJ setting forth the grounds of appeal and shall be accompanied by a certified copy of the order against which the appeal is sought:

Provided that where the party is represented by an authorized representative, a copy of such authorisation in favour of the representative and the written consent thereto by such authorized representative shall also be appended to the appeal:

Provided further that an appeal in Form ADJ shall not seek relief(s) therein against more than one order unless the reliefs prayed for are consequential.

(2) Every appeal filed under this rule shall be accompanied by such fee as provided in the Companies (Registration Offices and Fees) Rules, 2014.

5. Registration of appeal. -

(1) On the receipt of an appeal, office of the Regional Director shall endorse the date on such appeal and shall sign such endorsement.

(2) If, on scrutiny, the appeal is found to be in order, it shall be duly registered and given a serial number:

Provided that where the appeal is found to be defective, the Regional Director may allow the appellant such time, not being less than 14 days following the date of receipt of intimation by the appellant from the Regional Director about the nature of the defects, to rectify the defects and if the appellant fails to rectify such defects within the time period allowed as above, the Regional Director may by order and for reasons to be recorded in writing, decline to register such appeal and communicate such refusal to the appellant within a period of 7 days thereof:

Provided further that the Regional Director may, for reasons to be recorded in writing, extend the period referred to in the first proviso above by a further period of 14 days if an appellant satisfies the Regional Director that the appellant had sufficient cause for not rectifying the defects within the period of 14 days referred to in the first proviso.

6. Disposal of appeal by Regional Director.-

(1) On the admission of the appeal, the Regional Director shall serve a copy of appeal upon the adjudicating officer against whose order the appeal is sought along-with a notice requiring such adjudicating officer to file his reply thereto within such period, not exceeding 21 days, as may be stipulated by the Regional Director in the said notice:

Provided that the Regional Director may, for reasons to be recorded in writing, extend the period referred to in sub-rule (1) above for a further period of 21 days, if the adjudicating officer satisfies the Regional Director that he had sufficient cause for not being able to file his reply to the appeal within the above-said period of 21 days.

(2) A copy of every reply, application or written representation filed by the adjudicating officer before the Regional Director shall be forthwith served on the appellant by the adjudicating officer.

(3) The Regional Director shall notify the parties, the date of hearing of the appeal which shall not be a date earlier than 30 days following the date of such notification for hearing of the appeal.

(4) On the date fixed for hearing the Regional Director may, subject to the reasons to be recorded in writing, pass any order as he thinks fit including an order for adjournment of the hearing to a future date.

(5) In case the appellant or the adjudicating officer does not appear on the date fixed for hearing, the Regional Director may dispose of the appeal *ex-parte:*

Provided that where the appellant appears afterwards and satisfies the Regional Director that there was sufficient cause for his nonappearance, the Regional Director may make an order setting aside the *ex-parte* order and restore the appeal.

(6) Every order passed under this rule shall be dated and signed by the Regional Director.

(7) A certified copy of every order passed by the Regional Director shall be communicated to the adjudicating officer and to the appellant forthwith and to the Central Government.

Corporate Secretarial Practice

Chapter 14

Bird's eye-view of the Chapter

1	2
Nature of resolutions and requirements of drafting a resolution	Key points for drafting minutes of a Board meeting

14.1 Nature of resolutions and requirements of drafting a resolution

1. The resolutions passed by the members may be classified as follows:
   (i) Ordinary resolutions
   (ii) Special resolutions
   (iii) Resolution passed without any vote cast against it (Required under section 162).
2. An ordinary resolution or a special resolution, as the case may be, may be passed –
   (i) in a general meeting (whether AGM or EGM); or
   (ii) by postal ballot.
3. Postal ballot may be used for transacting any item of business requiring the approval of the members, other than –
   (i) ordinary business; and
   (ii) any business in respect of which directors or auditors have a right to be heard at the meeting.
4. The resolutions passed by the Board of directors may be classified as follows:
   (i) Resolutions by majority (also termed as Board resolutions)
   (ii) Unanimous resolutions.
5. Following points must be taken into account while drafting a resolution:
   (i) The resolution should contain a reference of the relevant Section, Rule, Schedule etc.
   (ii) Where authorisation is required in the articles for passing a resolution, the resolution should contain the reference of relevant Regulation No. of the articles.
   (iii) Where the resolution shall become effective only when the approval of any statutory authority (*e.g.* the Central Government, Tribunal, etc.) is obtained, the resolution must state so.
   (iv) Where any document is to be approved by passing a resolution, the resolution should contain a reference of such document.
   (v) A new paragraph should be used for starting a new sentence.
   (vi) A resolution should not contain more than one subject matter.

Practical Problems from CA Examinations

Drafting of resolution for appointment of managing director

P 14.1A. Draft a Board resolution for appointment of Mr. Paul as the managing director for 5 years with effect from 1st June, 2014 of DBM Limited passed in a Board meeting held on 2nd May, 2014 at its registered office. **[ICAI, RTP, May 2015]**

OR

Mr. Paul was appointed as the managing director for 5 years with effect from 1st June, 2011 in a Board meeting of DBM Limited. Draft a Board resolution for such appointment. **[ICAI, RTP, Nov. 2012]**

Ans.

Subject – Appointment of managing director
Passing Authority – Board of directors
Nature of the Resolution – Resolution with simple majority

"RESOLVED THAT pursuant to the provisions of sections 196, 197, 203, Schedule V and all other applicable provisions, if any, of the Companies Act, 2013 and pursuant to the recommendation of the Nomination and Remuneration Committee and subject to the approval of the members in the general meeting, Mr. Paul, who fulfils the requirements given under sub-section (3) of section 196 and Part I of Schedule V to the Companies Act, 2013 be and is hereby appointed as the managing director of the company for a period of 5 years with effect from 1st June, 2014 on such remuneration and such terms and conditions as are contained in the draft agreement entered into between the company and Mr. Paul, a copy of which has been initialed by the Chairman for the purpose of identification and is laid before this meeting.

FURTHER RESOLVED THAT Mr. Paul shall not be liable to retire by rotation.

FURTHER RESOLVED THAT Mr. ________, the Company Secretary of the company, be and is hereby authorised to file necessary returns with the Registrar, make necessary entries in the relevant Registers and take all such steps and actions as may be required to give effect to this resolution."

Drafting of resolution for appointment of a person as a managing director who is already the managing director of a public company

P 14.1B. Morbani Woods Limited decides to appoint Mr. Wahid as its Managing Director for a period of 5 years with effect from 1 May, 2018. Mr. Wahid fulfils all the conditions as specified in Part I of Schedule V to the Companies Act, 2013.

The terms of appointment are as under:

(i) Salary Rs. 1 lakh per month;

(ii) Commission, as may be decided by the Board of directors of the company;

(iii) Perquisites:

Free housing,
Medical reimbursement up to Rs. 10,000 per month,
Leave travel concession for the family,
Club membership fee,
Personal accident insurance Rs. 10 lakh,
Gratuity, and
Provident fund as per company's policy.

You, being the Secretary of the said company, are required to draft a resolution to give effect to give effect to the above, assuming that Mr. Wahid is already the Managing Director in a public limited company. **[CA (Final) May 2013]**

Ans.

Subject – Appointment of a person as managing director who is already managing director in one public company
Passing Authority – Board of directors
Nature of the Resolution – Unanimous resolution

"RESOLVED THAT pursuant to the provisions of sections 196, 197, 203, Schedule V and all other applicable provisions, if any, of the Companies Act, 2013 and pursuant to the recommendation of the Nomination and Remuneration Committee and subject to the approval of the members in the general meeting, consent of all the directors present at this meeting be and is hereby accorded to the appointment of Mr. Wahid, who is already a managing director in M/s __________ Limited, and who fulfils the requirements given under sub-section (3) of section 196 and Part I of Schedule V to the Companies Act, 2013, as the managing director of the company for a period of 5 years effective from 1st May, 2018 on the following terms and conditions:

(A) Salary: Rs. 1 lakh per month

(B) Commission: As may be decided by the Board of directors of the company

(C) Perquisites:

(i) Free housing

(ii) Medical reimbursement up to Rs. 10,000 per month

(iii) Leave travel concession for the family

(iv) Club membership fee

(v) Personal accident insurance Rs. 10 lakh

(vi) Gratuity

(vii) Provident fund as per company's policy.

FURTHER RESOLVED THAT in case of loss or inadequacy of profit, Mr. Wahid shall be paid remuneration in accordance with Section II and Section III of Part II of Schedule V.

FURTHER RESOLVED THAT the duties of Mr. Wahid shall be the overall supervision of the functioning of the company, handling day to day affairs of the company, regularly reporting to Board with respect to the activities of the company and to perform all other duties that the Board may delegate to him from time to time.

FURTHER RESOLVED THAT Mr. ________, the Company Secretary of the company, be and is hereby authorised to file necessary returns with the Registrar, make necessary entries in the relevant Registers and take all such steps and actions as may be required to give effect to this resolution."

Drafting of resolutions appointing additional director and filling a casual vacancy

P 14.1C. A public company proposes to appoint Shri Ram as additional director and Shri Gopal as director in the casual vacancy caused by resignation of the office of the director by Shri Mohan. Draft suitable resolutions for the appointment of Shri Ram and Shri Gopal as directors. **[CA (Final) Nov. 1999]**

OR

Draft a "Board Resolution" for appointment of a person as an additional director in a public company. **[CA (Final) Nov. 2012]**

OR

Mr. N is appointed as an additional director by the Board of directors of MNR Company Limited at its meeting held on 1st October, 2014 for a period as permitted by the law.

Draft a resolution and state the body which appoints N. **[CA (Final) Nov. 2014]**

Ans.

Subject – Appointment of an additional director

Passing Authority – Board of directors

Nature of the Resolution – Resolution with simple majority

"RESOLVED THAT pursuant to the provisions of section 161(1) and all other applicable provisions, if any, of the Companies Act, 2013 and pursuant to Regulation No. _____ of the articles of association of the Company, Shri Ram, who holds Director Identification No. ___________, and who has filed his consent with the company as per the provisions of section 152(5) of the Companies Act, 2013, and who is not disqualified as per the provisions of section 164 of the Companies Act, 2013, be and is hereby appointed as an additional director of the company.

FURTHER RESOLVED THAT Shri Ram shall hold office of additional director till the next annual general meeting or the last date on which the AGM should have been held, whichever is earlier.

FURTHER RESOLVED THAT Mr. ...., the Company Secretary of the company, be and is hereby authorised to file all the necessary returns in this regard with the Registrar, make necessary entries in the Register of Directors and to do all acts and things as may be necessary in this connection."

Subject – Filling up of a casual vacancy

Passing Authority – Board of directors

Nature of the Resolution – Resolution with simple majority

"RESOLVED THAT pursuant to the provisions of section 161(4) of the Companies Act, 2013, and subject to the approval of the members in the immediately next general meeting, Shri Gopal who holds Director Identification No. ___________, and who has filed his consent with the company as per the provisions of section 152(5) of the Companies Act, 2013, and who is not disqualified as per the provisions of section 164 of the Companies Act, 2013, be and is hereby appointed as a director of the company to fill up the casual vacancy caused by the resignation of Shri Mohan.

FURTHER RESOLVED THAT Shri Gopal shall hold office only upto the date upto which Shri Mohan would have held office had he not resigned.

FURTHER RESOLVED THAT Mr. ...., the Company Secretary of the company, be and is hereby authorised to file all the necessary returns in this regard with the Registrar, make necessary entries in the Register of Directors and to do all acts and things as may be necessary in this connection."

Drafting of resolution constituting an audit committee

P 14.1D. X Ltd. wants to constitute an Audit Committee. Draft a Board resolution covering the following matters (compliance with Companies Act, 2013 to be ensured):

(1) Members of the Audit Committee

(2) Chairperson of the Audit Committee

(3) Any 2 functions of the said Committee **[CA (Final) May 2002, May, 2003, May, 2007, Nov. 2008, May, 2016]**

OR

Draft a suitable Board resolution to appoint an Audit Committee covering the aspects as provided in the Companies Act, 2013.

Ans.

Subject – Constitution of audit committee

Passing Authority – Board of directors

Nature of the Resolution – Resolution with simple majority

"RESOLVED THAT pursuant to the provisions of section 177 and all other applicable provisions, if any, of the Companies Act, 2013, consent of the Company be and is hereby accorded to the constitution of an audit committee consisting of the following directors:

1. Mr.________, Managing Director
2. Mr.________, Independent Director
3. Mr.________, Independent Director
4. Mr.________, Independent Director
5. Mr.________, Independent Director
6. Mr.________, Non-Executive Director

FURTHER RESOLVED THAT the Chairperson of the audit committee shall be elected by the members of the committee from amongst themselves and shall attend the annual general meeting.

FURTHER RESOLVED THAT the quorum for the audit committee shall be one third of total number of its members or two directors, whichever is higher.

FURTHER RESOLVED THAT the audit committee shall have the authority to investigate into any matter as prescribed under section 177 or referred to it by the Board and for this purpose it shall have access to information contained in the records of the company and to seek external professional advice, if necessary.

FURTHER RESOLVED THAT the audit committee shall perform the following functions:

(i) The recommendation for appointment, remuneration and terms of appointment of auditors of the company

(ii) Review and monitor the auditor's independence and performance, and effectiveness of audit process

(iii) Examination of the financial statement and the auditors' report thereon

(iv) Approval or any subsequent modification of transactions of the company with related parties

(v) Scrutiny of inter-corporate loans and investments

(vi) Valuation of undertakings or assets of the company, wherever it is necessary

(vii) Evaluation of internal financial controls and risk management systems

(viii) Monitoring the end use of funds raised through public offers and related matters.

FURTHER RESOLVED THAT the recommendations of the audit committee shall be binding on the Board, unless the Board records the reasons for not accepting any such recommendation.

FURTHER RESOLVED THAT the audit committee shall meet at least 4 times in a year.

FURTHER RESOLVED THAT the Company Secretary be and is hereby authorised to act as the coordinator and facilitator for the smooth functioning of the audit committee."

Drafting of resolution for waiver of excess remuneration paid to a director

P 14.1E. Mr. Weldon was appointed as a director of Esquire Engineering Ltd. with effect from 1st April, 2014. Since the company, namely, Esquire Engineering Ltd. wanted to take full advantage of the wisdom and expertise of Mr. Weldon, it offered him remuneration payable on monthly basis. Esquire Engineering Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2018.

On scrutiny of the accounts, it was established that the company, till 31st March, 2018, has paid to Mr. Weldon a total sum of Rs. 1.20 lakhs in excess of the remuneration permissible under section 197. You are required to draft a resolution for waiver of recovery of the excess remuneration so paid by the company. **[CA (Final) Nov. 2004, Nov. 2007, Nov. 2009 (Modified)]**

Ans.

Subject – Waiver of recovery of excess remuneration

Passing Authority – General Meeting

Nature of the Resolution – Special Resolution

"RESOLVED THAT pursuant to the provisions of section 197 and other applicable provisions, if any, consent of the company be and is hereby given for waiving the recovery of an amount of Rs. 1,20,000 paid to Mr. Weldon, the director of the company, during the period 1st April, 2017 to 31st March, 2018, being in excess of the remuneration permissible under section 197.

FURTHER RESOLVED THAT the Company Secretary be and is hereby authorised to take the necessary steps in this regard."

Drafting of resolution terminating the services of a managing director and payment of compensation to him

P 14.1F. Draft a Board resolution to give effect to the following decision taken by the Board of directors of M/s. Handerson Gem and Company Limited:

The Board is dissatisfied with the performance of Mr. Indra Sen, managing director and has decided to terminate his contract of service from 1.6.2014 and to pay compensation for loss of office. He has been appointed as managing director for a period of three years with effect from 1.1.2013. **[CA (Final) May 1999]**

Ans.

Subject – Termination of services of a managing director and payment of compensation to him

Passing Authority – Board of directors

Nature of the Resolution – Resolution with simple majority

"WHEREAS Mr. Indra Sen was employed for period of 3 years as the managing director of the company with effect from 1.1.2013, AND WHEREAS the company wanted to terminate the services of Mr. Indra Sen with effect from 1.6.2014, AND WHEREAS the company has duly served the notice of termination to Mr. Indra Sen as per Clause ____ of the agreement between the company and him;

NOW THEREFORE IT IS HEREBY RESOLVED THAT an amount of Rs.____ be paid to Mr. Indra Sen as compensation for the loss of his office as the managing director of the company."

Drafting of resolution for declaration of interim dividend

P 14.1G. Draft a resolutio., for declaration of interim dividend.

Ans.

Subject – Declaration of interim dividend

Passing Authority – Board of directors

Nature of the Resolution – Resolution with simple majority

"RESOLVED THAT pursuant to the provisions of section 123 and all other applicable provisions, if any, of the Companies Act, 2013 and pursuant to Regulation No. ___ of Articles of Association of the Company, an interim dividend of ___% on equity shares of the company be and is hereby declared for the Financial Year 2017-2018, out of the profits of the Company for the Financial Year 2017-2018 and surplus in the Profit and Loss Account.

FURTHER RESOLVED THAT the interim dividend shall be paid to those shareholders whose names appear on the Register of members of the Company as on ____________.

FURTHER RESOLVED THAT the amount of interim dividend shall be deposited in a Separate Bank Account to be opened with ________ (Name of the Bank) within 5 days of declaration of interim dividend.

FURTHER RESOLVED THAT Mr. ________, the director of the company, be and is hereby authorised to sign the dividend warrants and ________ (Name of the Bank) be advised to honour all the dividend warrants / cheques bearing the signature of Mr. _______ by debiting the said Separate Bank Account.

FURTHER RESOLVED THAT the dividend warrants shall be posted to all the shareholders of the Company within 30 days of declaration of interim dividend.

FURTHER RESOLVED THAT the interim dividend so declared shall be ratified by the shareholders of the company in the forthcoming Annual General Meeting of the Company.

FURTHER RESOLVED THAT Mr. ________, the director of the company, be and is hereby authorised to take all such steps and actions as may be required to give effect to this resolution."

Drafting of resolution for declaration of final dividend

P 14.1H. Draft a resolution for declaration of final dividend.

Ans.

Subject – Declaration of final dividend

Passing Authority – General Meeting

Nature of the Resolution – Ordinary Resolution

"RESOLVED THAT pursuant to the provisions of section 123 and all other applicable provisions, if any, of the Companies Act, 2013 and pursuant to recommendation of dividend of ___% by the Board of directors of the Company, a final dividend of ___% on equity shares of the company be and is hereby declared for the Financial Year 2016-2017, out of the profits of the Company.

FURTHER RESOLVED THAT the dividend shall be paid to those shareholders whose names appear on the Register of members of the Company as on ____________.

FURTHER RESOLVED THAT the amount of dividend shall be deposited in a Separate Bank Account to be opened with ________ (Name of the Bank) within 5 days of declaration of dividend.

FURTHER RESOLVED THAT Mr. ________, the director of the company, be and is hereby authorised to sign the dividend warrants and ________ (Name of the Bank) be advised to honour all the dividend warrants / cheques bearing the signature of Mr. _______ by debiting the said Separate Bank Account.

FURTHER RESOLVED THAT the dividend warrants shall be posted to all the shareholders of the Company within 30 days of declaration of dividend.

FURTHER RESOLVED THAT Mr. ________, the director of the company, be and is hereby authorised to take all such steps and actions as may be required to give effect to this resolution."

Drafting of resolution for entrusting the chief accountant with the duty of maintaining proper books of account and preparation of annual accounts

P 14.1I. Mr. White is working as Chief Accountant in M/s. White Metal Limited. The Board of directors of the said company propose to charge him with the duty of ensuring compliance with the provisions of the Companies Act, 2013 so that books of account can be properly maintained and Balance Sheet and Profit and Loss Account can be prepared as per the provisions of law.

Draft a "Board Resolution" for the said purpose. [CA (Final) Nov. 2003, June 2009, May 2010, Nov. 2011]

OR

Mr. Shukla is working as General Manager (Finance and Accounts) in Target Limited. The Board of directors of the said company propose to entrust him with the duty of ensuring compliance with the provisions of the Companies Act, 2013 so that the books of accounts, balance sheet, statement of profit and loss and the cash flow statements can be prepared and maintained in accordance with law. Draft a Board Resolution for the said purpose. [CA (Final) Nov. 2017]

Ans.

Subject	–	Charging a person with the duty of compliance with the provisions of sections 128 and 129 of the Companies Act, 2013
Passing Authority	–	Board of directors
Nature of Resolution	–	Resolution with simple majority

"RESOLVED THAT pursuant to the provisions of sections 128, 129 and all other applicable provisions, if any, of the Companies Act, 2013, Mr. White, the chief accountant of the company be and is hereby charged with the duty of ensuring compliance with proper maintenance of books of account and preparation of financial statement.

RESOLVED FURTHER THAT the duties of Mr. White shall be supervision of functioning of the 'Finance and Accounts Department' of the company, handling day to day affairs of the Department, regularly reporting to Board on the activities of the Department and to perform all other duties that the Board may delegate to him from time to time."

Drafting of resolution for removing a Company Secretary

P 14.1J. Draft a resolution for removal of a Company Secretary.

Ans.

Subject	–	Removal of a Company Secretary
Passing Authority	–	Board of directors
Nature of the Resolution	–	Resolution with simple majority

"RESOLVED THAT Mr. C, the Company Secretary of the company having been convicted of an offence involving moral turpitude be and is hereby removed from the office of Company Secretary of the company.

FURTHER RESOLVED THAT Mr. E, the managing director of the company be and is hereby directed to inform Mr. C accordingly and to take custody of the records in the possession of Mr. C.

FURTHER RESOLVED THAT Mr. E, the managing director of the company be and is hereby authorised to file the necessary returns with the Registrar of Companies, make necessary entries in the Register of Directors and Key Managerial Personnel and to do all acts and things as may be necessary in this connection."

Drafting of resolution for removal of a managing director

P 14.1K. Adam, a 15% shareholder of a company and other shareholders have lost confidence in the Managing Director (MD) of the company. He is a director not liable to retire by rotation and was reappointed as Managing Director for 5 years w.e.f. 1.4.2012 in the last Annual General Meeting of the company.

Draft a suitable resolution to be passed for removal of MD. **[CA (Final) Nov. 2006]**

Ans.

Subject – Removal of a managing director

Passing Authority – General Meeting

Nature of the Resolution – Ordinary resolution

"RESOLVED THAT pursuant to the provisions of section 169 and all other applicable provisions, if any, of the Companies Act, 2013, Mr. ...., the managing director of the company be and is hereby removed.

FURTHER RESOLVED THAT, subject to the provisions of section 202 of the Companies Act, 2013 and other applicable provisions, if any, Mr. .... shall be paid a compensation of Rs. ...., in accordance with Clause ...., of the agreement dated ...., entered into between the company and Mr. ....

FURTHER RESOLVED THAT Mr. ...., the Company Secretary of the company, be and is hereby authorised to file all the necessary returns in this regard with the Registrar, make necessary entries in the Register of Directors and to do all acts and things as may be necessary in this connection."

Drafting of Board resolution for making investment in the equity shares of any other company

P 14.1L. The Board of directors of XYZ Limited decided to pass a resolution to purchase 35,000 equity shares of Rs. 100 each of PQR Limited at a meeting. Draft a specimen Board resolution to be passed at the said meeting.

[ICAI, Mock Test Paper, August 2018]

Ans.

Subject – Making investment in the equity shares of any other company

Passing Authority – Board of directors

Nature of the Resolution – Unanimous resolution

"RESOLVED THAT pursuant to the provisions of sections 179, 186 and a" other applicable provisions, if any, of the Companies Act, 2013, consent of all the directors present at this meeting be and is hereby accorded to invest a sum of Rs. 100 crore by acquiring 10 crore equity shares of XYZ Limited at Rs. 10 each, being such investment together with the loans and guarantees already made and securities already provided and investments already made does not exceed the limit specified under section 186(2).

RESOLVED FURTHER that Mr. _________, the director of the company, be and is hereby authorised to prepare, sign and execute the necessary documents, make necessary entries in the Register of investments and take all such steps and actions as may be required to give effect to this resolution."

Drafting of resolution appointing an independent director

P 14.1M. The members of XYZ Limited decided to pass a resolution for appointing Mr. Smith as an independent director of the company. Draft a specimen resolution to be passed at the said meeting. **[ICAI, RTP, Nov. 2016]**

Ans.

Subject – Appointment of an independent director

Passing Authority – General Meeting

Nature of the Resolution – Ordinary Resolution

"RESOLVED THAT pursuant to the provisions of sections 149, 150, 152 and all other applicable provisions, if any, of the Companies Act, 2013 read with Schedule IV to the Companies Act, 2013, Mr. Smith, who holds Director Identification No. ...., and who was appointed as an Additional Director of the Company with effect from .... under Section 161(1) of the Companies Act, 2013, and who holds office upto this annual general meeting, and whose appointment as an Independent Director has been recommended by the Nomination and Remuneration Committee, and who has submitted a declaration with the company that he meets the criteria of independence as required under section 149(6) of the Companies Act, 2013, be and is hereby appointed as an Independent Director of the Company."

FURTHER RESOLVED THAT Mr. Smith shall be a director not liable to retire by rotation.

FURTHER RESOLVED THAT Mr. Smith shall hold the office of independent director for a period of 5 years starting from .... and ending on ....

FURTHER RESOLVED THAT Mr. ...., the Company Secretary of the company, be and is hereby authorised to file all the necessary returns in this regard with the Registrar, make necessary entries in the Register of Directors and to do all acts and things as may be necessary in this connection."

Drafting of resolution authorising the Board of directors to borrow money exceeding the limit specified u/s 180(1)(c)

P 14.1N. Draft a resolution proposed to be passed at a general meeting of M/s. Red Rooster Limited, a public company, giving consent to the Board of directors for borrowing upto a specified amount in excess of the limits laid down under section 180(1)(c) of the Companies Act, 2013. **[ICAI, RTP, Nov. 2018]**

Ans.

Subject	–	Resolution authorising the Board of directors to borrow money exceeding the limit specified u/s 180(1)(c)
Passing Authority	–	General Meeting
Nature of the Resolution	–	Special Resolution

"RESOLVED THAT pursuant to the provisions of section 180(1)(c) and all other applicable provisions, if any, of the Companies Act, 2013, the consent of the company be and is hereby given to the Board of directors to borrow money exceeding the aggregate of paid up share capital, free reserves and securities premium account, subject to the condition that the moneys already borrowed together with moneys proposed to be borrowed (apart from temporary loans obtained from the company's bankers in the ordinary course of business) shall not exceed Rs. ....

FURTHER RESOLVED THAT the power to borrow money shall be exercised by the Board at a duly convened Board meeting and not by passing a resolution by circulation.

FURTHER RESOLVED THAT Mr. ...., the Company Secretary of the company, be and is hereby authorised to file a copy of the special resolution with the Registrar and to do all acts and things as may be necessary in this connection."

Drafting of resolution by circulation for allotment of shares

P 14.1O. The Board of directors of RPS Limited decides to pass a resolution by circulation for allotment of 1,000 equity shares to Mr. A. Draft a specimen Board resolution to be passed by circulation for this purpose. **[CA (Final) May 2015]**

Ans.

RPS Ltd.

Regd. Office: B-11, Third Floor, Swasthya Vihar, Delhi – 110092.

To

Mr. .... (Director)

Resident of ....

Sir,

Please find enclosed the following resolution which is proposed to be passed by circulation pursuant to the provisions of section 175 of the Companies Act. 2013 read with Regulation No. _______ of the Articles of Association of the company:

"RESOLVED THAT pursuant to the provisions of section 42 and all other applicable provisions, if any, of the Companies Act, 2013, and pursuant to the consent of the members obtained by passing a special resolution at an extraordinary general meeting held on ______, and pursuant to Regulation No. ______ of the Articles of Association of the Company, 1,000 equity shares of the company of Rs. 100 each be and are hereby allotted at par value to Mr. A, Resident of B-1, Nehru Vihar, Delhi from whom a sum of Rs. 1,00,000 has been received vide Cheque No. ________, dated ______, drawn on _____________ (Bank).

RESOLVED FURTHER THAT Mr. ________, the Company Secretary of the Company and Mr. ________, the Managing director, be and are hereby authorised to file a return of allotment with the Registrar in accordance with the provisions of section 39 of the Companies Act, 2013, make necessary entries in the Register of Members in accordance with the provisions of section 88 of the Companies Act, 2013, and to take all other steps and actions as may be required to give effect to the said resolution."

You are requested to send your assent or dissent to the aforesaid resolution, within 7 days of receipt of this letter, by sending the duly filled and signed 'Response / Reply Letter' attached herein below as a perforated slip.

However, if you are interested in the aforesaid resolution, you are not required to vote on this resolution.

Yours sincerely,

Sd/-

(Company Secretary)

RESPONSE / REPLY LETTER

I hereby convey my assent / dissent (Strike off whichever is not applicable) to the aforesaid resolution.

Name of the Director: ....

Signature: ....

14.2 Key points for drafting minutes of a Board meeting

1. The minutes should not be drafted in tabular or chart form. The minutes should be drafted in the form of paragraphs and points. Appropriate headings should be used.
2. The minutes should state the name of the company and the time, date, day and place of the meeting.
3. If the Board meeting was held by video conferencing, the minutes should state the same, and also state the names and locations of the directors who attended the meeting by video conferencing.
4. The minutes should state the names of directors present in the Board meeting. If persons other than directors were present in the meeting (*e.g.* the auditor, the internal auditor, the Company Secretary, any special invitee), the minutes should state the same.
5. The minutes should state as to whether the quorum was present.
6. The minutes should state as to whether the Chairperson of the Board presided the Board meeting or any director was appointed as the Chairperson of the Board meeting. The minutes should also state the name of the Chairperson.
7. The minutes should state that the statutory registers which are required to be placed in the Board meeting were placed at the Board meeting. The minutes should also contain the names of the directors who signed such registers.
8. If leave of absence was granted to any director, the minutes should state the same. Generally, the phrase used for this purpose is: "Mr. ...., who had expressed his inability to attend the Board meeting, was granted leave of absence."
9. The minutes of previous Board meeting are generally placed before the directors present in the Board meeting. The fact that such minutes were confirmed as correct by the directors present in the Board meeting, is recorded in the minutes. Generally, the phrase used for this purpose is: "Minutes of the previous Board Meeting held on ...., duly initialled by the Chairman, were placed before all the directors for their consideration and confirmation. All the directors confirmed the correctness of the minutes."
10. With respect to every resolution put before the directors at the meeting, the minutes should contain the subject of the resolution proposed, its complete contents, the number of directors who voted in favour, the number of directors who voted against and the number of directors who abstained from voting, and also the names of the directors who either voted against or abstained from voting.
11. If any director was interested in a resolution, the minutes should state such a fact along with the name of the interested director and nature of his interest, and the fact that the interested director did not participate in the meeting on such resolution.
12. All the appointments made at the meeting should be included in the minutes.
13. If any resolution was passed by circulation after the previous Board meeting was held, such resolution should be made part of the minutes of the Board meeting.
14. The minutes should contain the signatures of the person authorised to sign them (*i.e.* the chairman of the same meeting or the chairman of the next meeting) and the date of signing of the minutes.

Theoretical Questions from CA Examinations

Q 14.2A. Board of directors of DBM Limited held a Board meeting on 2nd May, 2014 at its registered office. You are required to state the salient points to be taken into account while drafting the minutes of the said Board meeting. [CA (Final) May 2008, May 2005]

Q 14.2B. Explain briefly the salient points to be taken into account while drafting the minutes of the meetings of Board of directors. [CA (Final) May 2001]

Practical Problems from CA Examinations

Drafting of minutes of Board meeting appointing the managing director along with other usual business

P 14.2A. Draft the minutes of 17th Board meeting of Jai Entertainment Limited held at its registered office situated at B-17, Industrial Area, Suncity containing the matter regarding appointment of Mr. Kaabil as the managing director in addition to the usual items. [CA (Final) May 2017]

Ans.

Jai Entertainment Limited

Minutes of the 17th Board Meeting

held at the Registered Office of the company at B-17, Industrial Area, Suncity
on Friday, the 16th February, 2018 at 11 A.M.

Directors Present:

1. Mr. .... (Director)
2. Mr. .... (Director)
3. Mr. .... (Director)
4. Mr. .... (Director)
5. Mr. .... (Director)

In attendance:

Mr. .... (Company Secretary)

1. **Chairman of the Meeting**

   Mr. .... was elected as the Chairman of the Board Meeting. Mr. .... welcomed all the directors present in the meeting.

2. **Grant of leave of absence**

   Mr. .... and Mr. .... who had expressed their inability to attend the Board meeting were granted leave of absence.

3. **Presence of Quorum**

   After ascertaining that the requisite quorum was present, the Chairman declared that the proceedings of the meeting could commence.

4. **Notice and agenda taken as read**

   With the consent of all the directors present in the meeting, the notice and agenda of the Board Meeting were taken as read.

5. **Confirmation of Minutes of previous Board Meeting**

   Minutes of the previous Board meeting held on ...., duly initialled by the Chairman, were placed before all the directors for their consideration and confirmation. All the directors confirmed the correctness of the minutes.

6. **Appointment of Mr. Kaabil as the Managing Director**

   The Chairman proposed the appointment of Mr. Kaabil as the managing director of the company. After discussions, the following resolution was passed:

   "RESOLVED THAT pursuant to the provisions of sections 196, 197, 203, Schedule V and all other applicable provisions, if any, of the Companies Act, 2013 and pursuant to the recommendation of the Nomination and Remuneration Committee and subject to the approval of the members in the general meeting, Mr. Kaabil, who fulfils the requirements given under sub-section (3) of section 196 and Part I of Schedule V to the Companies Act, 2013 be and is hereby appointed as the managing director of the company for a period of 5 years with effect from __ / __ / ____ on such remuneration and such terms and conditions as are contained in the draft agreement entered into between the company and Mr. Kaabil, a copy of which has been initialled by the Chairman for the purpose of identification and is laid before this meeting.

   RESOLVED FURTHER THAT Mr. ...., the Company Secretary of the company, be and is hereby authorised to file necessary returns with the Registrar, make necessary entries in the relevant Registers and take all such steps and actions as may be required to give effect to this resolution."

7. **Time, place and day of the next Board meeting**

   It was decided to hold the next Board meeting of the company on .... at .... at the registered office of the Company.

8. **Vote of Thanks**

   As there was no other business to be transacted, the meeting concluded with a vote of thanks to the Chair.

Sd/-
Dated: ....
(Chairman)

Drafting of notice of first Board meeting

P 14.2B. Draft a notice for the first meeting of the Board of directors of India Timber Ltd. **[CA (Final) Nov. 2015]**

Ans.

India Timber Ltd.

Regd. Office: B-11, Third Floor, Swasthya Vihar, Delhi – 110092.

Notice of First Board Meeting

To

Mr. ____________________ (Name of the Director)

____________________ (Address of the Director)

Dear Sir,

Notice is hereby given that the First Meeting of the Board of Directors of the Company will be held on Tuesday, 24th November, 2015 at 10:30 AM at the registered office of the company, at B-11, Third Floor, Swasthya Vihar, Delhi – 110092 to transact the following business:

1. To appoint the Chairman of the Board Meeting.
2. To grant leave of absence to Mr. ____________________ who has expressed his inability to attend the Board Meeting vide a letter dated __________.
3. To adopt the Common Seal of the Company.
4. To appoint the First Auditors of the Company.
5. To decide the opening of the Bank Account and the manner of its operation.
6. To decide the procedure for maintenance of minutes of the meetings of the Board and General Meetings.
7. To adopt the pre-incorporation contracts placed before the Company and reimburse the pre-incorporation expenses incurred by the promoters.
8. To authorise the Company Secretary to file the necessary forms and documents with the appropriate authorities.
9. To authorise the Company Secretary to maintain the Statutory Registers and Records.
10. To elect the Chairman of the Board.
11. To fix the date and time of the next Board Meeting.
12. To consider any other matter with the permission of the Chair.

You are requested to make it convenient to attend the meeting. You have the option to attend the Board meeting either in person or by video conferencing. You are requested to inform the option exercised by you. In case no reply is received from you, it shall be presumed that you will attend the Board meeting in person.

For India Timber Ltd.,
Sd/-
MB
(Company Secretary)

Place: New Delhi

Dated: 10th November, 2015

Drafting of notice of general meeting for extension of time for repayment of a loan payable by a director

P 14.2C. Big Ben Ltd, a reputed public company, had advanced certain sum of money to one of its directors, namely Mr. Tanmay on certain terms and conditions and fixing the time limit for repayment thereof. Now, Mr. Tanmay has approached the company with a request to extend the time limit for repayment of balance of loan amounting to Rs. 12 lakhs by another six months. Draft an appropriate notice for the meeting where such extension may be granted. **[CA (Final) June 2009, May 2012]**

Ans.

Big Ben Ltd.

Regd. Office: Big Ben Tower, 15 Community Centre, Laxmi Nagar, New Delhi – 92.

Notice is hereby given that an Extraordinary General Meeting (EGM) of the members of Big Ben Limited will be held on Friday, 5th June, 2014 at 10.30 A.M. at the Registered Office of the Company at Big Ben Tower, 15 Community Centre, Laxmi Nagar, New Delhi – 92 to transact the following business:

Special Business:

1. **Giving extension of time for repayment of loan by the director, Mr. Tanmay**

   To consider and, if thought fit, to pass, with or without modification(s), the following resolution as a Special Resolution:

   "RESOLVED THAT pursuant to the provisions of Section 180(1)(d) and all other applicable provisions, if any, of the Companies Act, 2013, the Board of Directors of the Company be and is hereby authorised to allow an extension of 6 months for repayment of loan of Rs. 12 lakh, otherwise due to be fully repaid by _______ out of the total amount of loan of Rs. _________ granted on ________ by the Company to Mr. Tanmay, a director of the Company.

RESOLVED FURTHER THAT Mr. ...., the Company Secretary of the company, be and is hereby authorised to file a copy of the special resolution and other necessary returns with the Registrar, and take all such steps and actions as may be required to give effect to this resolution."

By Order of the Board of Directors,
For Big Ben Limited,
Sd/-
XYZ
(Secretary)

Place: New Delhi

Dated: May 10, 2014

Notes:

1. A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote, on a poll, instead of himself and the proxy so appointed need not be a member of the company.
2. Proxies in order to be effective, must be sent so as to reach the registered office of the company latest by 10.30 A.M. on 3rd June, 2014 duly completed, stamped and signed, otherwise the proxy form will be rejected. A blank proxy form is enclosed.
3. Explanatory Statement pursuant to Section 102 of the Companies Act, 2013, in respect of the business under Item 1 as set out above is annexed hereto.

Annexure to the Notice of Extraordinary General Meeting

Explanatory statement pursuant to Section 102 of the Companies Act, 2013

Item No. 1

A Loan of Rs. _____ Lakhs was granted by the company to Director, Mr. Tanmay on _________ for the purpose of __________________. Out of Loan of Rs. _______ Lakhs, Mr. Tanmay has already paid Rs. _______, and balance amount of Loan of Rs. 12 lakhs is due to be paid on ________. Mr. Tanmay has expressed his inability to repay the balance amount of loan of Rs. 12 lakhs on the said due date, and has requested the company to grant extension of time of 6 months for repayment of Rs. 12 Lakhs.

As per section 180(1)(d) of the Companies Act, 2013, extension of time for repayment of a debt payable by a director requires approval of the Members by means of a special resolution passed in the general meeting.

The Board of Directors accordingly recommends passing of the aforesaid Resolution.

No director or manager or Key Managerial Personnel or any of their relatives, except Mr. Tanmay, is concerned or interested in the said resolution.

By Order of the Board of Directors,
For Big Ben Limited,
Sd/-
ABC
(Secretary)

Place: New Delhi

Dated: May 10, 2014

Drafting of minutes of AGM

P 14.2D. PNT Ltd. is a company, which is listed with Mumbai Stock Exchange. Its 16th annual general meeting was held at Mumbai on 30th September, 2014 in respect of financial year ended 31st March, 2014, whereat all the usual business required to be conducted by a company under the provisions of the Companies Act, 2013 were carried out. Following further information is also available

(i) The company has total 8 directors (including the Chairman) out of which 2 directors are not liable to retire by rotation.

(ii) The company has its registered office at Mumbai and a branch at Kolkata.

(iii) From the audited annual accounts for year ended 31st March, 2014, it is observed that directors have proposed a dividend of 20% on equity share capital.

(iv) 75% of the shares of the company are held in dematerialised form and balance in physical form.

(v) The accounts of Kolkata branch of the company are audited by a firm of Chartered Accountants, who are not the statutory auditors of the company.

Based on the above, you are required to draft the minutes of the proceedings of the annual general meeting of PNT Ltd.

[CA (Final) Nov. 2005 (Modified)]

Ans.

PNT Ltd.

Minutes of the 16th Annual General Meeting

held at the Registered Office of the company at .... Mumbai
on Friday, the 30th of September, 2014 at 11 A.M.

Present (as per signatures obtained on attendance slips):

1. Mr. .... (Chairman)

2. Mr. .... (Director and Member)
3. Mr. .... (Director and Member)
4. Mr. .... (Director and Member)
5. Mr. .... (Director and Member)
6. Mr. .... (Company Secretary and Member)
7. Mr. .... (Auditor)
8. Mr. .... (Representative of .... Ltd. under section 113)

AND

34 other members in person and 10 members represented by proxies.

Preliminaries

1. Mr. .... chaired the annual general meeting. The Chairman extended a very warm welcome to the members and introduced his colleagues on the Board to the members. Thereafter, the Chairman's speech was read.
   With the permission of the members, the notice convening the annual general meeting and the Board's Report, having been circulated to the members, were taken as read.
2. After ascertaining that the requisite quorum for the meeting was present, the Chairman informed that the formal proceedings of the meeting could commence.
3. The Auditor's report was read by the Company Secretary.
4. The Chairman informed the meeting that the Register of Members and Register of Directors and key managerial personnel and their shareholding were kept open and accessible during the continuance of the annual general meeting.

The Chairman proposed the following resolutions for consideration and approval of members:

1. **Adoption of financial statements and other documents**

   Following resolution was proposed as an ordinary resolution:

   "RESOLVED THAT the Profit and Loss Account for the year ended 31st March, 2014, the Balance Sheet as on that date, the Board's Report and Auditor's Report, as laid before the members at this meeting be and are hereby considered and adopted."

   The Chairman invited the members to ask queries relating to the Profit and Loss Account, Balance Sheet, Board's Report and the Auditor's Report.

   Several questions were asked and suitably replied by the Chairman and Chairman of the Audit Committee. The motion was then put to vote, and on voting by show of hands, the resolution was passed unanimously.

2. **Declaration of dividend**

   Following resolution was proposed as an ordinary resolution:

   "RESOLVED THAT, pursuant to the provisions of section 123 and all other applicable provisions, if any, of the Companies Act, 2013, and pursuant to the recommendations made by the Board of directors of the company, a dividend @ 20% on equity shares be and is hereby declared.

   FURTHER RESOLVED THAT, pursuant to the provisions of section 127 of the Companies Act, 2013, Director, Mr. ...., be and is hereby authorised to post the dividend warrants within 30 days to all the members."

   The motion was then put to vote and on voting by show of hands, it was passed unanimously.

3. **Retirement of Director, Mr. ...., and his reappointment**

   Following resolution was proposed as an ordinary resolution:

   "RESOLVED THAT pursuant to the provisions of section 152 and all other applicable provisions, if any, of the Companies Act, 2013, Mr. ...., who retires by rotation and being eligible for reappointment, be and is hereby reappointed as a director of the company."

   The motion was then put to vote and on voting by show of hands, it was passed unanimously.

4. **Retirement of Director, Mr. ...., and his reappointment**

   Following resolution was proposed as an ordinary resolution:

   "RESOLVED THAT pursuant to the provisions of section 152 and all other applicable provisions, if any, of the Companies Act, 2013, Mr. ...., who retires by rotation and being eligible for reappointment, be and is hereby reappointed as a director of the company."

   The motion was then put to vote and on voting by show of hands, it was passed unanimously.

5. **Appointment of auditors**

   Following resolution was proposed as an ordinary resolution:

   "RESOLVED THAT pursuant to the provisions of section 139 and all other applicable provisions, if any, of the Companies Act, 2013, M/s ...., Chartered Accountants, the retiring auditors of the company, be and are hereby reappointed as Auditors of the company for the period commencing from the conclusion of this annual general meeting till the conclusion of the twenty first annual general meeting of the company at a remuneration of Rs. .... plus actual out of pocket expenses incurred by them in connection with the company's audit.

FURTHER RESOLVED THAT pursuant to the provisions of section 139, 143(8) and all other applicable provisions, if any, of the Companies Act, 2013, M/s ...., Chartered Accountants, be and are hereby reappointed as Auditors of the Kolkata Branch for the period commencing from the conclusion of this annual general meeting till the conclusion of the twenty first annual general meeting of the company at a remuneration of Rs. .... plus actual out of pocket expenses incurred by them in connection with the audit of Kolkata Branch."

The motion was then put to vote and on voting by show of hands, it was passed unanimously.

Vote of Thanks

As there was no other business to be transacted, the meeting concluded with a vote of thanks to the Chair.

Sd/-

Dated: ....

(Chairman)

Application for investigation under section 210

P 14.2E. A majority of the Board of directors of M/s High Value Infotech Ltd. have realised that some of the business activities carried out in the name of the company are not in the interest of either the company or its members. They want that the company should make an application to the Central Government to appoint an inspector to carry out an investigation so as to find out the whole truth. Draft the application to be made to the Central Government. [CA (Final) Nov. 2001]

OR

A majority of the Board of directors of M/s Bulk Drugs Ltd. have reasons to believe that some of the business activities carried on in the name of the company are prima facie against the interests of the company and its members. They want the matter to be referred to Central Government in the form of an application for appointment of an inspector to reach to the bottom of the matter and unveil the truth. In this connection you are required to draft an application to be made to the Central Government. [CA (Final) May 2007, May 2005]

Ans.

High Value Infotech Ltd.
Regd. Office: S-80, Jagan Vihar, Delhi – 110083.

Dated: 16th August, 2016

To,
The Secretary,
Ministry of Corporate Affairs,
New Delhi.
Sir,

Subject: Application seeking an order of investigation under section 210 of the Companies Act, 2013

As per the provisions of section 210 of the Companies Act, 2013, the Central Government is empowered to order an investigation into the affairs of the company, if a special resolution is passed in the General Meeting of the company and an intimation of passing such special resolution is given to the Central Government.

In the Annual General Meeting held on 12th August, 2016 at the registered office of the company, the following special resolution was passed requiring an investigation into the affairs of the company:

"RESOLVED THAT pursuant to the provisions of section 210 and all other applicable provisions, if any, of the Companies Act, 2013, the consent of the company be and is hereby accorded to the conduct of an investigation into the affairs of the company by the Central Government.

RESOLVED FURTHER THAT Mr. ABC, the Company Secretary of the company, be and is hereby authorised to make an application to the Central Government seeking an order of investigation into the affairs of the company, to submit all such documents and furnish all such information to the Central Government as may be required by that Government so as to satisfy the Central Government that an investigation into the affairs of the company is required, and to take all such steps and actions as may be required to give effect to this resolution."

Therefore, the Central Government be pleased to make an order of investigation into the affairs of the company.

Yours sincerely,
Sd/-
Mr. ABC
(Company Secretary)

The Foreign Contribution (Regulation) Act, 2010

Chapter 15

Bird's eye-view of the Chapter

Introduction

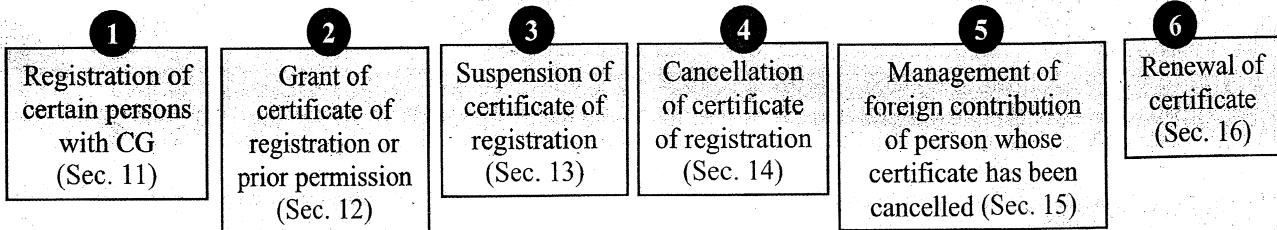
1. Extent, application and commencement of the Act (Sec. 1)
2. Object of the Act
3. Structure of the Act
4. Definitions (Sec. 2)

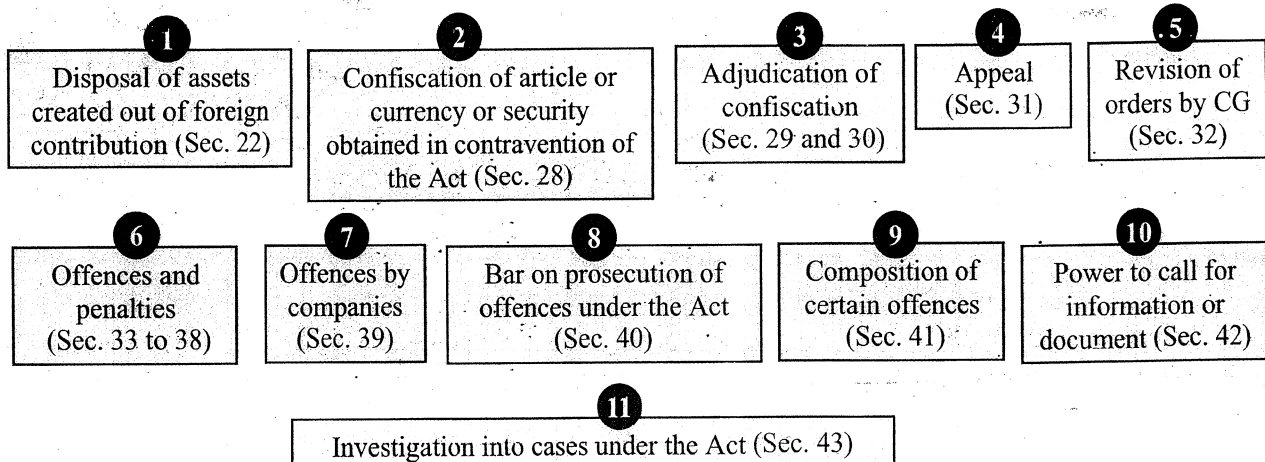
Regulation of foreign contribution

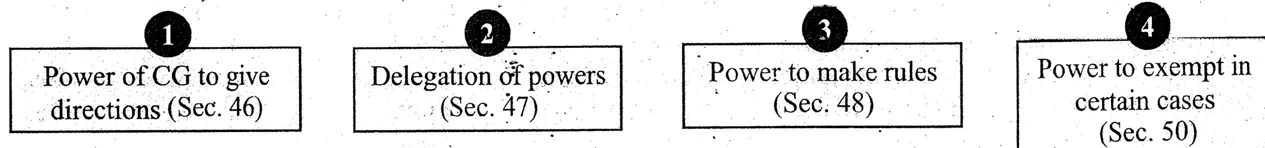
1. Prohibition on acceptance of foreign contribution (Sec. 3)
2. No prohibition on acceptance of foreign contribution by any person or organisation covered under section 3 in certain cases (Sec. 4)
3. Prohibition to transfer foreign contribution to other person (Sec. 7)
4. Restriction to utilise foreign contribution for administrative purpose (Sec. 8)
5. Power of CG to prohibit receipt of foreign contribution, etc., in certain cases (Sec. 9)
6. Power to prohibit payment of currency received in contravention of the Act (Sec. 10)
7. Foreign contribution through scheduled bank (Sec. 17)
8. Intimation (Sec. 18)
9. Maintenance of accounts (Sec. 19)
10. Audit of accounts (Sec. 20)

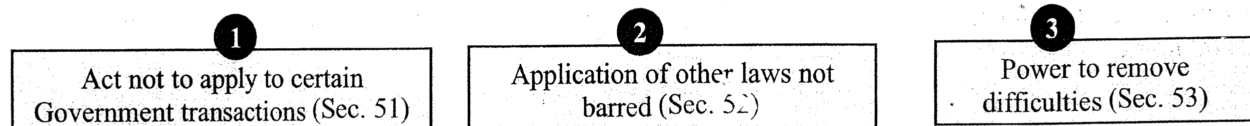
Foreign hospitality

Restriction on acceptance of foreign hospitality (Sec. 6)









Notes:

1. In this Chapter, unless otherwise specified, –
   (a) any reference to any section means reference to the sections of the Foreign Contribution (Regulation) Act, 2010; and
   (b) any reference to any Rule means reference to the Rules contained in the Foreign Contribution (Regulation) Rules, 2011.

2. The amendments made by the Foreign Contribution (Regulation) (Amendment) Rules, 2020 have not been included in this Book, as these amendments have come into force on 10th November, 2020 (i.e. after 31st October, 2020), and consequently, these amendments shall not be applicable for May, 2021 exams.

15.1 Extent, application and commencement of the Act (Section 1)

1. **Applicability of the Act**

   The Act extends to the whole of India, and it shall also apply to –

   (a) citizens of India outside India; and

   (b) associate branches or subsidiaries, outside India, of companies or bodies corporate, registered or incorporated in India.

2. **Date of enforcement of the Act**

   The Act came into force with effect from 1st May, 2011.

15.2 Objectives of the Act

1. To consolidate the law to regulate the acceptance and utilisation of foreign contribution by certain individuals or associations or companies
2. To consolidate the law to regulate the acceptance of foreign hospitality by certain individuals
3. To prohibit acceptance and utilisation of foreign contribution or foreign hospitality for any activities detrimental to the national interest
4. To provide for matters connected therewith or incidental thereto.

15.3 Structure of the Act

The Act contains 54 sections divided into 9 chapters, as follows:

Chapter No.	Chapter Name	Sections
Chapter I	Preliminary	1 and 2
Chapter II	Regulation of Foreign Contribution and Foreign Hospitality	3 to 10
Chapter III	Registration	11 to 16
Chapter IV	Accounts, Intimation, Audit and Disposal of Assets, etc.	17 to 22
Chapter V	Inspection, Search and Seizure	23 to 27
Chapter VI	Adjudication	28 and 30
Chapter VII	Appeal and Revision	31 and 32
Chapter VIII	Offences and Penalties	33 to 41
Chapter IX	Miscellaneous	42 to 54

15.4 Definitions (Section 2) *

1. **'Association' [Section 2(1)(a)]**

   'Association' means an association of individuals, whether incorporated or not, having an office in India and includes a society, whether registered under the Societies Registration Act, 1860, or not, and any other organisation, by whatever name called.

2. **'Foreign company' [Section 2(1)(g)]**

   'Foreign company' means any company or association or body of individuals incorporated outside India and includes –

   (i) a foreign company within the meaning of section 591 of the Companies Act, 1956 (corresponding to Clause (42) of section 2 of the Companies Act, 2013);

* In Foreign Contribution (Regulation) Act, 2010, the definitions are contained in various clauses of sub-section (1) of section 2. For example, the definition of 'association' is given in section 2(1)(a), which is to be read / written as 'clause (a) of sub-section (1) of section 2'.

(ii) a company which is a subsidiary of a foreign company;

(iii) the registered office or principal place of business of a foreign company referred to in sub-clause (i) or company referred to in sub-clause (ii);

(iv) a multi-national corporation.

Explanation: For the purposes of this sub-clause, a corporation incorporated in a foreign country or territory shall be deemed to be a multi-national corporation if such corporation, –

(a) has a subsidiary or a branch or a place of business in two or more countries or territories; or

(b) carries on business, or otherwise operates, in two or more countries or territories.

3. 'Foreign contribution' [Section 2(1)(h)]

'Foreign contribution' means the donation, delivery or transfer made by any foreign source, of any of the following:

(i) Any article.

Where an article is given to a person as a gift for his personal use, it shall not be termed as 'foreign contribution' if the market value, in India, of such article, on the date of such gift, is not more than such sum as may be specified from time to time, by the Central Government by the rules made by it in this behalf.

As per Rule 6A of the Foreign Contribution (Regulation) Rules, 2011, the sum specified for this purpose is Rs. 1 lakh.

Example: Mr. Bharat (a citizen of India) is a very good friend of Mr. Michael (a citizen of USA, *i.e.* a foreign source). Mr. Michael intends to make a gift of a wrist watch to Mr. Bharat. The market value in India of the wrist watch is Rs. 75,000. The gift of wrist watch shall not be termed as 'foreign contribution'.

(ii) Any currency, whether Indian or foreign.

Example: Mr. Bharat (a citizen of India) is a very good friend of Mr. Michael (a citizen of USA, *viz.* a foreign source).

Case I: Mr. Michael intends to make a gift of $ 1 lakh to Mr. Bharat. The gift of $ 1 lakh shall be termed as 'foreign contribution'. Reason: There is donation, delivery or transfer of foreign currency made by a foreign source.

Case II: Mr. Michael intends to make a gift of Rs. 5 lakh to Mr. Bharat. The gift of Rs. 5 lakh shall also be termed as 'foreign contribution'. Reason: There is donation, delivery or transfer of Indian currency made by a foreign source.

Case III: Mr. Michael intends to make a gift of Rs. 51,000 to Mr. Bharat. The gift of Rs. 51,000 shall also be termed as 'foreign contribution'. Reason: There is donation, delivery or transfer of Indian currency made by a foreign source, and Rule 6A does not apply since it exempts any gift of an article upto a value of Rs. 1 lakh, but does not exempt gift of any currency.

(iii) Any security.

Security means 'security' as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 and includes any foreign security as defined in clause (o) of section 2 of the Foreign Exchange Management Act, 1999.

Deemed 'foreign contribution':

(a) A donation, delivery or transfer of any article, currency or foreign security by any person who has received it from any foreign source, shall also be deemed to be foreign contribution.

(b) As per section 17, where any foreign contribution is accepted by a person who has been granted a certificate of registration or prior permission, such foreign contribution shall be received only in the exclusive bank account which such person had specified in the application form filed for grant of certificate of registration or obtaining prior permission.

As per section 2(1)(h), any interest accrued on the foreign contribution so deposited in the exclusive bank account, shall also be deemed to be foreign contribution. Also, any other income derived from the foreign contribution or interest thereon shall be deemed to be foreign contribution.

Exclusions from the definition of 'foreign contribution': Following shall be excluded from the definition of 'foreign contribution':

(a) Any amount charged by an educational institution in India from a foreign student

(b) Any amount received by way of fees by any person from any foreign source (*e.g.* fees charged by any institution for any seminar, conference, workshop, training programme etc.)

(c) Any amount received by any person towards cost of goods supplied or services rendered in the ordinary course of business, whether within India or outside India.

4. 'Person' [Section 2(1)(m)]

'Person' includes –

(i) an individual;

(ii) a Hindu undivided family;

(iii) an association;

(iv) a company registered under section 25 of the Companies Act, 1956 (corresponding to section 8 of the Companies Act, 2013).

5. **'Foreign hospitality' [Section 2(1)(i)]**

'Foreign hospitality' means any offer made in cash or kind by a foreign source for providing a person with –

(i) the cost of travel to any foreign country or territory;

(ii) free boarding or lodging;

(iii) free transport; or

(iv) free medical treatment.

Any offer which is purely a 'casual one' shall not be termed as foreign hospitality.

6. **'Foreign source' [Section 2(1)(j)]**

'Foreign source' includes all of the following:

(i) The Government of any foreign country or territory and any agency of such Government

(ii) Any international agency

However, the following agencies shall not be included in the definition of 'foreign source':

(a) The United Nations or any of its specialised agencies

(b) The World Bank

(c) International Monetary Fund

(d) Such other agency as the Central Government may, by notification, specify in this behalf.

More than 100 agencies have been specified by the Central Government (which shall not be treated as 'foreign source'). Some of the agencies specified by the Central Government are United Nations Children's Fund (UNICEF), United Nations Development Programme (UNDP), United Nations Statistical Office (UNSCO), International Organisation for Standardisation (ISO), International Labour Organisation (ILO), Asian Development Bank (ADB), World Food Council (WFC), World Food Programme (WFP) and World Health Organisation (WHO).

(iii) A foreign company

(iv) A corporation, not being a foreign company, incorporated in a foreign country or territory

(v) A multi-national corporation

(vi) A company as defined under the Companies Act, 1956 or the Companies Act, 2013, if more than one-half of the nominal value of its share capital is held, either singly or in the aggregate, by one or more of the following:

(A) The Government of a foreign country or territory

(B) The citizens of a foreign country or territory

(C) Corporations incorporated in a foreign country or territory

(D) Trusts, societies or other associations of individuals (whether incorporated or not), formed or registered in a foreign country or territory

(E) Foreign company

However, where the nominal value of share capital is within the limits specified for foreign investment under the Foreign Exchange Management Act, 1999, or the rules or regulations made thereunder, then, notwithstanding the nominal value of share capital of a company being more than one-half of such value at the time of making the contribution, such company shall not be a foreign source. This provision shall be deemed to have come into effect with effect from 5th August, 1976.

(vii) A trade union in any foreign country or territory, whether or not registered in such foreign country or territory

(viii) A foreign trust or a foreign foundation, by whatever name called, or such trust or foundation mainly financed by a foreign country or territory

(ix) A society, club or other association of individuals formed or registered outside India

(x) A citizen of a foreign country.

7. **'Political party' [Section 2(1)(n)]**

'Political party' means –

(i) an association or body of individual citizens of India –

(A) to be registered with the Election Commission of India as a political party under section 29A of the Representation of the People Act, 1951; or

(B) which has set up candidates for election to any Legislature, but is not so registered or deemed to be registered under the Election Symbols (Reservation and Allotment) Order, 1968;

(ii) a political party mentioned in column 2 of Table I and Table 2 to the notification of the Election Commission of India No. 56/J&K/02, dated the 8th August, 2002, as in force for the time being.

8. 'Relative' [Section 2(1)(r)]

'Relative' has the meaning assigned to it in section 2(41) of the Companies Act, 1956 (corresponding to section 2(77) of the Companies Act, 2013).

1. The meanings assigned to the words and expressions used in section 2 shall apply, unless the context otherwise requires.
2. Words and expressions used but not defined in this Act but defined in the Representation of the People Act, 1950 or the Representation of the People Act, 1951 or the Foreign Exchange Management Act, 1999 shall have the meanings respectively assigned to them in those Acts.

Theoretical Questions from CS Examinations

Q 15.4A. Define 'foreign contribution' under the Foreign Contribution (Regulation) Act, 2010? [CS (Executive) June 2015]

15.5 Prohibition on acceptance of foreign contribution (Section 3)

1. Certain persons and organisations prohibited from accepting foreign contribution [Section 3(1)]

No foreign contribution shall be accepted by any of the following:

(a) Candidate for election

(b) Correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper

(c) Public servant, Judge, Government servant or employee of any corporation or any other body controlled or owned by the Government

The expression 'public servant' means a public servant as defined in section 21 of the Indian Penal Code, 1860.

The expression 'corporation' means a corporation owned or controlled by the Government and includes a Government company as defined in clause (45) of section 2 of the Companies Act, 2013.

(d) Member of any Legislature

(e) Political party or office-bearer of a political party

(f) Any organisation which has been specified as an 'organisation of a political nature' under section 5

Section 5 empowers the Central Government to specify an organisation as an 'organisation of a political nature'.

(g) Association or company engaged in the production or broadcast of –

(i) audio news; or

(ii) audio visual news; or

(iii) current affairs programmes

through any electronic mode, or any other electronic form or any other mode of mass communication

(h) Correspondent or columnist, cartoonist, editor, owner of the association or company referred to in clause (g).

2. Further prohibitions on acceptance of foreign contribution, etc.

(a) No person resident in India, and no citizen of India resident outside India, shall accept any foreign contribution, or acquire or agree to acquire any currency from a foreign source, on behalf of –

(i) a political party; or

(ii) any person who is prohibited from accepting foreign contribution under section 3(1).

(b) No person resident in India, shall deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to any person if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to –

(i) any political party; or

(ii) any person who is prohibited from accepting foreign contribution under section 3(1).

(c) No citizen of India resident outside India shall deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to –

(i) any political party; or

(ii) any person who is prohibited from accepting foreign contribution under section 3(1); or

(iii) any other person, if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to –
- a political party; or
- any person who is prohibited from accepting foreign contribution under section 3(1).

3. **Prohibitions on person receiving any currency from a foreign source on behalf of some other person**
No person receiving any currency, whether Indian or foreign, from a foreign source on behalf of any person or class of persons, referred to in section 9, shall deliver such currency –
(a) to any person other than a person for whom it was received, or
(b) to any other person, if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to a person other than the person for whom such currency was received.

Theoretical Questions from CS Examinations

Q 15.5A. State the persons who are prohibited from accepting foreign contributions under the Foreign Contribution (Regulation) Act, 2010. [CS (Executive) June 2007, June 2008, Dec. 2013]

Q 15.5B. Which organisations / individuals are specifically prohibited from receiving foreign contribution under the Foreign Contribution (Regulation) Act, 2010? [CS (Executive) Dec. 2015]

15.6 No prohibition on acceptance of foreign contribution by any person or organisation covered under section 3 in certain cases (Section 4)

It shall be lawful for any person or organisation referred to in section 3 to accept foreign contribution without contravening the provisions of section 3, in the following cases:

(a) Receipt of foreign contribution from any foreign source by way of salary, wages or other remuneration –
  (i) due to him; or
  (ii) due to any group of persons working under him.

(b) Receipt of foreign contribution from any foreign source in the ordinary course of business transacted in India by such foreign source.

(c) Receipt of foreign contribution by way of payment, in the course of international trade or commerce, or in the ordinary course of business transacted by him outside India.

(d) Foreign contribution received as an agent of a foreign source in relation to any transaction made by such foreign source with the Central Government or State Government.

(e) Foreign contribution received by way of a gift or presentation made to him as a member of any Indian delegation.

It shall be ensured that such gift or present is accepted in accordance with the rules made by the Central Government in this regard.

(f) Foreign contribution received from a relative.

1. **Intimation of receipt of foreign contribution from relatives (Rule 6 of the Foreign Contribution (Regulation) Rules, 2011):**
Any person who receives foreign contribution in excess of Rs. 1 lakh or equivalent thereto in a financial year from any of his relatives shall inform the Central Government by uploading details electronically online in Form FC-1 within 30 days from the date of receipt of such contribution.

2. **Receipt of foreign contribution from an entity holding the amount on behalf of relative is covered under section 4:**
Mr. Arvind Khanna held the office of MLA in Punjab. He was covered under section 3, *viz.* the categories of persons who are prohibited from accepting foreign contribution. He had accepted foreign contribution from a foreign entity named 'New Heaven Nominees'. Mr. Arvind Khanna submitted before the Court that the amount received by him from 'New Heaven Nominees' was in fact a gift received by him from his father (*viz.* Mr.Vipin Khanna), and the foreign entity (*viz.* New Heaven Nominees) through whom such funds were sent was holding such funds on behalf of his father. Mr.Vipin Khanna and New Heaven Nominees confirmed the submission made by Mr. Arvind Khanna. It was held that the receipt of foreign contribution by Mr. Arvind Khanna from New Heaven Nominees amounted to a gift from relative, and so it was in accordance with the provisions of section 4, and accordingly, there was no contravention of section 3 ***[Arvind Khanna v Central Bureau of Investigation]***.

(g) Foreign contribution received in the ordinary course of business through any official channel, post office, or any authorised person in foreign exchange under the Foreign Exchange Management Act, 1999.

(h) Receipt of foreign contribution by way of any scholarship, stipend or any payment of like nature.

In case, any foreign contribution is received by any person or organisation specified under section 3, for any purpose other than the purposes specified under section 4, such contribution shall be deemed to have been accepted in contravention of the provisions of section 3.

Theoretical Questions from CS Examinations

Q 15.6A. Mention the provisions of the Foreign Contribution (Regulation) Act, 2010 in respect of exemptions from accepting foreign contributions. [CS (Executive) Dec. 2008]

Q 15.6B. What are the exemptions to the prohibition of acceptance of foreign contributions under the Foreign Contribution (Regulation) Act, 2010? [CS (Executive) Dec. 2010]

Practical Problems from CA and CS Examinations

Whether acceptance of foreign contribution is permitted – Various cases

P 15.6A.

Case I. Do the following transactions amount to contravention of the Foreign Contribution (Regulation) Act, 2010? Give reasons in support of your answer and refer to relevant provisions:

(i) Abhay, general secretary, Loktantrik Sangathan, Moradabad (UP) receives a sum of US $ 1,000 by way of payment in the ordinary course of business transacted by him in India.

(ii) Avtar, a government servant, is in receipt of contribution by way of gift as a member of Indian delegation.

(iii) Vidur, a District and Sessions Judge, accepts a diamond studded watch from his relative residing in UK.

(iv) Sanjay, a private school teacher, is given a gift by his student living in USA for his personal use and the market value of the article is Rs. 2,200 only. [CS (Executive) Dec. 2006]

Case II. In the light of the provision of the Foreign Contribution (Regulation) Act, 2010 examine and decide whether the following persons in India are permitted to receive the amount/articles in the following situations:

(i) M/s KG & Co. a partnership firm obtained loan from a club registered in London for its business purpose.

(ii) Hello FM, a registered association, received funds from a foreign company for establishing Frequency Model Radio Station to broadcast audio news.

(iii) Mr. Happy received a wrist watch as marriage anniversary gift from his uncle, a citizen of USA. The market value of the wrist watch is Rs. 25,000. [CA (Final) Nov. 2019]

Ans. The given problems relate to section 3 and section 4 of the Foreign Contribution (Regulation) Act, 2010, as discussed below:

1. Section 3 imposes prohibition on acceptance of foreign contribution by certain persons specified therein (viz. in section 3).

   As per section 3, no foreign contribution shall be accepted by any of the following:

   (a) Candidate for election

   (b) Correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper

   (c) Public servant, Judge, Government servant or employee of any corporation or any other body controlled or owned by the Government

   (d) Member of any Legislature

   (e) Political party or office-bearer of a political party

   (f) Any organisation which has been specified as an 'organisation of a political nature' under section 5

   (g) Association or company engaged in the production or broadcast of –

   (i) audio news; or

   (ii) audio visual news; or

   (iii) current affairs programmes

   through any electronic mode, or any other electronic form or any other mode of mass communication

   (h) Correspondent or columnist, cartoonist, editor, owner of the association or company referred to in clause (g).

2. Section 4 enlists certain cases in which acceptance of foreign contribution by any person specified in section 3 is permitted. Thus, it shall be lawful for any person or organisation referred to in section 3 to accept foreign contribution without contravening the provisions of section 3, in the following cases:

(a) Receipt of foreign contribution from any foreign source by way of salary, wages or other remuneration –
  (i) due to him; or
  (ii) due to any group of persons working under him.

(b) Receipt of foreign contribution from any foreign source in the ordinary course of business transacted in India by such foreign source.

(c) Receipt of foreign contribution by way of payment, in the course of international trade or commerce, or in the ordinary course of business transacted by him outside India.

(d) Foreign contribution received as an agent of a foreign source in relation to any transaction made by such foreign source with the Central Government or State Government.

(e) Foreign contribution received by way of a gift or presentation made to him as a member of any Indian delegation.

It shall be ensured that such gift or present is accepted in accordance with the rules made by the Central Government in this regard.

(f) Foreign contribution received from a relative.

(g) Foreign contribution received in the ordinary course of business through any official channel, post office, or any authorised person in foreign exchange under the Foreign Exchange Management Act, 1999.

(h) Receipt of foreign contribution by way of any scholarship, stipend or any payment of like nature.

Case I.

(i) Abhay is the general secretary of Loktantrik Sangathan, Moradabad (UP). He is covered under section 3 as he is the office bearer of a political party.

Any foreign contribution received from any foreign source in the ordinary course of business transacted in India is covered under section 4. In the given case, Abhay has received US $ 1,000 by way of payment in the ordinary course of business transacted in India. So, Abhay can avail of the benefit of section 4. Accordingly, it is permissible for Abhay to receive US $ 1,000, and so he has not contravened any provisions of the Act.

(ii) Avtar is a Government servant, and so he is covered under section 3.

As per section 4, any person specified in section 3 is allowed to receive foreign contribution by way of a gift or presentation made to him as a member of any Indian delegation, if such gift or present is accepted in accordance with the rules made by the Central Government in this regard.

In the given case, Avtar has received foreign contribution as a gift in the capacity of a member of Indian delegation. This is allowed as per section 4, provided that Avtar shall comply with the rules made by the Central Government in this regard.

(iii) As per section 2(1)(h) read with Rule 6A of the Foreign Contribution (Regulation) Rules, 2011, 'foreign contribution' does not include donation, delivery or transter made by any foreign source, of any article given to a person as a gift for his personal use, if the market value, in India, of such article, on the date of such gift, is not more than Rs. 1 lakh.

As per section 4 read with Rule 6 of the Foreign Contribution (Regulation) Rules, 2011, a person specified under section 3 is allowed to receive foreign contribution from his relative, subject to the condition that if the amount of foreign contribution received is more than Rs. 1 lakh during a financial year, he shall inform the Central Government by uploading details electronically online in Form FC-1 within 30 days from the date of receipt of such foreign contribution.

In the given case, Vidur is a District and Sessions Judge, and so he is covered under section 3.

Vidur has accepted a diamond studded watch from his relative residing in UK.

If the value of the watch in India as on the date of the gift is upto Rs. 1 lakh, then, it would not amount to foreign contribution, and so provisions contained in the Act and the Rules shall not be attracted. Accordingly, Vidur can accept the gift, and he shall not be required to given any information to the Central Government with respect to acceptance of such gift.

If the market value of the watch in India as on the date of the gift is more than Rs. 1 lakh, then, it would amount to foreign contribution, but this case would be covered under section 4, and so Vidur can accept the gift. But, Vidur shall be required to inform the Central Government by uploading details electronically online in Form FC-1 within 30 days.

(iv) Mr. Sanjay is a teacher in a private school. He has accepted an article as a gift from one of his students living in USA. The market value of the article gifted to Mr. Sanjay is Rs. 2,200.

Mr. Sanjay is not one of those persons who are covered under section 3. Therefore, the provisions contained in section 3 with respect to prohibition on acceptance of foreign contribution are not applicable to Mr. Sanjay. Further, the market value in India of the article gifted to Mr. Sanjay as on the date of the gift is within the limit of Rs. 1 lakh, and so acceptance of such gift by him does not amount to acceptance of foreign contribution. Accordingly, the provisions contained in the Act and the Rules are not attracted. Therefore, by accepting the gift of Rs. 2,200, Mr. Sanjay has not contravened any provision of the Act.

Case II.

(i) M/s KG & Co. is a partnership firm. It is not one of those persons who are covered under section 3. Therefore, the provisions contained in section 3 with respect to prohibition on acceptance of foreign contribution are not applicable to M/s KG & Co.

So, it is permitted for KG & Co. to obtain loan from a club registered in London without attracting the provisions contained in the Act.

(ii) Hello FM is covered under section 3 as it is an association or company engaged in the production or broadcast of audio news. It has received foreign contribution from a foreign company, i.e. a foreign source. Any receipt of foreign contribution by Hello FM is prohibited under section 3. Therefore, by accepting funds from a foreign company, Hello FM has contravened the provisions of section 3.

(iii) Mr. Happy has accepted a wrist watch as a gift from his uncle who is a citizen of USA. The market value of the article gifted to Mr. Happy is Rs. 25,000.

Mr. Happy is not one of those persons who are covered under section 3. Therefore, the provisions contained in section 3 with respect to prohibition on acceptance of foreign contribution are not applicable to Mr. Happy. Further, the market value in India of the wrist watch gifted to Mr. Happy as on the date of the gift is within the limit of Rs. 1 lakh, and so acceptance of wrist watch by Mr. Happy does not amount to acceptance of foreign contribution. Accordingly, the provisions contained in the Act and the Rules are not attracted. Therefore, by accepting the gift of Rs. 25,000, Mr. Happy has not contravened any provision of the Act.

15.7 Restriction on acceptance of foreign hospitality (Section 6)

1. Prior permission required for accepting any foreign hospitality

Prior permission of the Central Government shall be required for accepting any foreign hospitality by any of the following categories of persons, while they are on visit to any country or territory outside India:

(a) Members of a Legislature

(b) Office-bearers of a political party

(c) Judges

(d) Employees of any corporation or any other body owned or controlled by the Government

The expression 'corporation' means a corporation owned or controlled by the Government and includes a Government company as defined in section 617 of the Companies Act, 1956 (corresponding to section 2(45) of the Companies Act, 2013).

(e) Government servants.

Procedure for receiving foreign hospitality (Rule 7 of the Foreign Contribution (Regulation) Rules, 2011):

1. Any person belonging to any of the categories specified in section 6 who wishes to avail of foreign hospitality shall apply electronically online in Form FC-2 for obtaining prior permission of the Central Government.
2. Such application shall be accompanied by –
   (a) an invitation letter from the host or the host country, as the case may be; and
   (b) administrative clearance of the Ministry or department concerned in case of visits sponsored by a Ministry or department of the Government.
3. The application must reach the Central Government ordinarily 2 weeks before the proposed date of the journey.

2. Acceptance of foreign hospitality without permission

(a) No permission of the Central Government shall be required, if –

(i) any of the persons specified in section 6 suddenly falls ill during a visit outside India; and

(ii) he requires emergency medical aid.

(b) The person receiving such hospitality shall give an intimation to the Central Government.

(c) The intimation shall be given within 1 month from the date of receipt of such hospitality.

(d) The intimation shall contain the details with respect to –

(i) the receipt of such hospitality;

(ii) the source from which such hospitality was received by him; and

(iii) the manner in which such hospitality was received by him.

Foreign hospitality received in case of sudden illness (Rule 7 of the Foreign Contribution (Regulation) Rules, 2011):

1. In case where emergency medical aid is required on account of sudden illness during a visit abroad, following details shall be intimated to the Central Government:
   (a) Full details including the source
   (b) Approximate value in Indian Rupees
   (c) The purpose for which the foreign hospitality was utilised
   (d) The manner in which the foreign hospitality was utilised.

2. However, no such intimation is required if the value of foreign hospitality in case of emergency medical aid is upto Rs. 1 lakh or equivalent thereto.
3. Such intimation shall be given within 1 month of receipt of the foreign hospitality.

Theoretical Questions from CS Examinations

Q 15.7A. Write a short note on 'Restrictions on acceptance of foreign hospitality'. [CS (Executive) Dec. 2006]

Practical Problems from CA Examinations

Meaning of foreign hospitality, requirement for availing foreign hospitality by General Secretary of a political party and relaxation from the provisions of the Act

P 15.7A. Mr. Satish, General Secretary of a political party received an invitation from the American Labour Party. He wants to avail foreign hospitality.

Define the term "foreign hospitality". In the light of the provisions of the Foreign Contribution (Regulation) Act, 2010, decide whether he can avail it. Discuss also the exception, if any, under which the provisions of the said Act may be relaxed.

[CA (Final) May 2018]

Ans. The given problem relates to section 2(1)(i), section 6 and section 50 of the Foreign Contribution (Regulation) Act 2010.

Definition of 'foreign hospitality'

The term 'foreign hospitality' has been defined under section 2(1)(i) as follows:

'Foreign hospitality' means any offer made in cash or kind by a foreign source for providing a person with –

(i) the cost of travel to any foreign country or territory;
(ii) free boarding or lodging;
(iii) free transport; or
(iv) free medical treatment.

Any offer which is purely a 'casual one' shall not be termed as foreign hospitality.

Whether Mr. Satish can avail the foreign hospitality?

As per section 6, prior permission of the Central Government shall be required for accepting any foreign hospitality by any of the categories of persons specified in section 6, while they are on visit to any country or territory outside India. Office-bearers of a political party are one of the persons specified in section 6.

In the given case, Mr. Satish is the General Secretary of a political party. Since Mr. Satish is an office-bearer of a political party, he can accept the foreign hospitality while on a visit to America, only after obtaining prior permission of the Central Government. For this purpose, he shall make an application in Form FC-2. The application must reach the Central Government ordinarily 2 weeks before the proposed date of the journey. Such application shall be accompanied by –

(a) an invitation letter from the American Labour Party; and
(b) administrative clearance of the Ministry or department concerned in case visit of Mr. Satish is sponsored by a Ministry or department of the Government.

Relaxation from the provisions of the Act

Section 50 empowers the Central Government to exempt any person or association or organisation or any individual from the operation of all or any of the provisions of this Act.

However, no exemption shall be given to a political party or a candidate for election.

The exemption may be subject to such conditions as may be specified by the Central Government in the order of exemption.

The Central Government may grant such exemption if it is of the opinion that it is necessary or expedient in the interests of the general public so to do.

Thus, the provisions of the Act may be relaxed by the Central Government in accordance with the provisions of section 50.

Practical Problems from CS Examinations

A director of a public company suddenly falls ill on a trip to USA and is provided medical treatment by a foreign national – Is there any violation of the Act?

P 15.7B. Ashok, a director of a public limited company, was on a business trip to USA. Suddenly, he developed chest pain there and was provided medical treatment in a hospital, the funds for which were provided by one John, a US national, who happened to be his friend. Did Ashok violate the provisions of the Foreign Contribution (Regulation) Act, 2010? Give reasons.

[CS (Executive) June 2013]

OR

Aditya, a director of Amex Ltd., visited Germany thrice in 2005 on invitations and free air-tickets, boarding and lodging extended to Amex Ltd. by the Chamber of Commerce and Industry, Germany. Has Aditya or the company contravened the provisions of the Foreign Contribution (Regulation) Act, 2010? Mention relevant provisions. [CS (Executive) June 2006]

Ans. The given problem relates to section 6 read with section 2(1)(i) of the Foreign Contribution (Regulation) Act, 2010, as discussed below:

1. The term 'foreign hospitality' has been defined under section 2(1)(i) as follows:

   'Foreign hospitality' means any offer made in cash or kind by a foreign source for providing a person with –

   (i) the cost of travel to any foreign country or territory;

   (ii) free boarding or lodging;

   (iii) free transport; or

   (iv) free medical treatment.

   Any offer which is purely a 'casual one' shall not be termed as foreign hospitality.

2. As per section 6, prior permission of the Central Government shall be required for accepting any foreign hospitality by any of the following categories of persons, while they are on visit to any country or territory outside India:

   (a) Members of a Legislature

   (b) Office-bearers of a political party

   (c) Judges

   (d) Employees of any corporation or any other body owned or controlled by the Government

   (e) Government servants.

3. However, no permission of the Central Government shall be required under section 6, if –

   (i) any of the persons specified in section 6 suddenly falls ill during a visit outside India; and

   (ii) he requires emergency medical aid.

   In such a case, the person receiving such hospitality shall give an intimation to the Central Government. The intimation shall be given within 1 month from the date of receipt of such hospitality.

4. In the given case, Mr. Ashok is a director of a public limited company. He is not covered under the categories of person specified under section 6 of the Act. Thus, the provisions of section 6 are not attracted to Mr. Ashok. Accordingly, Mr. Ashok can avail the foreign hospitality from his friend without attracting any provisions of the Act.

   Thus, by availing the foreign hospitality, Mr. Ashok has not contravened any provisions of the Act.

15.8 Prohibition to transfer foreign contribution to other person (Section 7)

1. No person who is registered and granted a certificate or has obtained prior permission under this Act, shall transfer such foreign contribution to any other person.
2. No person who receives any foreign contribution, shall transfer such foreign contribution to any other person.

Tutorial Note:

Section 7 of the Foreign Contribution (Regulation) Act, 2010 has been amended by the Foreign Contribution (Regulation) Amendment Act, 2020 with effect from 29th September, 2020. The provisions, as given above, are as per the amended section 7. Before amendment of section 7, the transfer of foreign contribution was possible subject to fulfilment of certain conditions, and the procedure and conditions for transfer of foreign contribution were contained in Rule 24 of the Foreign Contribution (Regulation) Rules, 2011. As a consequence of amendment of section 7, Rule 24 of the Foreign Contribution (Regulation) Rules, 2011 has been omitted.

Practical Problems from CA Examinations

Transfer of foreign contribution to a registered person and unregistered person – Conditions

P 15.8A. An association registered under the Foreign Contribution (Regulation) Act, 2010 (the Act) received donation from a club registered in Singapore. The Association proposes to transfer 10% of the donation to "Home for Aged Society", an unregistered person and 15% to "Welfare Club" a registered person under the Act.

In the light of provisions of the Foreign Contribution (Regulation) Act, 2010 decide whether the association can carry out the above proposal and if so state the procedures to be followed under the said Act? [CA (Final) Nov. 2018]

Ans. The given problem relates to section 7 of the Foreign Contribution (Regulation) Act, 2010. The provisions contained in section 7 are stated as under:

(a) No person who is registered and granted a certificate or has obtained prior permission under this Act, shall transfer such foreign contribution to any other person.

(b) No person who receives any foreign contribution, shall transfer such foreign contribution to any other person.

Applying the provisions of section 7, the donation (i.e. foreign contribution) received by the association from a club registered in Singapore can neither be transferred to 'Home for Aged Society' (an unregistered person) nor be transferred to 'Welfare Club' (a registered person).

Tutorial Note:

Section 7 of the Foreign Contribution (Regulation) Act, 2010 has been amended by the Foreign Contribution (Regulation) Amendment Act, 2020 with effect from 29th September, 2020. As per the amended section 7, the transfer of foreign contribution is not possible. However, before such amendment, the transfer of foreign contribution was possible subject to fulfilment of certain conditions.

The Author of this Book has answered the given practical problem as per amended section 7. However, the answers given in the Suggested Answers issued by ICAI are not updated by ICAI to give effect to any amendment made in the Act or the Rules. So, students may find that some of the answers given in this Book do not match with the answers given in the Suggested Answers issued by ICAI.

15.9 Restriction to utilise foreign contribution for administrative purpose (Section 8)

1. Conditions with respect to utilisation of foreign contribution

(a) Where a person, who is granted a certificate of registration or prior permission under section 12, receives any foreign contribution, he shall utilise such contribution for the purposes for which the contribution has been received.

(b) Further, any foreign contribution or any income arising out of it shall not be used for speculative business.

(c) The Central Government shall, by rules, specify the activities or business which shall be construed as speculative business for the purpose of this section.

Meaning of speculative activities (Rule 4 of the Foreign Contribution (Regulation) Rules, 2011):

1. Following activities shall be treated as speculative activities:
   (i) Any activity or investment that has an element of risk of appreciation or depreciation of the original investment, linked to marked forces, including investment in mutual funds or in shares.
   (ii) Participation in any scheme that promises high returns like investment in chits or land or similar assets not directly linked to the declared aims and objectives of the organisation or association.
2. A debt-based secure investment shall not be treated as speculative investment.
3. Every association shall maintain a separate register of investments.
4. Every register of investments shall be submitted for audit.

2. Limit on utilisation of foreign contribution for administrative purposes

Where a person, who is granted a certificate of registration or prior permission under section 12, receives any foreign contribution, he shall not defray as far as possible such sum, not exceeding 20% of such contribution, received in a financial year, to meet the administrative expenses.

However, administrative expenses exceeding 20% of such contribution may be defrayed with the prior approval of the Central Government.

3. Elements to be included in administrative expenses

The Central Government may prescribe –

(a) the elements which shall be included in the administrative expenses; and

(b) the manner in which the administrative expenses shall be calculated.

Administrative expenses (Rule 5 of the Foreign Contribution (Regulation) Rules, 2011):

The following shall constitute administrative expenses:

(i) Salaries, wages, travel expenses or any remuneration realised by the Members of the Executive Committee or Governing Council of the person

(ii) All expenses towards hiring of personnel for management of the activities of the person and salaries, wages or any kind of remuneration paid, including cost of travel, to such personnel

(iii) All expenses related to consumables like electricity and water charges, telephone charges, postal charges, repairs to premise(s) from where the organisation or Association is functioning, stationery and printing charges, transport and travel charges by the Members of the Executive Committee or Governing Council and expenditure on office equipment

(iv) Cost of accounting for and administering funds

(v) Expenses towards running and maintenance of vehicles

(vi) Cost of writing and filing reports

(vii) Legal and professional charges

(viii) Rent of premises, repairs to premises and expenses on other utilities:

Provided that the expenditure incurred on salaries or remuneration of personnel engaged in training or for collection or analysis of field data of an association primarily engaged in research or training shall not be counted towards administrative expenses:

Provided further that the expenses incurred directly in furtherance of the stated objectives of the welfare oriented organisation shall be excluded from the administrative expenses such as salaries to doctors of hospital, salaries to teachers of school, etc.

Practical Problems from CA Examinations

Whether it is permitted to invest the foreign contribution in chits promising high returns?

P 15.9A. An association registered under the Foreign Contribution (Regulation) Act, 2010 (the Act) received donation from a club registered in Singapore. The association proposes to invest portion of the donation in chits promising high returns.

In the light of provisions of the Foreign Contribution (Regulation) Act, 2010 decide whether the association can carry out the above proposal and if so state the procedures to be followed under the said Act? [CA (Final) Nov. 2018]

Ans. The given problem relates to section 8 of the Foreign Contribution (Regulation) Act, 2010 read with Rule 4 of the Foreign Contribution (Regulation) Rules, 2011.

The legal position

1. As per section 8, if a person, who has been granted a certificate of registration or prior permission under section 12, receives any foreign contribution, he shall utilise such contribution for the purposes for which the contribution has been received.
2. Section 8 further provides that any foreign contribution or any income arising out of it shall not be used for speculative business.
3. Section 8 empowers the Central Government to specify the activities or business which shall be construed as speculative business for this purpose. As per Rule 4 of the Foreign Contribution (Regulation) Rules, 2011, following activities shall be treated as speculative activities:
   (i) Any activity or investment that has an element of risk of appreciation or depreciation of the original investment, linked to marked forces, including investment in mutual funds or in shares.
   (ii) Participation in any scheme that promises high returns like investment in chits or land or similar assets not directly linked to the declared aims and objectives of the organisation or association.

The given case and analysis of the case

4. An association which has been granted a certificate of registration under section 12 has received donation (viz. foreign contribution) from a club registered in Singapore. The association proposes to invest a portion of such donation in chits promising high returns. Such investment can be made by the association only if it is permitted in accordance with section 8 read with Rule 4.
5. The proposed investment is in the chits promising high returns. Such investment is specifically covered in 'speculative activities' as per Rule 4.

Conclusion

6. The association cannot make investment of foreign contribution received by it in the chits promising high returns since it amounts to 'speculative activities' as per Rule 4, and investment in speculative activities is prohibited as per section 8.

15.10 Power of Central Government to prohibit receipt of foreign contribution, etc., in certain cases (Section 9)

1. Powers of the Central Government to impose prohibitions and require any person to obtain prior permission or furnish information

The Central Government is empowered to make any of the following orders:

(a) Prohibit any person or organisation (not being a person or organisation specified in section 3) from accepting any foreign contribution.

(b) Require any person (not being a person specified in section 6) to obtain prior permission of the Central Government before accepting any foreign hospitality.

(c) Require any person (not being a person specified in section 6) to furnish intimation as to –
   (i) the receipt of any foreign hospitality;
   (ii) the source from which such hospitality was received; and
   (iii) the manner in which such hospitality was received.

In case, such an order is made, the person concerned shall furnish such intimation within such time and in such manner as may be prescribed.

(d) Require any person (not being a person specified in section 11) to furnish intimation as to –

(i) the amount of any foreign contribution received; and

(ii) the source from which such contribution was received;

(iii) the manner in which such contribution was received;

(iv) the purpose for which such contribution was utilised; and

(v) the manner in which such contribution was utilised.

In case, such an order is made, the person concerned shall furnish such intimation within such time and in such manner as may be prescribed.

(e) Require any person specified in section 11 to obtain prior permission of the Central Government before accepting any foreign contribution.

Section 9 does not contain any provision requiring the Central Government to give an opportunity of being heard to the person concerned before passing an order.

However, the Courts have held that the order of the Central Government is capable of affecting the civil rights of a person, and therefore, it is essential that before making any order under section 9, the person concerned shall be given a reasonable opportunity of being heard, as it is requirement of natural justice. Thus, even if the Statute (*viz.* the Foreign Contribution (Regulation) Act, 2010) does not lay down the requirement of giving an opportunity of being heard, the Court can read the Statute as if the requirement of giving an opportunity of being heard was contained in the Statute, since an order under section 9 is likely to cause prejudice to the civil rights of the person concerned.

Further, the order passed by the Central Government must be based on some material on the basis of which such an order is necessary, and such material and all relevant facts must be disclosed to the concerned person and the concerned person must be given an opportunity to explain his case.

An order of prohibition which contained no reasons and which was passed without giving any prior hearing to the person concerned violated the principles of natural justice, and so such order was quashed by the Court ***[Asian Aid Organisation Welfare Trust* v *Union of India]***.

The Central Government made an order prohibiting Usmania Trust from accepting foreign contribution from Islamic Development Bank. No reasons were given in the prohibitory order, and no opportunity of being heard was given to Usmania Trust. The Court set aside the order passed by the Central Government ***[Usmania Trust* v *Union of India]***.

It is essential to give proper notice while ordering a person to obtain prior permission as that affects his civil rights. It is also a requirement of natural justice ***[Ministry of Home Affairs in Government of India* v *Indian Church of Christ Evangelistic Association]***.

2. Criteria for imposing prohibition and requiring any person to obtain prior permission or furnish intimation

No order shall be made under this section unless the Central Government is satisfied that the acceptance of foreign contribution or foreign hospitality by such person, is likely to affect prejudicially –

(i) the sovereignty and integrity of India; or

(ii) public interest; or

(iii) freedom or fairness of election to any Legislature; or

(iv) friendly relations with any foreign State; or

(v) harmony between religious, racial, social, linguistic or regional groups, castes or communities.

The above grounds are also contained in section 12 as the grounds, on the basis of which an applicant shall not be granted a certificate of registration or prior permission.

Theoretical Questions from CS Examinations

Q 15.10A. What are the powers of the Central Government regarding receipt of foreign contributions under the Foreign Contribution (Regulation) Act, 2010? [CS (Executive) June 2007, June 2008]

Q 15.10B. Discuss the powers of the Central Government to prohibit receipt of foreign contribution under the Foreign Contribution (Regulation) Act, 2010? [CS (Executive) June 2007, Dec. 2012, Dec. 2014]

15.11 Power to prohibit payment of currency received in contravention of the Act (Section 10)

1. Power of the Central Government to impose prohibition on transfer etc. of articles, currency etc.

Section 10 empowers the Central Government to make an order prohibiting a person from transferring or dealing in any article or currency or security. Following points are worth noting in this regard:

(a) The Central Government shall make an inquiry as to whether a person, who has in his custody or control any article or currency or security (whether Indian or foreign), has accepted such article or currency or security in contravention of the provisions of this Act.

(b) After making such inquiry, if the Central Government is satisfied that such person had accepted any article or currency or security in contravention of the provisions of the Act, it may, by a written order, prohibit such person from paying, delivering, transferring or dealing with such article or currency or security.

(c) The Central Government may, by written order, permit such person to pay, deliver, transfer or deal with such article or currency or security in accordance with such terms and conditions as the Central Government may deem fit.

(d) The Central Government shall serve a copy of the order on the person so prohibited.

Manner of service of copy of the order (Rule 8 of the Foreign Contribution (Regulation) Rules, 2011):

1. The order may be served on the person concerned by delivering it to that person or to his duly authorised agent.
2. The order may be served on the person concerned by sending to him by 'registered post with acknowledgement due' or 'speed post'.
3. If the order cannot be served in any of the aforesaid manner, the order may be affixed on the outer door of the premises in which that person resides or carries on business or personally works for gain, and a written report of the same shall be witnessed by at least 2 persons.

2. Effect of order of the Central Government

(a) The person who is so prohibited, shall not pay, deliver, transfer or deal with such article or currency or security except in accordance with such terms and conditions as are contained in the order of the Central Government.

Effect of payment, transfer etc. of any article, currency etc. in contravention of the order of the Central Government:

As per section 34, if any person, on whom any prohibitory order has been served under section 10, pays, delivers, transfers or otherwise deals with, in any manner whatsoever, any article or currency or security, whether Indian or foreign, in contravention of such prohibitory order, he shall be punishable as follows:

(i) Imprisonment upto 3 years; or

(ii) Fine; or

(iii) Both; and

(iv) Additional fine equivalent to the market value of the article or the amount of the currency or security in respect of which the prohibitory order has been contravened by him or such part thereof as the court may deem fit.

(b) The provisions contained in sub-sections (2), (3), (4) and (5) of section 7 of the Unlawful Activities (Prevention) Act, 1967 shall apply in relation to such article or currency or security.

Effect of section 10 of the Foreign Contribution (Regulation) Act, 2010 read with sub-sections (2), (3), (4) and (5) of section 7 of the Unlawful Activities (Prevention) Act, 1967:

1. The Central Government may send a copy of the prohibitory order to such Gazetted Officer as it may deem fit. The copy of the prohibitory order shall be deemed to be a warrant authorising such Gazetted Officer to enter the premises of the person concerned, examine his books, search for the article, currency or security and make inquiries from such person.
2. Any person aggrieved by a prohibitory order made by the Central Government may, within 15 days of service of such order, make an application to the Court of District Judge, and the Court of District Judge shall decide as to whether such person had accepted such article or currency or security in contravention of the provisions of the Foreign Contribution (Regulation) Act, 2010.
3. No information obtained in the course of investigation shall be divulged by the Gazetted Officer without the consent of the Central Government.

15.12 Registration of certain persons with Central Government (Section 11)

1. **Mandatory registration or requirement of prior permission before accepting foreign contribution**

   A person having a definite cultural, economic, educational, religious or social programme shall not accept foreign contribution unless such person –

   (a) obtains a certificate of registration from the Central Government; or

   (b) obtains the prior permission of the Central Government.

   Such prior permission shall be valid for the specific purpose for which it is obtained and from the specific source.

2. **Persons registered under the old Act deemed to be registered under the new Act**

   A person shall be deemed to be registered or granted prior permission under this Act, if such person was –

   (a) registered with the Central Government under the Foreign Contribution (Regulation) Act, 1976; or

   Such registration shall be valid for a period of 5 years from the date on which this section comes into force, *viz.* 5 years from 1st May, 2011, *viz.* till 30th April, 2016.

   (b) granted prior permission by the Central Government under the Foreign Contribution (Regulation) Act, 1976.

   Such prior permission shall remain valid for the specific purpose for which it was obtained and from the specific source.

3. **Effect of contravention**

   (a) If the person referred to in this section is found guilty of violation of any of the provisions of this Act or the Foreign Contribution (Regulation) Act, 1976, then –

   (i) the unreceived amount of foreign contribution shall not be received, without prior approval of the Central Government;

   (ii) the unutilised amount of foreign contribution shall not be utilised, without prior approval of the Central Government.

   (b) If the Central Government, on the basis of any information or report, and after holding a summary inquiry, has reason to believe that a person who has been granted prior permission has contravened any of the provisions of this Act, it may, pending any further inquiry, direct that such person shall not utilise the unutilised foreign contribution or receive the remaining portion of foreign contribution which has not been received or, as the case may be, any additional foreign contribution, without prior approval of the Central Government.

4. **Prior permission of the Central Government required in certain cases**

   Notwithstanding anything contained in this Act, the Central Government may, by notification in the Official Gazette, specify –

   (i) the person or class of persons who shall obtain the prior permission of the Central Government before accepting the foreign contribution; or

   (ii) the areas in which foreign contribution shall be accepted and utilised with prior permission of the Central Government; or

   (iii) the purposes for which the foreign contribution shall be utilised with the prior permission of the Central Government; or

   (iv) the sources from which the foreign contribution shall be accepted with the prior permission of the Central Government.

Whether an organisation pursuing a definite social programme can receive $5,000 from a charitable trust in Canada?

P 15.12A. Sarva Kalyan Morcha, an organisation pursuing a definite social programme, is in receipt of $5,000 from a charitable trust in Canada. Whether it amounts to contravention of the Foreign Contribution (Regulation) Act, 2010? Give reasons in support of your answer and refer to relevant provisions. **[CS (Executive) Dec. 2006]**

OR

Destitutes Rehabilitation (India), an NGO devoted to the cause of ameliorating the lot of destitutes and the needy, has been offered a contribution of $5,000 by an American foundation. Mention the provisions of the Foreign Contribution (Regulation) Act, 2010 regulating the receipt of foreign contribution by an organisation pursuing a definite social, cultural, economic, educational or religious programme. **[CS (Executive) Dec. 2007]**

OR

Ananda Swar Mondal, a cultural association in Kolkata formed for the sole purpose of promoting Rabindra Sangeet, has been offered gift of $ 5,000 by a society in USA. Can the association receive it without violating the provisions of the Foreign Contribution (Regulation) Act, 2010? [CS (Executive) June 2005]

OR

Gurukul Vidyarthi Manch, a body formed for the purposes of imbibing patriotism and character-building among students, receives a grant of £ 1,500 from Struarts, a British-philanthropist. Does it violate the provisions of the Foreign Contribution (Regulation) Act, 2010? [CS (Executive) Dec. 2005]

Ans. The given problem relates to section 11 of the Foreign Contribution (Regulation) Act, 2010.

As per section 11, a person having a definite cultural, economic, educational, religious or social programme shall not accept foreign contribution unless such person –

(a) obtains a certificate of registration from the Central Government; or

(b) obtains the prior permission of the Central Government.

In the given case, Sarva Kalyan Morcha is an organisation pursuing a definite social programme, and so the provisions of section 11 are applicable to it. Accordingly, Sarva Kalyan Morcha can accept foreign contribution of $ 5,000 from a charitable trust in Canada only after obtaining –

(a) a certificate of registration from the Central Government; or

(b) the prior permission of the Central Government.

15.13 Grant of certificate of registration or prior permission (Section 12)

1. Application for obtaining certificate of registration or prior permission

An application for obtaining certificate of registration or prior permission under section 11 shall be made to the Central Government in such form and manner and along with such fee, as may be prescribed. The applicant shall be required to open 'FCRA Account' in the manner specified in section 17 and mention details of such account in the application.

Procedure for making application (Rule 9 of the Foreign Contribution (Regulation) Rules, 2011):

1. An application for obtaining certificate of registration shall be made electronically online in Form FC-3A. The application shall be accompanied by a fees of Rs. 5,000.
2. An application for obtaining prior permission shall be made electronically online in Form FC-3B. The application shall be accompanied by a fees of Rs. 3,000.
3. The application (for obtaining certificate of registration or prior permission, as the case may be) shall be accompanied by an affidavit executed by each office bearer and key functionary and member in Proforma 'AA' appended to the Foreign Contribution (Regulation) Rules, 2011.
4. The applicant shall upload the signed or digitally signed application along with scanned documents as specified by the Central Government from time to time.
5. The applicant shall open an exclusive bank account for the purpose of receiving the foreign contribution.
6. The applicant may open one or more accounts in one or more banks for the purpose of utilising the foreign contribution after it has been received and, in all such cases, intimation electronically online in Form FC-6D shall be furnished to the Secretary, Ministry of Home Affairs, New Delhi within 15 days of the opening of any account.

Note: The Foreign Contribution (Regulation) Rules, 2011 were amended by the Foreign Contribution (Regulation) Amendment Rules, 2015. After such amendment, there is no requirement of submission of hard copies of the online application and other documents.

2. Rejection of application

(a) On receipt of an application for grant of certificate of registration or prior permission, the Central Government shall reject the application, if –

(i) the application is not in the prescribed form; or

(ii) the application does not contain any of the particulars specified in that form.

A person shall not be eligible for grant of certificate of registration or prior permission, if –

(i) he had earlier been granted a certificate of registration;

(ii) afterwards, his certificate of registration was suspended; and

(iii) such suspension of certificate continues on the date of making application.

Accordingly, if such a person makes an application for grant of certificate or prior permission, his application shall be rejected.

(b) Where the Central Government rejects the application, it shall record the reasons for such rejection and furnish a copy of such reasons to the applicant. However, the Central Government may not communicate the reasons for such rejection to the applicant if there is no obligation to give any such information or documents or records or papers under the Right to Information Act, 2005.

3. Grant of certificate of registration or prior permission

The Central Government may grant a certificate of registration or prior permission if it is of the opinion that the conditions for grant of certificate of registration or prior permission (as specified in sub-section (4) of section 12) are satisfied.

(a) Before granting the certificate of registration or prior permission, the Central Government may make such inquiry as it may deem fit.

(b) The Central Government may grant the certificate of registration or the prior permission subject to such terms and conditions as it may deem fit.

(c) Where the Central Government is of the opinion that the conditions specified in section 12(4) are satisfied, it shall ordinarily grant the certificate of registration or prior permission within 90 days of the receipt of application. However, if the certificate of registration or prior permission is not granted within the said period of 90 days, the Central Government shall communicate to the applicant the reasons for the same.

(d) The certificate of registration shall be valid for a period of 5 years from the date of its issue.

(e) The prior permission shall be valid for the specific purpose or specific amount of foreign contribution proposed to be received.

4. Conditions for grant of certificate of registration or prior permission [Section 12(4)]

(a) The applicant (*viz.* the person who has made the application for obtaining certificate of registration or prior permission) –

(i) is not fictitious or benami;

(ii) has not been prosecuted or convicted for indulging in activities aimed at conversion through inducement or force, either directly or indirectly, from one religious faith to another;

(iii) has not been prosecuted or convicted for creating communal tension or disharmony in any specified district or any other part of the country;

(iv) has not been found guilty of diversion or mis-utilisation of funds;

(v) is not engaged or likely to engage in propagation of sedition or advocate violent methods to achieve its ends;

(vi) is not likely to use the foreign contribution for personal gains or divert it for undesirable purposes;

(vii) has not contravened any of the provisions of this Act;

(viii) has not been prohibited from accepting foreign contribution.

(b) The applicant has undertaken reasonable activity in its chosen filed for the benefit of the society for which the foreign contribution is proposed to be utilised.

(c) The applicant has prepared a reasonable project for the benefit of the society for which the foreign contribution is proposed to be utilised.

(d) In case the applicant is an individual, such individual has neither been convicted under any law for the time being in force nor any prosecution for any offence is pending against him.

(e) In case the applicant is other than an individual, none of its directors or office bearers has been convicted under any law for the time being in force and no prosecution for any offence is pending against any of them.

(f) The acceptance of foreign contribution by the applicant is not likely to affect prejudicially –

(i) the sovereignty and integrity of India; or

(ii) the security, strategic, scientific or economic interest of the State; or

(iii) the public interest; or

(iv) freedom or fairness of election to any Legislature; or

(v) friendly relation with any foreign State; or

(vi) harmony between religious, racial, social, linguistic, regional groups, castes or communities.

(g) The acceptance of foreign contribution –

(i) shall not lead to incitement of an offence;

(ii) shall not endanger the life or physical safety of any person.

15.14 Power of CG to require Aadhaar number, etc., as identification document (Section 12A)

1. Power of the Central Government to require identification document

Section 12A empowers the Central Government to require that –

(a) any person who seeks prior permission or prior approval under section 11; or

(b) any person who makes an application for grant of certificate under section 12; or

(c) any person who makes an application for renewal of certificate under section 16,

shall provide an identification document of all its office bearers or Directors or other key functionaries, by whatever name called.

2. Documents permissible as identification document

(a) The Aadhaar number issued under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016.

(b) Passport or Overseas Citizen of India Card, in case of a foreigner.

The provisions contained in section 12A shall apply notwithstanding anything contained in any provision of this Act.

15.15 Suspension of certificate of registration (Section 13)

1. Conditions for suspension of certificate of registration

The Central Government is empowered to suspend the certificate of registration granted under section 12, if the following conditions are satisfied:

(a) The question as to whether the certificate of registration should be cancelled on any of the grounds mentioned in section 14, is pending before the Central Government.

(b) Pending such cancellation, the Central Government is satisfied that it is necessary to suspend the certificate.

(c) The reasons for suspension shall be recorded in writing by the Central Government.

2. Period of suspension

The suspension shall be for a period of 180 days or such further period, not exceeding 180 days, as may be specified in the order of suspension.

3. Consequences of suspension of certificate of registration

(a) Every person whose certificate has been suspended shall not receive any foreign contribution during the period of suspension.

The Central Government may, on an application made by such person, if it considers appropriate, allow such person to receive any foreign contribution on such terms and conditions as it may specify.

(b) Every person whose certificate has been suspended shall not utilise the foreign contribution in his custody, except with the prior approval of the Central Government.

Extent of amount that can be utilised in case of suspension of the certificate of registration (Rule 14 of the Foreign Contribution (Regulation) Rules, 2011:

(i) Upto 25% of the unutilised foreign contribution may be spent, with the prior approval of the Central Government, for the declared aims and objects for which the foreign contribution was received.

(ii) The remaining 75% of the unutilised foreign contribution shall be utilised only after revocation of suspension of the certificate of registration.

15.16 Cancellation of certificate of registration (Section 14)

1. Conditions for cancellation of certificate of registration

The Central Government is empowered to cancel the certificate of registration if –

(a) an inquiry is made by the Central Government in this regard;

(b) as a result of the inquiry, the Central Government is satisfied that one or more of the grounds contained in this section are attracted; and

(c) the person concerned has been given a reasonable opportunity of being heard.

2. **Grounds for cancellation of certificate of registration**
   (a) The holder of the certificate has made an incorrect or false statement in the application for the grant of certificate of registration or renewal thereof
   (b) The holder of the certificate has violated any of the terms and conditions of the certificate or renewal thereof
   (c) In the opinion of the Central Government, it is necessary in the public interest to cancel the certificate
   (d) The holder of certificate has violated any of the provisions of this Act or rules or order made thereunder
   (e) The holder of the certificate has not been engaged in any reasonable activity in its chosen field for the benefit of the society for 2 consecutive years or has become defunct.
3. **Effect of cancellation of certificate of registration**
   Any person whose certificate of registration has been cancelled, shall not be eligible for registration or grant of prior permission for a period of 3 years from the date of cancellation of such certificate.

   Custody of foreign contribution in respect of a person whose certificate of registration has been cancelled (Rule 15 of the Foreign Contribution (Regulation) Rules, 2011:

   The amount of foreign contribution lying unutilised in the exclusive foreign contribution bank account of a person whose certificate has been cancelled, shall vest with the Bank concerned till any further direction in this regard is made by the Central Government.

Theoretical Questions from CS Examinations

Q 15.16A. Write a short note on 'cancellation of certificate under the Foreign Contribution (Regulation) Act, 2010'.

[CS (Executive) Dec. 2006]

Q 15.16B. State the circumstances under which Government can cancel the certificate of registration granted to a person under the Foreign Contribution (Regulation) Act, 2010. [CA (Final) May 2019]

Practical Problems from CA Examinations

Whether a person whose certificate of registration has been cancelled, can apply for re-registration after a period of 2.5 years?

P 15.16A. After giving a reasonable opportunity of being heard, Central Government cancelled the certification of registration of Toastea Ltd., a company registered under FCRA on the ground of public interest. 2.5 years have passed since such cancellation. Company has submitted its written declaration not to involve in such activity again and request to restore the registration. Advise Toastea Ltd. on its eligibility for re-registration or grant of prior permission. [CA (Final) May, 2019]

Ans. The given problem relates to section 14 of the Foreign Contribution (Regulation) Act, 2010.

1. As per section 14, any person whose certificate of registration has been cancelled, shall not be eligible for registration or grant of prior permission for a period of 3 years from the date of cancellation of such certificate.
2. In the given case, a period of 3 years has not elapsed since the date of cancellation of certificate of registration of Toastea Ltd.
3. Therefore, Toastea Ltd. is not eligible to make an application to the Central Government for obtaining certificate of registration or prior permission.

15.17 Surrender of certificate (Section 14A)

A person to whom a certificate has been granted, may surrender such certificate. For this purpose, such person is required to make a request to the Central Government. On receipt of such request, the Central Government may make such inquiry as it may deem fit. After making the inquiry, the Central Government is empowered to permit surrender of the certificate if it is satisfied that –

(a) such person has not contravened any of the provisions of this Act; and
(b) the management of foreign contribution and asset, if any, created out of such contribution has been vested in the authority prescribed under section 15.

15.18 Management of foreign contribution of person whose certificate has been cancelled or surrendered (Section 15)

1. **Vesting of foreign contribution and assets where certificate of registration is cancelled**
   Where the certificate of registration of a person is cancelled or surrendered, any foreign contribution and any assets created out of such foreign contribution which are in his custody, shall vest in such authority as may be prescribed.

2. Management of activities of the person whose certificate of registration is cancelled

(a) The authority prescribed by the Central Government may manage the activities of the person concerned, if –

(i) the authority considers it necessary; and

(ii) it is in public interest.

(b) The activities of the person concerned may be managed by the authority for such period and in such manner, as the Central Government may direct.

(c) The authority may utilise the foreign contribution for the purpose of managing the activities of the person concerned.

(d) The authority may dispose of the assets created out of the foreign contribution in case adequate funds are not available for managing the activities of the person concerned.

3. Return of foreign contribution and assets if such person is subsequently registered

The authority shall return the foreign contribution and the assets vested upon it to the person concerned if the person concerned is subsequently registered under this Act.

15.19 Renewal of certificate (Section 16)

1. Validity period of certificate of registration

As per section 12, the certificate of registration shall be valid for a period of 5 years from the date of its issue.

2. Application for renewal of certificate

(a) Every person who has been granted a certificate of registration under section 12 shall get such certificate renewed.

(b) The application for renewal shall be in such form and manner and accompanied by such fee as may be prescribed.

Procedure for renewal of registration certificate (Rule 12 of the Foreign Contribution (Regulation) Rules, 2011:

(i) The application for renewal shall be made to the Central Government electronically online in Form FC-3C.

(ii) The application shall be accompanied by an affidavit executed by each office bearer and key functionary and member in Proforma 'AA' appended to the Foreign Contribution (Regulation) Rules, 2011.

(iii) The application shall be accompanied by a fee of Rs. 1,500.

(iv) The fee for renewal of the certificate of registration shall be remitted by demand draft or banker's cheque in favour of the "Pay and Accounts Officer, Ministry of Home Affairs", payable at New Delhi or through online electronic payment gateway as specified by the Central Government.

(c) The application for renewal shall be made to the Central Government at least 6 months before the date of expiry of the certificate of registration.

Condonation of delay in making application (Rule 12 of the Foreign Contribution (Regulation) Rules, 2011):

If a person fails to make an application for renewal within the stipulated time period, his application may be accepted, if –

(i) such application is made not later than 1 year after the date of expiry of the certificate of registration;

(ii) the person explains the reasons for not submitting the application for renewal within the stipulated time;

(iii) the reasons so explained by the applicant constitute 'sufficient grounds' for not making the application within the stipulated time; and

(iv) the application is accompanied by requisite fee (i.e. Rs. 1,500) and with late fee of Rs. 5,000.

3. Inquiry by the Central Government

The Central Government may, before renewing the certificate, make such inquiry, as it may deem fit, to satisfy itself that such person has fulfilled all the conditions specified in sub-section (4) of section 12.

4. Renewal of certificate by the Central Government

(a) The Central Government shall renew the certificate, ordinarily within 90 days from the date of receipt of the application.

If the Central Government does not renew the certificate within the said period of 90 days, it shall communicate to the applicant the reasons for the same.

(b) The renewal shall be subject to such terms and conditions as the Central Government may deem fit.

(c) The renewal of the certificate shall be for a period of 5 years.

5. Refusal to renew the certificate

The Central Government may refuse to renew the certificate where the person concerned has violated any of the provisions of this Act or rules made thereunder.

6. Effect of not making the application for renewal

If no application for renewal of registration is received by the Central Government or such application is not accompanied by the requisite fee, the validity of the certificate of registration of such person shall be deemed to have ceased from the date of completion of the period of 5 years from the date of the grant of registration.

Illustration:

A certificate of registration granted on the 1st January, 2012 shall be valid till the 31st December, 2016. A request for renewal of the registration certificate shall reach the Central Government, accompanied by the requisite fee, by the 30th June, 2016. If no application is received or is not accompanied by the renewal fee, the validity of the registration certificate issued on the 1st January 2012 shall be deemed to have lapsed with effect from the close of the day on 31st December, 2016.

7. Effect of cessation of validity of certificate of registration

If the validity of the certificate of registration ceases, a fresh request for the grant of a certificate of registration may be made by the person concerned in accordance with the provisions of Rule 9.

Theoretical Questions from CS Examinations

Q 15.19A. State the procedure for making an application for renewal of certificate under the Foreign Contribution (Regulation) Act, 2010. [CS (Executive) Dec. 2015]

15.20 Foreign contribution through scheduled bank (Section 17)

1. 'FCRA Account' for receiving foreign contribution

(a) Every person who has been granted certificate or prior permission under section 12 shall receive foreign contribution only in an account designated as 'FCRA Account' by the bank.

(b) Such account shall be opened in such branch of the State Bank of India at New Delhi, as the Central Government may, by notification, specify in this behalf.

(c) Such account shall be used for the purpose of remittances of foreign contribution.

2. 'FCRA' Account for keeping or utilising foreign contribution

(a) A person who has been granted a certificate of registration or prior permission under section 12 may also open another 'FCRA Account' in any scheduled bank of his choice for the purpose of keeping or utilising the foreign contribution which has been received in the 'FCRA Account' in the specified branch of State Bank of India at New Delhi.

(b) However, no funds other than foreign contribution shall be received or deposited in such account.

3. One or more Accounts for utilising foreign contribution

(a) A person who has been granted a certificate of registration or prior permission under section 12 may also open one or more accounts in one or more scheduled banks of his choice to which he may transfer for utilising any foreign contribution received by him in his 'FCRA Account' in the specified branch of the State Bank of India at New Delhi or kept by him in another 'FCRA Account' in a scheduled bank of his choice.

(b) However, no funds other than foreign contribution shall be received or deposited in such account.

4. Reporting by SBI or Scheduled Bank

The specified branch of the State Bank of India at New Delhi or the branch of the scheduled bank in which 'FCRA Account' has been opened, or the authorised person in foreign exchange, shall report to such authority as may be specified, –

(a) the amount of foreign remittance;

(b) the source and manner in which the foreign remittance was received; and

(c) other particulars,

in such form and manner as may be prescribed.

Reporting by banks of receipt of foreign contribution (Rule 16 of the Foreign Contribution (Regulation) Rules, 2011):

The bank shall report to the Central Government, within 48 hours, any transaction in respect of –

(a) receipt of any foreign contribution by any person;

(b) utilisation of any foreign contribution by any person

whether or not such person is registered or granted prior permission under the Act.

15.21 Intimation of receipt and utilisation of foreign contribution (Section 18)

1. Intimation of foreign contribution received and utilised

(a) Every person who has been granted a certificate of registration or prior permission under section 12 shall give an intimation to –

(i) the Central Government; and

(ii) such other authority as may be specified by the Central Government.

(b) The intimation shall be given within such time and in such manner as may be prescribed.

(c) The intimation shall contain the following details:

(i) The amount of each foreign contribution received by it

(ii) The source from which such foreign contribution was received

(iii) The manner in which such foreign contribution was received

(iv) The purposes for which such foreign contribution was utilised by him

(v) The manner in which such foreign contribution was utilised by him.

2. Certified copy of statement to be submitted along with intimation

(a) Every person who receives the foreign contribution shall submit to the Central Government a copy of a statement containing the particulars of foreign contribution received by him.

(b) The statement shall be duly certified by officer of the bank or authorised person in foreign exchange.

(c) The statement shall be submitted to the Central Government along with the intimation.

Intimation of foreign contribution by the recipient (Rule 17 of the Foreign Contribution (Regulation) Rules, 2011):

1. Every person who receives the foreign contribution, shall submit an annual report.
2. The annual report shall be in Form FC-4.
3. The annual report shall be signed or digitally signed, and shall be submitted online.
4. The annual report shall reflect –
   (a) the foreign contribution received in the exclusive bank account; and
   (b) the details in respect of the funds transferred to other bank accounts for utilisation.
5. The annual report shall be accompanied with –
   (a) scanned copies of income and expenditure account, receipts and payments account and balance sheet;
   (b) a copy of a statement of account from the bank where the exclusive foreign contribution account is maintained, duly certified by an officer of such bank.
6. The annual report shall be submitted within 9 months of the closure of the financial year.
7. The annual report shall be duly certified by a chartered accountant.

15.22 Maintenance of accounts (Section 19)

Every person who has been granted a certificate of registration or prior permission under section 12 shall maintain, in such form and manner as may be prescribed, –

(a) an account of foreign contribution received by him; and

(b) manner of utilisation of foreign contribution received by him.

Provisions contained in Rule 11 of the Foreign Contribution (Regulation) Rules, 2011:

Every person who has been granted a certificate of registration or prior permission under section 12 shall maintain a separate set of accounts and records, exclusively, for the foreign contribution received and utilised.

15.23 Audit of accounts (Section 20)

1. Order of conduct of audit

(a) The Central Government may make an order of audit of books of account kept by a person.

(b) The Central Government may authorise any of the following persons to conduct such audit:

(i) A Gazetted Officer holding a Group A post under the Central Government

(ii) Any other officer or authority or organisation, as the Central Government may think fit.

(c) The Central Government may make such an order if –

(i) any person who has been granted a certificate of registration or prior permission, fails to submit any intimation within the time specified for submission of such intimation; or

(ii) the intimation furnished by a person is not in accordance with the provisions of law; or

(iii) the Central Government has reasonable cause to believe, after inspection of any intimation submitted to it, that any provision of this Act has been, or is being, contravened.

2. **Rights of the person authorised to conduct audit**

Every such officer shall have the right to enter in any premises at any reasonable hour, before sunset and after sunrise, for the purpose of auditing the books of account.

3. **Confidentiality of information**

Any information obtained from audit shall be kept confidential and shall not be disclosed except for the purposes of this Act.

15.24 Disposal of assets created out of foreign contribution (Section 22)

Where any person who was permitted to accept foreign contribution under this Act, ceases to exist or has become defunct, then –

(a) all the assets of such person shall be disposed of in accordance with the provisions contained in any law for the time being in force under which the person was registered or incorporated;

(b) in the absence of any such law, the Central Government may, by notification, specify that all such assets shall be disposed of by such authority, as it may specify.

In such a case the manner and procedure of disposal of assets shall be such as may be prescribed by the Central Government.

15.25 Confiscation of article or currency or security obtained in contravention of the Act (Section 28)

Any article or currency or security which is seized under section 25 shall be liable to confiscation if such article or currency or security has been adjudged under section 29 to have been received or obtained in contravention of this Act.

15.26 Adjudication of confiscation (Sections 29 and 30)

1. **Authorities to adjudge confiscation (Section 29)**

Whether or not any article or currency or security is liable to be confiscated, shall be adjudged by –

(a) the Court of Session within the local limits of whose jurisdiction the seizure was made;

The Court of Session shall be empowered to adjudicate confiscation of any article or currency or security, without any limit.

(b) such officer, as the Central Government may, by notification in the Official Gazette, specify in this behalf.

The officer so specified shall not be below the rank of an Assistant Sessions Judge.

The officer so specified shall be empowered to adjudicate confiscation of any article or currency or security, the value of which is upto Rs. 10 lakh (Rule 19 of the Foreign Contribution (Regulation) Rules, 2011).

2. **Opportunity of being heard to be given (Section 30)**

Before making any order of confiscation of any article or currency or security, a reasonable opportunity of making a representation against such confiscation shall be given to the person from whom such article or currency or security was seized.

3. **Disposal of the article or currency or security confiscated (Section 29)**

When adjudication is concluded, the Court of Session or the officer specified by the Central Government may make an order that the article or currency or security so confiscated shall be delivered to a person who claims to be entitled thereto.

15.27 Appeals (Section 31)

1. **Appeal against order of confiscation**

(a) Any person aggrieved by an order of confiscation made by the Court of Session, may prefer an appeal to the High Court to which such Court of Session is subordinate.

(b) Any person aggrieved by an order of confiscation made by an officer specified by the Central Government, may prefer an appeal to the Court of Session.

(c) The appeal may be preferred within 1 month from the date of communication of the order.

(d) The appellate court may, if it is satisfied that the appellant was prevented by sufficient cause from preferring the appeal within the said period of 1 month, allow such appeal to be preferred within a further period of 1 month, but not thereafter.

2. Appeal against order refusing to give permission under the Act etc.

(a) In the following cases, the aggrieved person may prefer an appeal to the High Court within the local limits of whose jurisdiction the aggrieved person ordinarily resides or carries on business or personally works for gain, or, where the aggrieved person is an organisation or association, the principal office of such organisation or association is located:

(i) Order of the Central Government (made under section 5), specifying an organisation as an organisation of a political nature.

(ii) Refusal by the Central Government (under section 6) to grant prior permission for accepting foreign hospitality by the persons specified under section 6 (*viz.* members of a Legislature, office-bearers of a political party, Judges, employees of any corporation or any other body owned or controlled by the Government and Government servants).

(iii) Order of the Central Government (made under section 9) prohibiting any person or organisation from receiving foreign contribution, etc.

(iv) Rejection by the Central Government, of an application made to it by a person under section 12 for grant of certification of registration or prior permission.

(v) Order of the Central Government (made under section 14) cancelling the certificate of registration.

(b) Such appeal may be made within 60 days from the date of the order of the Central Government.

15.28 Revision of orders by the Central Government (Section 32)

1. Powers of the Central Government to examine records, conduct inquiry and pass orders

The Central Government is empowered to –

(a) call for and examine the record of any proceeding under this Act in which any order has been passed by it;

(b) make such inquiry or cause such inquiry to be made as it may think fit;

(c) pass such order thereon (including revision of an order passed earlier) as it may think fit.

2. Power exercisable *suo motu* or on receipt of an application

The Central Government may exercise such power –

(a) of its own motion (*viz. suo motu*); or

(b) on receipt of an application for revision from the person concerned.

3. Time limit for making *suo motu* revision

The Central Government shall not, of its own motion, revise any order if the order has been made more than 1 year previously.

4. Time limit for making application for revision

An application for revision can be made by the person concerned within 1 year from–

(a) the date, the order in question was communicated to him; or

(b) the date on which he came to know of the order in question,

whichever is earlier.

If the Central Government is satisfied that the person concerned was prevented by sufficient cause from making the application within the said period of 1 year, it may admit the application after the expiry of 1 year.

5. Situations where revision shall not be made

The Central Government shall not revise any order in any of the following cases:

(a) Where an appeal lies against the order of the Central Government, but the appeal has not been preferred and the time for preferring the appeal has not expired and the aggrieved person has not waived his right of appeal.

(b) An appeal has been filed against the order of the Central Government.

15.29 Offences and penalties (Sections 33 to 38)

Section	Nature of offence	Punishment for offence, if convicted by court
Section 33	**Making of false statement, declaration or delivering false accounts.** Any person, subject to this Act, who knowingly, – (a) gives false intimation under section 9 or 18; or (b) seeks prior permission or registration by means of fraud, false representation or concealment of material fact.	▪ Imprisonment upto 6 months; or ▪ Fine; or ▪ Both.
Section 34	**Penalty for article or currency or security obtained in contravention of section 10.** If any person, on whom any prohibitory order has been served under section 10, pays, delivers, transfers or otherwise deals with, in any manner whatsoever, any article or currency or security, whether Indian or foreign, in contravention of such prohibitory order.	▪ Imprisonment upto 3 years ▪ Fine; or ▪ Both; and ▪ Additional fine equivalent to the market value of the article or the amount of the currency or security in respect of which the prohibitory order has been contravened by him or such part thereof as the court may deem fit.
Section 35	**Punishment for accepting or assisting in accepting foreign contribution in contravention of any provision of the Act.** Any person accepts, or assists any other person, political party or organisation in accepting, any foreign contribution or any currency or security from a foreign source, in contravention of any provision of this Act or any rule or order made thereunder.	▪ Imprisonment upto 5 years; or ▪ Fine; or ▪ Both.
Section 36	**Power to impose additional fine where article or currency or security is not available for confiscation.** A person, who, in relation to any article or currency or security, whether Indian or foreign, does or omits to do any act which act or omission would render such article or currency or security liable to confiscation under this Act.	▪ Fine not exceeding 5 times the value of the article or currency or security or Rs. 1,000, whichever is more, if such article or currency or security is not available for confiscation. ▪ The fine so imposed shall be in addition to any other fine which may be imposed on such person under this Act.
Section 37	**Penalty for offences where no separate punishment has been provided.** Any person fails to comply with any provision of this Act for which no separate penalty has been provided in this Act.	▪ Imprisonment upto 1 year; or ▪ Fine; or ▪ Both.
Section 38	**Prohibition of acceptance of foreign contribution.** Any person having been convicted of any offence under section 35 or section 37, in so far as such offence relates to the acceptance or utilisation of foreign contribution, is again convicted of such offence.	He shall not accept any foreign contribution for a period of 5 years from the date of the subsequent conviction.

15.30 Offences by companies (Section 39)

1. **Persons liable for punishment in case of offences by companies**

   Where an offence under this Act or any rule or order made under this Act is committed by a company, then the following persons shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

   (a) Every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company.

   (b) The company.

2. **No liability if the offence was committed without knowledge of such person**

   A person shall not be liable for any punishment if he proves that –

   (a) the offence was committed without his knowledge; or

   (b) he had exercised all due diligence to prevent the commission of such offence.

3. **Liability of directors, manager etc. for offences committed by the company**

   If it is proved that the offence was committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation: For the purposes of this section, –

(a) 'company' means any body corporate and includes a firm, society, trade union or other association of individuals; and

(b) 'director', in relation to a firm, society, trade union or other association of individuals, means a partner in the firm or a member of the governing body of such society, trade union or other association of individuals.

15.31 Bar on prosecution of offences under the Act (Section 40)

No court shall take cognisance of any offence under this Act, except with the previous sanction of the Central Government or any officer authorised by the Central Government in this behalf.

15.32 Composition of certain offences (Section 41)

1. **Offences that may or may not be compounded**

   (a) An offence punishable under the Act cannot be compounded if it is punishable with imprisonment only. All other offences may be compounded.

   (b) It is immaterial as to whether the offence is committed by an individual or association or any officer or employee of such association.

   (c) An offence may be compounded in accordance with the provisions of this section, notwithstanding anything contained in the Code of Criminal Procedure, 1973.

2. **Time limit for compounding of offences**

   An offence may be compounded before the institution of any prosecution.

3. **Application for compounding**

   The application for compounding shall be made in such form and manner along with such fee as may be prescribed.

4. **Authority for compounding of offences**

   (a) The offence may be compounded by such officers or authorities as the Central Government may, by notification in the Official Gazette, specify in this behalf.

   (b) The officer or authority so specified by the Central Government shall exercise the powers to compound an offence, subject to the direction, control and supervision of the Central Government.

   (c) While considering the application for compounding of an offence, the officer or authority specified by the Central Government may direct the offender to file any return, account or other document within such time, as may be specified in the order.

5. **Payment of sum specified for compounding**

   For compounding of an offence, the applicant shall pay such sums as the Central Government may, by notification in the Official Gazette, specify in this behalf.

6. When is compounding not permissible?

An offence shall not be compounded if it is committed within 3 years from the date on which a similar offence was earlier committed or compounded. *In other words*, after compounding of an offence, if a similar offence is committed, the subsequent offence cannot be compounded if it has been committed within a period of 3 years from the date when the first offence was compounded.

A subsequent offence committed after a period of 3 years from the date on which an offence was earlier compounded, shall be deemed to be a first offence.

7. Effect of compounding

Where an offence is compounded, no prosecution shall be instituted against the offender in relation to that offence.

15.33 Power to call for information or document (Section 42)

An inspection of accounts or records maintained by any political party, person, organisation or association may be conducted in order to ascertain the contravention of any provision of this Act. During the course of such inspection, the inspecting officer shall have the following powers.

(a) Call for information from any person for the purpose of satisfying himself whether there has been any contravention of the provisions of this Act or rule or order made under the Act

(b) Require any person to produce or deliver any document or thing useful or relevant to such inspection

(c) Examine any person acquainted with the facts and circumstances of the case related to the inspection.

15.34 Investigation into cases under the Act (Section 43)

1. Investigation by authority specified by the Central Government

Any offence punishable under this Act may also be investigated into by such authority as the Central Government may specify in this behalf.

2. Powers of the authority

The authority so specified by the Central Government shall have all the powers which an officer-in-charge of a police station has, while making an investigation into a cognizable offence.

15.35 Power of Central Government to give directions (Section 46)

The Central Government may give such directions as it may deem necessary to any other authority or any person or class of persons regarding the carrying into execution of the provisions of this Act.

15.36 Delegation of powers (Section 47)

1. The Central Government may, by notification, direct that any of its powers or functions under this Act, shall be exercised or discharged also by such authority as may be specified.

   The power to make rules (as provided under section 48 of the Act) shall not be delegated by the Central Government.

2. The delegation by the Central Government shall be subject to such conditions as may be specified in the notification.

15.37 Power to make rules (Section 48)

1. The Central Government may, by notification, make rules for carrying out the provisions of this Act.
2. In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters:

   (a) The value of the article which may be given to a person as a gift for his personal use (sub-clause (i) of clause (h) of sub-section (1) of section 2)

   (b) Guidelines specifying the grounds on the basis of which an organisation may be specified as an organisation of political nature (under section 5)

   (c) The activities or business which shall be construed as speculative business (under section 8).

15.38 Power to exempt in certain cases (Section 50)

1. The Central Government may exempt any person or association or organisation or any individual from the operation of all or any of the provisions of this Act.

   However, no exemption shall be given to a political party or a candidate for election.

2. The exemption may be subject to such conditions as may be specified by the Central Government in the order of exemption.
3. The Central Government may grant such exemption if it is of the opinion that it is necessary or expedient in the interests of the general public so to do.
4. The Central Government may, at anytime, revoke or modify any exemption granted by it.

The Central Government has, in public interest, exempted all such bodies as have been constituted or established by or under any Central Act or any State Act and which are required to have their accounts compulsorily audited by the Comptroller and Auditor General of India, from the operation of all the provisions of the Foreign Contribution (Regulation) Act, 2010 [Notification No. S.O. 1492(E), dated 01.07.2011].

15.39 Act not to apply to certain Government transactions (Section 51)

Nothing contained in this Act shall apply to any transaction between the Government of India and the Government of any foreign country or territory.

15.40 Application of other laws not barred (Section 52)

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.

15.41 Power to remove difficulties (Section 53)

1. If any difficulty arises in giving effect to the provisions of this Act, the Central Government may make such provisions as may appear to it as necessary for removing the difficulty. Such provision may be made by making an order, which shall be published in the Official Gazette.

   The provision made for removing the difficulty shall not be inconsistent with the provisions contained in the Act.

2. No order removing any difficulty shall be made after the expiry of 2 years from the commencement of the Act.
3. Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

The Arbitration and Conciliation Act, 1996

Chapter 16

Bird's eye-view of the Chapter

Introduction

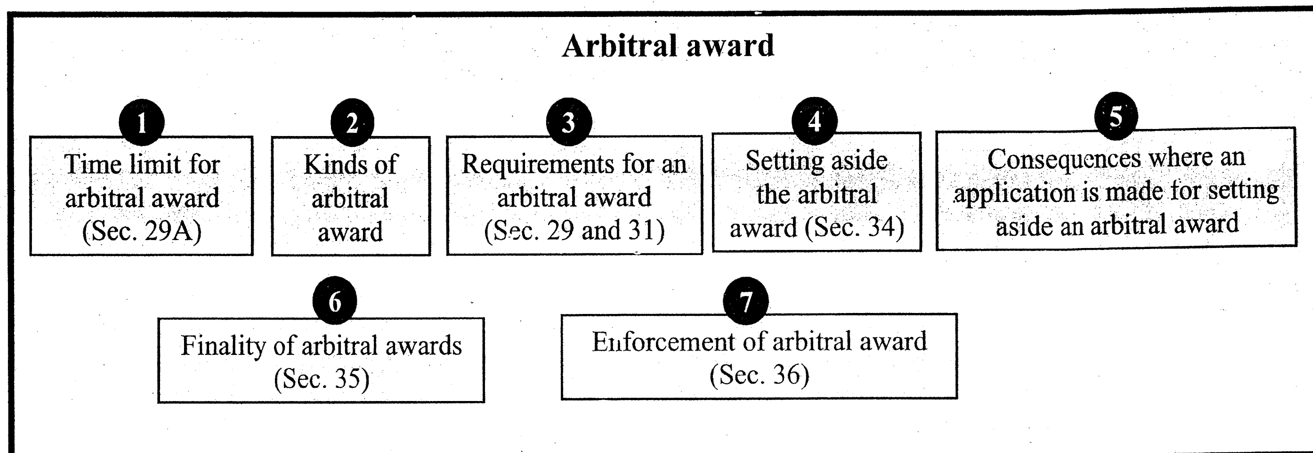
1. Alternative Dispute Resolution
2. Meaning of arbitration
3. Features of arbitration
4. Advantages of arbitration
5. Distinction between arbitration and litigation

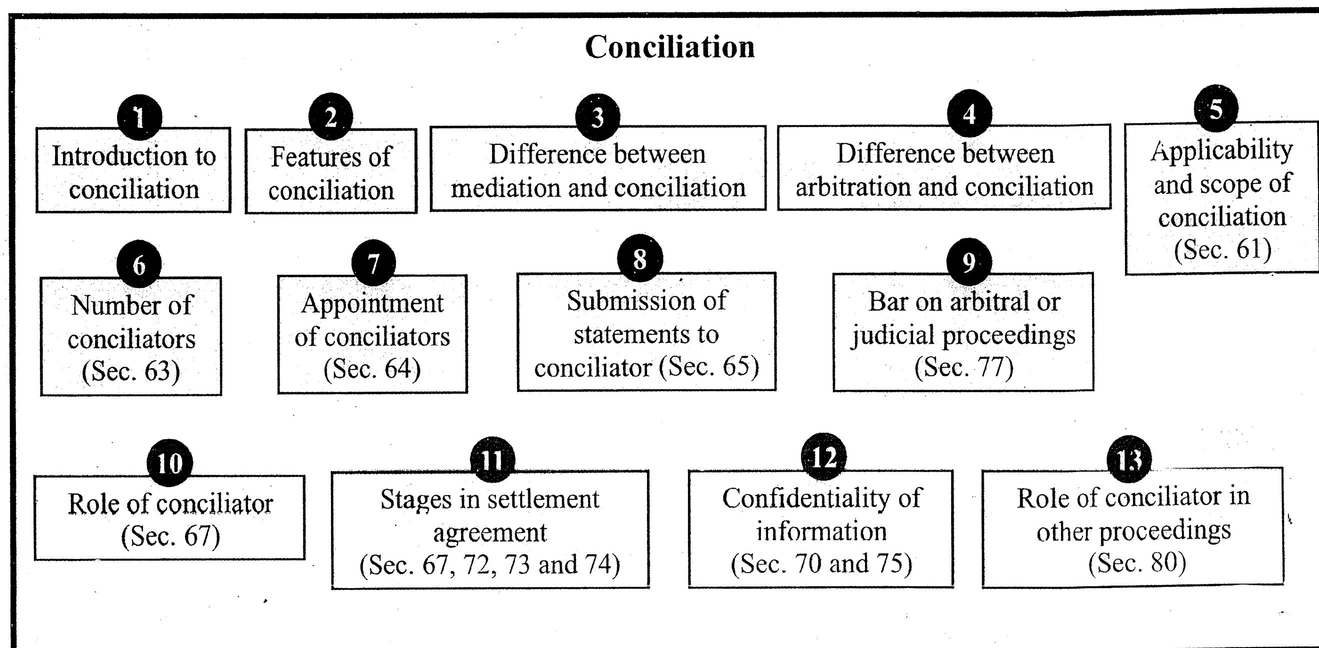
Arbitration

1. Definitions (Sec. 2)
2. Arbitration agreement (Sec. 7)
3. Which disputes can be submitted to arbitration?
4. Legal requirements for a valid arbitration agreement
5. Kinds of arbitration agreements
6. Form of arbitration agreement, scope and subject matter of arbitration etc.
7. Legal effect of arbitration agreement (Sec. 8)
8. Competence of arbitral tribunal to rule on its jurisdiction (Sec. 16)
9. Termination of an arbitration agreement

Arbitral tribunal

1. Arbitral tribunal
2. Grounds for determining independence and impartiality (Fifth Schedule)
3. Disqualifications for appointment as arbitrator (Seventh Schedule)
4. Types of arbitration procedures
5. Number of arbitrators (Sec. 10)
6. Appointment of arbitrators (Sec. 11)
7. Duties of the arbitrator
8. Termination of arbitrator





Notes:

1. In this Chapter, unless otherwise specified, any reference to any section means reference to the sections of the Arbitration and Conciliation Act, 1996.
2. Certain amendments made by the Arbitration and Conciliation (Amendment) Act, 2019 have not been included in this Book, as these amendments have not come into force till 31st October, 2020, and consequently, these amendments shall not be applicable for May, 2021 exams.
3. The amendments made by the Arbitration and Conciliation (Amendment) Ordinance, 2020 have not been included in this Book, as these amendments have come into force on 4th November, 2020 (i.e. after 31st October, 2020), and consequently, these amendments shall not be applicable for May, 2021 exams.

16.1 Introduction

1. Prior to coming into force of the Arbitration and Conciliation Act, 1996, the statutory provisions relating to arbitration were contained in the Arbitration Act, 1940, the Arbitration (Protocol and Convention) Act, 1937 and the Foreign Awards (Recognition and Enforcement) Act, 1961.

2. The Arbitration and Conciliation Act, 1996 has repealed the Arbitration Act. 1940, the Arbitration (Protocol and Convention) Act, 1937 and the Foreign Awards (Recognition and Enforcement) Act, 1961.
3. The Arbitration and Conciliation Bill, 1996 was passed by both houses of Parliament and received the assent of the President on 16th August, 1996. The Arbitration and Conciliation Act, 1996 was brought into force with effect from 22nd August, 1996.
4. The Arbitration and Conciliation Act, 1996 contains 86 sections and 7 Schedules. It is divided into 4 Parts. Part I contains the provisions for domestic and international commercial arbitration in India. Part II provides for enforcement of foreign awards. Part III contains the provisions with respect to conciliation. Part IV contains the supplementary provisions.
5. The Arbitration and Conciliation Act, 1996 extends to the whole of India.
6. As per the Long Title of the Act, the Act has been enacted –
   (a) to consolidate and amend the law relating to domestic arbitration and international commercial arbitration and enforcement of foreign arbitral awards.
   (b) to define the law relating to conciliation.
   (c) to provide for matters connected therewith or incidental thereto.
7. The objects of the Act are as under:
   (a) To make effective India's economic reforms by bringing India's dispute resolution provisions in tune with international regime.
   (b) To comprehensively cover international and commercial arbitration and conciliation as well as domestic arbitration and conciliation.
   (c) To make provision for an arbitral procedure which is fair, transparent and efficient.
   (d) To provide that the arbitral tribunal gives reasons for its arbitral award.
   (e) To ensure that the arbitral tribunal remains within the limits of its jurisdiction.
   (f) To minimise the supervisory role of the courts in the arbitral procedure.
   (g) To permit the arbitral tribunal to use mediation, conciliation or other procedures during the arbitral proceedings to encourage settlement of disputes.
   (h) To provide that every final arbitral award is enforced in the same manner as if it were a decree of the court.
   (i) To provide that a settlement agreement reached by the parties as a result of conciliation proceedings will have the same status and effect as an arbitral award.
8. The Arbitration and Conciliation Act 1996 is based on the 1985 UNCITRAL Model Law on International Commercial Arbitration.

   The United Nations Commission on International Trade Law (UNCITRAL) had adopted the UNCITRAL Model Law on International Commercial Arbitration in 1985. The General Assembly of the United Nations had recommended that all countries should give due consideration to the said Model Law, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice. The said Model Law makes significant contribution to the establishment of a unified legal framework for the fair and efficient settlement of disputes arising in international commercial relations. Therefore, it was deemed expedient to make the law respecting arbitration and conciliation, taking into account the aforesaid Model Law.

16.2 Alternative Dispute Resolution

1. The conventional method of resolving disputes between the parties is to approach the court, *i.e.* litigation. This is time consuming and expensive.
2. Alternative Dispute Resolution (termed as 'ADR') is a process in which an impartial person assists the parties in resolving the disputes between them, without referring the disputes to the courts.
3. Following types of ADR are used in India:
   (a) Arbitration
   (b) Conciliation
   (c) Mediation
   (d) Negotiation

(e) Lok Adalat
(f) Neutral fact finding
(g) Ombudsperson
(h) Case evaluation

4. Advantages of ADR are as under:
   (a) ADR is speedier than the litigation proceedings. In litigation, it may take years for a case to be heard and decided upon. Further, an order of the court is subject to numerous appeals. In many litigation cases, the relief given to a party loses its relevance because of the delay in the final order.
   (b) ADR is less costly as compared to the litigation in court. The expenses of litigation (*e.g.* court fees, fees payable to the advocates, expenses of preparation of a number of documents) are much more as compared to the fees payable in ADR process.
   (c) It is flexible such that the parties are free to decide the rules and procedure and the person to be chosen as the arbitrator, mediator or conciliator.
   (d) In litigation, a party can make his submissions only through his counsel. However, ADR is more informal and each party gets an opportunity to tell his side of the story himself. Thus, ADR is more responsive to the individual needs of the parties involved.
   (e) The involvement of the parties in the ADR process creates greater commitment to the result so that compliance is more likely.
   (f) It is confidential in nature.
   (g) ADR process is more likely to preserve goodwill of the parties or at least it does not escalate the conflict, which is especially important in situations where there is a continuing relationship.
   (h) ADR is less stressful for the parties as compared to litigation.
5. Certain limitations or disadvantages of ADR are as under:
   (a) With the exception of arbitration, ADR does not always lead to dispute resolution. The success of ADR depends upon the cooperation extended by the parties. In case the parties do not cooperate, ADR fails. Thus, it is possible that despite investing time and money in trying to resolve a dispute by ADR (except arbitration), the parties may have to resort to litigation.
   (b) If the dispute is not resolved by ADR, and the time period for bring the lawsuit expires, the litigation becomes time barred. In such a case, the party who was entitled to relief shall lose the right to claim any remedy.
   (c) It is often difficult to enforce the final outcome of the ADR.
   (d) The arbitrator, mediator or the conciliator charges fees for his services. At times, such fees may be substantially higher than the expenses of litigation.
   (e) In comparison to litigation, there are more chances of favouritism or partiality in ADR since the arbitrator, mediator or conciliator may only appear to be neutral but may not actually act impartially.
   (f) In ADR, the arbitrator, mediator or conciliator has very limited powers to make interim orders and no power to enforce the interim orders.

Theoretical Questions from GS Examinations

Q 16.2A. State the various alternate dispute resolution mechanisms. [CS (Executive) June 2007]

16.3 Meaning of arbitration

1. Arbitration is the most commonly used method of Alternative Dispute Resolution.
2. In arbitration, any dispute between the parties is submitted to one or more neutral persons (termed as 'arbitral tribunal') who is/are appointed by the parties to adjudicate the dispute, *viz.* to resolve the dispute. The arbitral tribunal considers all the evidences, documents and information submitted to him by each party, and determines the dispute (*viz.* resolves the dispute) by applying the applicable laws. The resolution of disputes by the arbitral tribunal is termed as 'arbitral award' and is binding on the parties.

16.4 Features of arbitration

1. **One of the methods of Alternative Dispute Resolution**

   Arbitration is the most commonly used method of Alternative Dispute Resolution.

2. **Applicability, only if so agreed to by the parties**

   Any dispute between the parties shall be submitted to arbitration and the provisions of the Arbitration and Conciliation Act, 1996 shall apply only if the parties have agreed in writing to submit the dispute to arbitration.

3. **All disputes cannot be submitted to arbitration**

   Any existing or future dispute may be submitted to arbitration. However, if any law for the time being in force provides that a dispute shall not be submitted to arbitration, then, such dispute cannot be submitted to arbitration. *For example*, matrimonial disputes, disputes with respect to criminal matters and revenue matters cannot be submitted to arbitration.

4. **Bar on legal proceedings in the court**

   If there is an arbitration agreement between the parties, no party can initiate the litigation through the court.

5. **Resolution of dispute by neutral person(s)**

   One or more persons to whom the dispute is submitted is / are termed as arbitrator(s) or 'arbitral tribunal'. An arbitrator should be neutral, *i.e.* independent and impartial. The arbitrator(s) is / are appointed by the parties in accordance with the provisions contained in the Act.

6. **Finality of arbitral award**

   The decision / order / resolution of disputes by the arbitral tribunal is termed as 'arbitral award'. An arbitral award is binding on the parties, and no appeal shall lie in any court against the arbitral award. However, on certain limited grounds, an arbitral award may be challenged in the court.

7. **Seat of arbitration**

   In case of international commercial arbitration, the seat of arbitration assumes importance. If the 'seat of arbitration' is India, it means that –

   (a) the Indian courts shall supervise and provide supportive measures for the arbitral proceedings; and

   (b) any challenge against the arbitral award shall be made to the Indian courts.

8. **Party autonomy**

   In arbitration, the parties have the freedom to –

   (a) choose the arbitrator(s);

   (b) choose the arbitral procedure;

   (c) choose as to the law of which country shall apply (in case of international commercial arbitration);

   (d) choose the language to be used in arbitral proceedings;

   (e) extend the period (by any period not exceeding 6 months) within which the arbitral award shall be made by the arbitral tribunal;

   (f) decide that the dispute shall be resolved by fast track procedure, etc.

9. **Confidentiality**

   All evidences and documents submitted to the arbitrator and even oral submissions made before the arbitrator have to be kept confidential by the arbitrator and every party to arbitration.

10. **Enforcement of arbitral award**

    An arbitral award is enforced in accordance with the provisions of the Code of Civil Procedure, 1908 in the same manner as if it were a decree of the court. In case of international commercial arbitration, it is easier to enforce the arbitral award in accordance with the international treaties between the countries.

1. Many a times, retired Judges are appointed as arbitrators. Even where a retired judge is appointed as the arbitrator, legally speaking, he shall not be termed as 'Judge'.
2. An arbitrator is not a Judge, though his functions are similar to the functions of a Judge, *e.g.* a dispute is submitted to him, he conducts arbitration proceedings, he examines the evidences and witnesses, he interprets the law and he makes his decision (termed as 'arbitral award').

Practical Problems from CA Examinations

Validity of the statement 'Every Court would be a Judicial Authority but every Judicial Authority would not be a Court

P 16.4A. Examine the validity of the following statement with reference to the Arbitration and Conciliation Act, 1996:
Every Court would be a Judicial Authority but every Judicial Authority would not be a Court. [CA (Final) Nov. 2018]

Ans.

1. The function of any judicial authority is to perform the judicial functions like determining disputes by applying the provisions of law and interpreting the Statutes.
2. Courts are judicial bodies set up by the Government to perform the judicial functions.
3. However, the judicial functions are also performed by Tribunals and arbitrators.
4. Thus, the term 'judicial authority' is wider than the term 'court'.
5. Accordingly, the statement 'Every Court would be a Judicial Authority but every Judicial Authority would not be a Court' is correct.

16.5 Advantages of arbitration

1. In case of ordinary court litigation, where the dispute is resolved by the courts, the parties do not have any say in the selection of a Judge. However arbitration is a private arrangement between the parties. In arbitration, appointment of one or more persons as arbitrator(s) is made with the consent of the parties (termed as 'party autonomy', *i.e.* the parties have the freedom to choose one or more arbitrators). So, in case of arbitration, each party has the trust and confidence in the arbitrator.
2. The parties have the freedom to appoint the arbitrator. The parties may appoint as arbitrator a person who has good reputation and is an expert in the field to which the dispute pertains. This results in expert evaluation.
3. In arbitration proceedings, the arbitral tribunal shall not be bound by the Code of Civil Procedure, 1908, and the provisions of the Indian Evidence Act, 1872 shall not apply. Thus, the parties have the freedom to decide the procedure for arbitral proceedings. This results in expeditious completion of arbitration proceedings and speedy resolution of disputes.
4. The parties are free to agree on the place of arbitration. Thus, the parties may choose such place as the place of arbitration which is convenient to all of them. However, in case of litigation where disputes are resolved by courts, the jurisdiction of court is decided as per the provisions of the Code of Civil Procedure, 1908 and other applicable laws, which may not be convenient to all the parties.
5. The parties are free to agree upon the language or languages to be used in the arbitral proceedings.
6. Oral proceedings are possible under arbitration. This helps in saving of time, effort and cost for all the parties.
7. It is the duty of the arbitrator and of every party to keep confidentiality of the arbitration proceedings. All evidences and documents submitted to the arbitrator and even oral submissions made before the arbitrator have to be kept confidential by the arbitrator and every party to arbitration. The confidentiality of information is one of the key advantages of arbitration because of which many people avoid litigation through court proceedings and instead prefer arbitration.

To sum up, arbitration is a faster and less expensive alternative for resolving disputes and seeking legal remedies as compared to litigation in a court of law. Also, in arbitration, the parties have the freedom to choose the arbitrator(s), the arbitral procedure, the language, the place of arbitration etc.

16.6 Distinction between arbitration and litigation

Basis of distinction	Arbitration	Litigation
1. Selection of judge / arbitrator	Appointment of one or more persons as arbitrator(s) is made with the consent of the parties.	The parties do not have any say in the selection of a Judge.
2. Procedure for conduct of court proceedings / arbitral proceedings	In arbitration, the Code of Civil Procedure, 1908, and the Indian Evidence Act, 1872 do not apply. The parties have the freedom to decide the procedure for arbitral proceedings.	Court proceedings are conducted as per the provisions contained in the Code of Civil Procedure, 1908, the Indian Evidence Act, 1872 and the Court Rules.

3. *Place of court proceedings / arbitration*	The parties may choose such place as the place of arbitration which is convenient to all of them.	In case of litigation, the jurisdiction of court is decided as per the provisions of the Code of Civil Procedure, 1908 and other applicable laws.
4. *Confidentiality*	It is the duty of the arbitrator and of every party to keep confidentiality of the arbitration proceedings.	The court proceedings and decision of the court are made public.
5. *Finality of decision*	An arbitral award is binding on the parties, and no appeal shall lie in any court against the arbitral award. However, on certain limited grounds, an arbitral award may be challenged in the court.	A decision of the court is subject to numerous appeals.
6. *Enforceability of decision in other country*	It is easier to enforce the arbitral award in a foreign country in accordance with the international treaties between the countries.	Due to procedural and other issues, it is difficult to enforce a decision of the court of one country in another country.

16.7 • Definitions (Section 2) *

1. Arbitration [Section 2(1)(a)]

'Arbitration' means any arbitration whether or not administered by permanent arbitral institution.

2. Arbitration agreement [Section 2(1)(b)]

'Arbitration agreement' means an agreement referred to in section 7.

In simple terms, 'arbitration agreement' means the document which contains the consent of the parties to submit any dispute(s) to arbitration, instead of submitting the dispute to the court.

If there is no arbitration agreement, the dispute cannot be referred to arbitration, and so the provisions of this Act shall not apply.

3. Arbitral award [Section 2(1)(c)]

'Arbitral award' includes an interim award.

'Arbitral award' means the order, decision or the judgment given by arbitral tribunal. In simple terms, 'arbitral award' means the final determination of the dispute by the arbitral tribunal. The arbitral award contains the resolution of all the disputes, questions and issues raised by the parties before the arbitral tribunal.

4. Arbitral institution [Section 2(1)(ca)]

'Arbitral institution' means an arbitral institution designated by the Supreme Court or a High Court under this Act.

5. Arbitral tribunal [Section 2(1)(d)]

'Arbitral tribunal' means a sole arbitrator or a panel of arbitrators.

In simple terms, 'arbitral tribunal' means one or more persons who conduct the arbitration proceedings and give an arbitral award. In case there is a sole arbitrator, he is termed as 'arbitral tribunal'. Where there more than one arbitrators, all the arbitrators collectively are termed as 'arbitral tribunal'.

6. Court [Section 2(1)(e)]

'Court' means –

(i) in the case of an arbitration other than international commercial arbitration, the principal Civil Court of original jurisdiction in a district, and includes the High Court in exercise of its ordinary original civil jurisdiction, having jurisdiction to decide the questions forming the subject-matter of the arbitration if the same had been the subject-matter of a suit, but does not include any Civil Court of a grade inferior to such principal Civil Court, or any Court of Small Causes;

* In the Arbitration and Conciliation Act, 1996, the definitions are contained in various clauses of sub-section (1) of section 2. For example, the definition of 'arbitration' is given in section 2(1)(a), which is to be read / written as 'clause (a) of sub-section (1) of section 2'.

(ii) in the case of international commercial arbitration, the High Court in exercise of its ordinary original civil jurisdiction, having jurisdiction to decide the questions forming the subject-matter of the arbitration if the same had been the subject-matter of a suit, and in other cases, a High Court having jurisdiction to hear appeals from decrees of courts subordinate to that High Court.

7. **International commercial arbitration [Section 2(1)(f)]**

'International commercial arbitration' means an arbitration relating to disputes arising out of legal relationships, whether contractual or not, considered as commercial under the law in force in India and where at least one of the parties is –

(i) an individual who is a national of, or habitually resident in, any country other than India; or

(ii) a body corporate which is incorporated in any country other than India; or

(iii) an association or a body of individuals whose central management and control is exercised in any country other than India; or

(iv) the Government of a foreign country.

8. **Legal representative [Section 2(1)(g)]**

'Legal representative' means a person who in law represents the estate of a deceased person, and includes any person who intermeddles with the estate of the deceased, and, where a party acts in a representative character, the person on whom the estate devolves on the death of the party so acting.

9. **Party [Section 2(1)(h)]**

'Party' means a party to an arbitration agreement.

The definitions given in section 2 shall apply to Part I of the Act (consisting of sections 2 to 43) unless the context otherwise requires.

Theoretical Questions from CS Examinations

Q 16.7A. Define international commercial arbitration. [CS (Executive) Dec. 2009, June 2014]

Q 16.7B. How has the 'Court' been defined under the Arbitration and Conciliation Act, 1996? [CS (Executive) Dec. 2014]

Q 16.7C. Define 'legal representative' under the Arbitration and Conciliation Act, 1996. [CS (Executive) Dec. 2014]

Q 16.7D. What is an 'arbitral award' under the Arbitration and Conciliation Act, 1996? [CS (Executive) June 2015]

16.8 Arbitration agreement (Section 7)

1. 'Arbitration agreement' means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.
2. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.
3. An arbitration agreement shall be in writing.
4. An arbitration agreement is in writing if it is contained in –

   (a) a document signed by the parties;

   (b) an exchange of letters, telex, telegrams or other means of telecommunication including communication through electronic means which provide a record of the agreement; or

   (c) an exchange of statements of claim and defence in which the existence of the agreement is alleged by one party and not denied by the other.
5. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to make that arbitration clause part of the contract.

16.9 Disputes which can be submitted to arbitration

1. Any existing or future dispute may be submitted to arbitration.
2. Any dispute may be submitted to arbitration, whether it has arisen by reason of a contractual relationship between the parties or otherwise.

3. Generally, any dispute involving private rights, which may be submitted to a civil court for resolution, can be submitted to arbitration (*e.g.* disputes relating to property or money, disputes relating to amount of damages payable for breach of a contract etc., partnership disputes, disputes relating to joint venture). However, as per section 2(3), if any law for the time being in force provides that a dispute shall not be submitted to arbitration, then, such dispute cannot be resolved by arbitration. An illustrative list of the disputes which cannot be submitted to arbitration is as follows:
   (i) Matrimonial disputes like divorce
   (ii) Disputes with respect to criminal matters
   (iii) Dispute with respect to guardianship of a minor or a disabled person
   (iv) Disputes with respect to charities and charitable trusts
   (v) Disputes with respect to testamentary matters, *e.g.* dispute with respect to validity of will of a deceased
   (vi) Industrial disputes
   (vii) Mortgage suits for sale of mortgaged property
   (viii) Disputes relating to revenue matters, *e.g.* payment of taxes, duties and cesses

Practical Problems from CA Examinations

Validity of the statement 'The disputes submitted to arbitration must be arbitrable'

P 16.9A. Examine the validity of the following statement with reference to the Arbitration and Conciliation Act, 1996:
The disputes submitted to arbitration must be arbitrable. [CA (Final) Nov. 2018]

Ans. Generally, any dispute involving private rights, which may be submitted to a civil court for resolution, can be submitted to arbitration. However, certain disputes cannot be referred to arbitration, like matrimonial disputes, disputes with respect to criminal matters, disputes with respect to testamentary matters (e.g. a dispute with respect to validity of will of a deceased), industrial disputes, disputes relating to revenue matters (e.g. payment of taxes, duties and cesses), etc. In other words, these disputes are not arbitrable.

Thus, the statement "The disputes submitted to arbitration must be arbitrable' is correct.

Practical Problems from CS Examinations

Whether an agreement to refer a dispute to arbitration is valid if the dispute relates to genuineness of a will?

P 16.9B. Ram and Shyam entered into an agreement to refer a dispute relating to genuineness of a will to arbitrator. In spite of this Shyam commenced proceedings relating to the dispute in the district court of competent jurisdiction. Ram, therefore, submits an application for stay of legal proceedings under the Arbitration and Conciliation Act, 1996. Will he succeed?
[CS (Executive) June 2008, June 2011]

Ans. Generally, any dispute involving private rights, which may be submitted to a civil court for resolution, can be submitted to arbitration. However, certain disputes cannot be referred to arbitration, like matrimonial disputes, disputes with respect to criminal matters, disputes with respect to testamentary matters (e.g. a dispute with respect to validity of will of a deceased), etc.

In the given case, the dispute is with respect to genuineness of a will. This dispute falls under 'testamentary matters', and so such dispute cannot be referred to arbitration.

Accordingly, commencement of legal proceedings in the Court by Shyam is valid. Therefore, Ram's application to the Court for stay of legal proceedings is not tenable.

16.10 Legal requirements for a valid arbitration agreement

A dispute may be submitted to arbitration only if the following conditions are satisfied:

1. Clear consent of parties

A dispute cannot be submitted to arbitration unless the parties have consented to submission of the dispute to arbitration. *In other words*, a dispute may be submitted to arbitration only if there is an agreement between the parties that any dispute(s) between them shall be submitted to arbitration.

The words used by the parties should make it clear that the parties intend to enter into an arbitration agreement.

Example 1. The words used should disclose that the parties were determined to submit the dispute to arbitration, and consequently there was an obligation to submit the dispute to arbitration. If the words used show that parties had merely contemplated the possibility of going for arbitration in future, there is no valid and binding arbitration agreement ***[U N Automobiles Pvt. Ltd.* v *Bank of Baroda]*.**

Example 2. If the words used by the parties are vague and ambiguous with the result that it is uncertain as to whether the parties intend to enter into an arbitration agreement, there is no *consensus ad idem* (*viz.* meeting of minds), and consequently, there would be no arbitration agreement [***Dresser Rand S.A.* v *Bindal Agro Chem. Ltd. and K. G. Khosla Compressors Ltd.***]. This is based on section 29 of the Indian Contract Act, 1872 which provides that an agreement, the meaning of which is uncertain and is not capable of being made certain, is void.

Example 3. There was a dispute between the partners of a firm. Clause 16 of the Partnership Deed (for settlement of disputes) read as under:

"If during the continuance of the partnership or at any time afterwards any dispute touching the partnership arises between the partners, the same shall be mutually decided by the partners or shall be referred for arbitration if the parties so determine."

The court held as follows:

"If clause 16 had merely said that in the event of disputes arising between the parties, they "shall be referred to arbitration", it would have been an arbitration agreement. But the use of the words "shall be referred for arbitration if the parties so determine" completely changes the complexion of the provision. The expression "if the parties so determine" indicates that the parties are required to reach a decision by application of mind. Therefore, when clause 16 uses the words "the dispute shall be referred for arbitration if the parties so determine", it means that it is not an arbitration agreement but a provision which enables arbitration only if the parties mutually decide after due consideration as to whether the disputes should be referred to arbitration or not. In effect, the clause requires the consent of parties before the disputes can be referred to arbitration. The main attribute of an arbitration agreement, namely, *consensus ad idem* to refer the disputes to arbitration is missing in clause 16 relating to settlement of disputes. Therefore it is not an arbitration agreement, as defined under section 7 of the Act." ***[Jagdish Chander* v *Ramesh Chander and Others]*.**

Substance over form

It is the substance and not the form of the document which is material in deciding as to whether the document constitutes the arbitration agreement. Mere absence of the word 'arbitration' or 'arbitrator' does not make any difference.

A clause contained in an agreement provided as under:

"The contractor agrees that in case of any difference/dispute, the decision of the Managing Director/Director, South, Shimla, HPSFC Ltd. shall be final and binding."

It was held that the given clause constituted a valid arbitration agreement **[*Mohan Singh* v *Himachal Pradesh State Forest Corporation*].**

2. Written agreement

Generally, an agreement may be entered into by way of a written document or orally or it can even be implied by the conduct of the parties and circumstances of the case. However, an agreement by the parties to submit the dispute to arbitration shall be valid and enforceable only if it is in writing. But, it is not necessary that the arbitration agreement shall be contained in one document only; an arbitration agreement may be contained in 2 or more documents.

Example. The invoice prepared by a seller of goods contained an arbitration clause. The buyer of the goods had accepted the invoice and paid money for the goods. There was no written provision with respect to arbitration in any document other than the invoice. It was held that the contract between the parties clearly contemplated a provision for Arbitration, and consequently there was a valid and enforceable arbitration agreement ***[Skanska Cementation India Ltd.* v *Bajranglal Agarwal and Others]*.**

'Arbitration agreement' by reference to other documents

Section 7(5) of the Act reads as under:

"The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to make that arbitration clause part of the contract."

Groupe Chimique Tunisien Sa v Southern Petrochemicals Industries Corpn. Ltd.

Southern Petrochemicals placed an order with Groupe Chimique Tunisien for supply of phosphoric acid. The purchase order contained a provision that the parties shall be subject to FAI terms *viz.* Fertilizer Association of India Terms and Conditions for Sale and Purchase of Phosphoric Acid. The terms and conditions as contained in FAI terms contained an arbitration clause. In the invoice raised by Group Chimique Tunisien Sa there was no reference to FAI terms or arbitration agreement.

It was held that since the purchase order incorporated an arbitration agreement by reference, the invoice need not contain a provision for arbitration. Accordingly, there was an arbitration agreement by reference to the other document, *viz.* the purchase order.

Thus, the arbitration agreement need not be contained in the contract itself. It is sufficient to incorporate the arbitration clause by reference to a set of trade terms which themselves include provisions requiring disputes to be submitted to arbitration. The only requirement is that by referring to the contract between the parties and the document which is referred to by the parties, it must be clear that the parties had the intention to submit the disputes to arbitration.

3. Defined legal relationship

As per section 7, an arbitration agreement can come into existence only in respect of a defined legal relationship between the parties. The term 'legal relationship' has not been defined in the Act. Thus, a dispute cannot be submitted to arbitration if there is no legal relationship between the parties. Where any party has any legal obligation towards the other party, there shall be legal relationship between the parties. *In other words*, where a party has a right which it can enforce against the other party, 'legal relationship' exists. Thus, where a party takes upon himself an obligation to do an act which is unlawful, no legal relationship arises, and so there can be no arbitration agreement, and consequently, any dispute arising because of non-fulfilment of such obligation cannot be submitted to arbitration. Similarly, if the principal agreement becomes time barred, no dispute arising out of such principal agreement can be submitted to arbitration.

4. Consent of the parties to be bound by the award

There shall be an arbitration agreement only if the parties have consented that they shall be bound by the arbitral award. *In other words*, the parties must agree that the resolution of the disputes and their rights, as would be determined by the arbitral tribunal, shall be final and binding upon them.

Challenge of award

Despite the fact that the arbitral award is final and binding upon the parties, it is possible to challenge the arbitral award before the court on certain limited grounds in accordance with the provisions of section 34.

5. Existence of dispute

An arbitration agreement has no relevance unless there is a dispute between the parties. Where the arbitration agreement exists by way of an 'arbitration clause' in the principal agreement, there is no existing dispute, but there is a possibility of a future dispute, and in future, if any dispute arises, effect shall be given to the arbitration agreement, but if no dispute arises in future, the arbitration agreement shall not have any relevance.

6. Submission of all or some disputes to arbitration

The arbitration agreement assumes importance when any dispute is submitted to arbitration. The parties may agree to submit all the disputes to arbitration or to submit only some of the disputes to arbitration. The arbitral tribunal shall adjudge only such disputes as are submitted to him.

7. Dispute must be one which can be subjected to arbitration

Not all disputes can be submitted to arbitration. Thus, an arbitration agreement to submit a dispute shall not be valid and enforceable, if the dispute is one which cannot be subject to arbitration.

8. Signatures

(a) Where the agreement to submit the disputes to arbitration is contained in one document, such document shall constitute an arbitration agreement only if it is signed by all the parties.

(b) Where the parties, by way of exchange of letters, telex, telegrams or other means of telecommunication, agree to submit the disputes to arbitration, there shall be an arbitration agreement even if it is not signed by any party, if one party has proposed resolution of disputes by arbitration and the other party has not denied it.

Theoretical Questions from CS Examinations

Q 16.10A. What is meant by 'arbitration agreement' under the Arbitration and Conciliation Act, 1996? Should the arbitration agreement be in writing and whether jurisdiction of civil court is barred? [CS (Executive) Dec. 2015]

16.11 Kinds of arbitration agreements

The arbitration agreements are of two kinds, as explained below:

1. **'Arbitration clause'**

   The parties may, while entering into an agreement or contract, provide a clause in such agreement or contract (*viz.* principal agreement or principal contract) that if any dispute arises between them in the future, such dispute shall be referred to arbitration. Such clause is termed as 'arbitration clause'.

2. **'Submission agreement' or 'separate agreement'**

   If there is no 'arbitration clause' in the principal agreement, and a dispute arises between the parties, the parties may, after the dispute has arisen, agree that the dispute shall be referred to arbitration. Such agreement is termed as 'submission agreement' or 'separate agreement'.

   Example 1. Bestword Publications Pvt. Ltd. entered into a distribution agreement with one of its distributors 'Star Books Agency'. Clause No. 15 of the distribution agreement provided that any dispute between the parties shall be submitted to arbitration. There is an 'arbitration agreement' since the principal agreement contains an arbitration clause.

   Example 2. Bestword Publications Pvt. Ltd. entered into a distribution agreement with one of its distributors 'Uphar Books Agency'. There was no clause with respect to arbitration in the distribution agreement. A dispute arises between the parties. The parties, by mutual consent, agreed to submit the dispute to arbitration. There is an 'arbitration agreement' since there is a submission agreement between the parties.

16.12 Form of arbitration agreement, scope and subject matter of arbitration etc.

1. **Form of arbitration agreement**

   No special form or template has been prescribed for entering into an arbitration agreement. Thus, use of any words which makes clear the intention of the parties to enter into an arbitration agreement would constitute an arbitration agreement.

2. **Names of arbitrator(s)**

   (a) An arbitration agreement may or may not contain the name the arbitrator(s).

   (b) An arbitration agreement may or may not contain the provisions specifying the mode of appointment of the arbitrator(s).

3. **Place, scope and subject matter of arbitration**

   The arbitration agreement should specify the place, scope and the subject matter of the reference, so as to leave no vagueness or uncertainty about it when the dispute arises. However, even if the arbitration agreement is silent, it remains valid.

4. **Effect of submission of a dispute to arbitration**

   Where a dispute is submitted to arbitration, it shall be heard by one or more arbitrators (also referred to as 'arbitral tribunal'). In simple terms, 'arbitral tribunal' means one or more persons who conduct the arbitration proceedings and give an arbitral award. In case there is a sole arbitrator, he is termed as 'arbitral tribunal'. Where there more than one arbitrators, all the arbitrators collectively are termed as 'arbitral tribunal'.

16.13 Legal effect of arbitration agreement (Section 8)

1. Generally, the disputes between the parties are submitted to the courts for their resolution.
2. However, if there is an arbitration agreement between the parties, the dispute shall not be submitted to the court, but instead, shall be submitted to arbitration. Thus, no party can initiate the litigation through the court if there is an arbitration agreement between the parties.
3. If, despite an arbitration agreement, one of the parties approaches the court, but the other party requests the court not to entertain the dispute, but instead refer it to arbitration, the court shall refer the parties to arbitration.

Simply speaking, the jurisdiction of the court is ousted where a valid arbitration agreement exists.

Practical Problems from CS Examinations

Whether a party can file a suit in the Court with respect to a dispute which is subject matter of an arbitration agreement?

P 16.13A. Ajoy and Bijoy make an agreement in writing to refer a dispute between them to an arbitrator for determination. In spite of this agreement, Ajoy files a suit against Bijoy relating to the dispute in a Court. Advise Bijoy. [CS (Executive) June 2001]

Ans. The given problem relates to section 8 of the Arbitration and Conciliation Act, 1996, as discussed below:

The legal position

1. As per section 8, if there is an arbitration agreement between the parties, the dispute shall not be submitted to the court, but instead, shall be submitted to arbitration. Thus, no party can initiate the litigation through the court if there is an arbitration agreement between the parties.
2. Section 8 further provides that if, despite an arbitration agreement, one of the parties approaches the court, but the other party requests the court not to entertain the dispute, and instead refer it to arbitration, the court shall refer the parties to arbitration.

The given case and analysis of the case

3. There is a valid arbitration agreement between Ajoy and Bijoy.
4. So, neither Ajoy nor Bijoy is entitled to file a suit in the Court with respect to any dispute which is subject matter of the arbitration agreement between them.
5. The suit filed in the court by Ajoy against Bijoy is not maintainable.

Conclusion

6. Advice to Bijoy: Bijoy should request the court not to entertain the suit filed by Ajoy. On receiving such request, the Court shall pass an order dismissing the suit and to resolve the dispute by arbitration.

16.14 Competence of arbitral tribunal to rule on its jurisdiction (Section 16)

1. Competence to rule on its own jurisdiction

The arbitral tribunal may rule on its own jurisdiction, including ruling on any objections with respect to the existence or validity of the arbitration agreement.

Simply speaking, where an objection is raised before the arbitral tribunal that there is no arbitration agreement or that the arbitral tribunal is not competent to act as an arbitral tribunal, but the arbitral tribunal rejects such plea, then, the arbitral tribunal shall be competent to proceed with the arbitration proceedings and to give its award.

2. Doctrine of separability

Where any objection is raised before the arbitral tribunal with respect to the existence or validity of the arbitration agreement, then –

(a) the arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract; and

(b) a decision by the arbitral tribunal that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause.

Simply speaking, an arbitration clause shall be treated as an agreement independent of the principal contract. *In other words*, an arbitration clause, though it forms part of the principal contract, is considered to be separate from the principal contract. This is because of the legal fiction contained in section 16. Thus, even though the principal contract is invalid, the arbitration agreement shall survive, *i.e.* it shall not be rendered invalid. Consequently, the unenforceability of the principal contract does not automatically render an arbitration agreement contained within it, unenforceable. This is termed as 'doctrine of separability'.

3. Plea that the arbitral tribunal is exceeding the scope of its authority

A plea that the arbitral tribunal is exceeding the scope of its authority shall be raised as soon as the matter alleged to be beyond the scope of its authority is raised during the arbitral proceedings.

Theoretical Questions from CS Examinations

Q 16.14A. Write a short note on jurisdiction of arbitral tribunal. [CS (Executive) June 2007]

Practical Problems from CA Examinations

Whether arbitration clause survives where the term of the principal contract comes to an end?

P 16.14A. Smart Automobiles Limited and Apex Four wheelers Limited entered into an agreement regarding annual maintenance services to be provided by Smart Automobiles for all vehicles within the state of Uttar Pradesh for five years. The agreement was containing a clause that in the event of a dispute between the parties the matter would be submitted to arbitration. At the end of the fifth year the service agreement was not renewed.

Decide whether the arbitration agreement should not be treated as terminated. [CA (Final) May 2018]

Ans. The given problem relates to section 16 of the Arbitration and Conciliation Act, 1996, as discussed below:

The legal position

As per section 16, the arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. Accordingly, the arbitration clause shall survive even after the term of the principal contract has come to an end. This is termed as doctrine of separability.

The given case

The principal contract between Smart Automobiles Limited and Apex Four Wheelers Limited has come to an end. The issue raised is as to whether the arbitration clause contained in such principal contract shall be treated to have been terminated or not.

Analysis of the case

The dispute between the parties relates to the relationship created by way of the principal contract and so the arbitration agreement contained in the principal contract would bind the parties. The parties had agreed to subject all disputes, arising out of and in connection with the principal contract, to arbitration. So, the arbitration clause constitutes a separate and independent agreement in itself **[*Ashapura Mine-Chem Ltd.* v *Gujarat Mineral Development Corporation*]**.

Conclusion

As per section 16 and the judgement given in ***Ashapura Mine-Chem Ltd.* v *Gujarat Mineral Development Corporation***, the arbitration clause shall survive, i.e. it shall not terminate even though the principal contract has been terminated.

16.15 Termination of an arbitration agreement

An arbitration agreement can be terminated in any of the following ways:

1. **Mutual consent**

   Just like any agreement or contract may be entered into or terminated by mutual consent, the arbitration agreement can also be terminated by the mutual consent of the parties.

2. **Termination of the principal contract**

   Where the arbitration agreement exists by way of an 'arbitration clause' in the principal contract, and the principal contract is terminated (say, by reason of discharge of the principal contract, or by reason of novation), the arbitration agreement is automatically terminated.

   No termination of arbitration agreement by reason of breach of principal contract

   Where a party commits a breach of the principal contract, the other party (*viz.* the aggrieved party) has a right to seek legal remedies from the party who has committed the breach. In case the principal contract contains an arbitration clause, the arbitration clause survives (*viz.* it does not terminate) even though the principal contract terminates by reason of breach. This is generally termed as 'doctrine of separability', *i.e.* the arbitration clause shall be treated as an agreement independent of the principal contract.

3. **Operation of law**

   An arbitration agreement is terminated by operation of law. Thus, if there is a dispute with respect to a particular right of a party and such dispute is submitted to arbitration, but such right is extinguished by operation of law, then, the arbitration agreement shall come to an end.

No termination of arbitration agreement by reason of death of any party (Section 40)

Death of any party does not result in termination of the arbitration agreement. Even if a party dies, the arbitration agreement shall be enforceable by / against the legal representative of the deceased party.

Theoretical Questions from CA Examinations

Q 16.15A. Describe the grounds of termination of an arbitration agreement. [CA (Final) May 2018]

16.16 Arbitral tribunal

1. **Definition of arbitral tribunal**

   'Arbitral tribunal' means a sole arbitrator or a panel of arbitrators.

2. **Meaning of arbitral tribunal**

   The person(s) who resolve the dispute between the parties is/are termed as 'arbitral tribunal'. The arbitral tribunal acts like a Judge, conducts the arbitration proceedings and gives an arbitration award.

   The term 'arbitral tribunal' is also termed as 'arbitrator(s)'. So, the terms 'arbitral tribunal' and 'arbitrator(s)' are used interchangeably.

3. **Eligibility for appointment as arbitrator**

(a) The Act does not lay down any qualifications for appointment as arbitrator.

However, the parties may agree that a person possessing certain specified qualifications only shall be appointed as arbitrator.

(b) An arbitrator has to be independent and impartial. He should be neutral towards all the parties. He should not favour any party at any stage of arbitration proceedings. *In other words*, an arbitrator should not be biased.

Bias exists if a reasonable man who is in possession of all the relevant information believes that a particular matter is likely to be disposed off in such a way so as to favour one party over the other.

As per section 12(1), when a person is approached in connection with his possible appointment as an arbitrator, he shall disclose in writing (in the form specified in the Sixth Schedule) any circumstances, –

(a) such as the existence, either direct or indirect, of any past or present relationship with or interest in any of the parties or in relation to the subject matter in dispute, whether financial, business, professional or other kind, which is likely to give rise to justifiable doubts as to his independence or impartiality; and

(b) which are likely to affect his ability to devote sufficient time to the arbitration and in particular his ability to complete the entire arbitration within a period of 12 months.

(c) Only a person who has attained the age of majority and is of sound mind can be appointed as an arbitrator, *i.e.* the arbitrator must have the capacity to contract. This is because an arbitration agreement is a 'contract' as defined under the Indian Contract Act, 1872, and so the arbitration agreement must satisfy all the essentials of a valid contract.

4. **Grounds for determining independence and impartiality**

The grounds stated in the Fifth Schedule shall guide in determining whether circumstances exist which give rise to justifiable doubts as to the independence or impartiality of an arbitrator.

5. **Challenging the appointment of an arbitrator**

As per section 12(3), the appointment of a person as arbitrator may be challenged if –

(a) circumstances exist that give rise to justifiable doubts as to his independence or impartiality; or

(b) he does not possess the qualifications agreed to by the parties.

A party may challenge an arbitrator appointed by him, or in whose appointment he has participated, only for reasons of which he becomes aware after the appointment has been made.

6. **Disqualifications for appointment as arbitrator**

As per section 12(5), any person whose relationship, with the parties or counsel or the subject-matter of the dispute, falls under any of the categories specified in the Seventh Schedule, shall be ineligible to be appointed as an arbitrator.

1. Even if there was any prior agreement between the parties that a person could be appointed as an arbitrator even though he was ineligible to be appointed as an arbitrator as per the Seventh Schedule, the provisions of section 12(5) shall apply. *In other words*, a person who is disqualified for appointment as an arbitrator as per the Seventh Schedule cannot be appointed as an arbitrator even if prior to the disputes having arisen between them, the parties had agreed for his appointment as arbitrator.
2. If after the disputes arose between the parties, the parties expressly agree in writing to waive the disqualifications contained in the Seventh Schedule, then, the provisions of section 12(5) shall not apply, *i.e.* a person disqualified as per the Seventh Schedule may also be appointed as the arbitrator.

16.17 Grounds for determining independence and impartiality (Fifth Schedule)

The grounds stated in the Fifth Schedule shall guide in determining whether circumstances exist which give rise to justifiable doubts as to the independence or impartiality of an arbitrator. These grounds are as under:

(A) Arbitrator's relationship with the parties or counsel

1. The arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party.
2. The arbitrator currently represents or advises one of the parties or an affiliate of one of the parties.
3. The arbitrator currently represents the lawyer or law firm acting as counsel for one of the parties.
4. The arbitrator is a lawyer in the same law firm which is representing one of the parties.

5. The arbitrator is a manager, director or part of the management, or has a similar controlling influence, in an affiliate of one of the parties if the affiliate is directly involved in the matters in dispute in the arbitration.
6. The arbitrator's law firm had a previous but terminated involvement in the case without the arbitrator being involved himself or herself.
7. The arbitrator's law firm currently has a significant commercial relationship with one of the parties or an affiliate of one of the parties.
8. The arbitrator regularly advises the appointing party or an affiliate of the appointing party even though neither the arbitrator nor his or her firm derives a significant financial income therefrom.
9. The arbitrator has a close family relationship with one of the parties and in the case of companies with the persons in the management and controlling the company.
10. A close family member of the arbitrator has a significant financial interest in one of the parties or an affiliate of one of the parties.
11. The arbitrator is a legal representative of an entity that is a party in the arbitration.
12. The arbitrator is a manager, director or part of the management, or has a similar controlling influence in one of the parties.
13. The arbitrator has a significant financial interest in one of the parties or the outcome of the case.
14. The arbitrator regularly advises the appointing party or an affiliate of the appointing party, and the arbitrator or his or her firm derives a significant financial income therefrom.

(B) Relationship of the arbitrator to the dispute

15. The arbitrator has given legal advice or provided an expert opinion on the dispute to a party or an affiliate of one of the parties.
16. The arbitrator has previous involvement in the case.

(C) Arbitrator's direct or indirect interest in the dispute

17. The arbitrator holds shares, either directly or indirectly, in one of the parties or an affiliate of one of the parties that is privately held.
18. A close family member of the arbitrator has a significant financial interest in the outcome of the dispute.
19. The arbitrator or a close family member of the arbitrator has a close relationship with a third party who may be liable to recourse on the part of the unsuccessful party in the dispute.

(D) Previous services for one of the parties or other involvement in the case

20. The arbitrator has within the past three years served as counsel for one of the parties or an affiliate of one of the parties or has previously advised or been consulted by the party or an affiliate of the party making the appointment in an unrelated matter, but the arbitrator and the party or the affiliate of the party have no ongoing relationship.
21. The arbitrator has within the past three years served as counsel against one of the parties or an affiliate of one of the parties in an unrelated matter.
22. The arbitrator has within the past three years been appointed as arbitrator on two or more occasions by one of the parties or an affiliate of one of the parties.
23. The arbitrator's law firm has within the past three years acted for one of the parties or an affiliate of one of the parties in an unrelated matter without the involvement of the arbitrator.
24. The arbitrator currently serves, or has served within the past three years, as arbitrator in another arbitration on a related issue involving one of the parties or an affiliate of one of the parties.

(E) Relationship between an arbitrator and another arbitrator or counsel

25. The arbitrator and another arbitrator are lawyers in the same law firm.
26. The arbitrator was within the past three years a partner of, or otherwise affiliated with, another arbitrator or any of the counsel in the same arbitration.
27. A lawyer in the arbitrator's law firm is an arbitrator in another dispute involving the same party or parties or an affiliate of one of the parties.
28. A close family member of the arbitrator is a partner or employee of the law firm representing one of the parties, but is not assisting with the dispute.
29. The arbitrator has within the past three years received more than three appointments by the same counsel or the same law firm.

(F) Relationship between arbitrator and party and others involved in the arbitration

30. The arbitrator's law firm is currently acting adverse to one of the parties or an affiliate of one of the parties.
31. The arbitrator had been associated within the past three years with a party or an affiliate of one of the parties in a professional capacity, such as a former employee or partner.

(G) Other circumstances

32. The arbitrator holds shares, either directly or indirectly, which by reason of number or denomination constitute a material holding in one of the parties or an affiliate of one of the parties that is publicly listed.
33. The arbitrator holds a position in an arbitration institution with appointing authority over the dispute.
34. The arbitrator is a manager, director or part of the management, or has a similar controlling influence, in an affiliate of one of the parties, where the affiliate is not directly involved in the matters in dispute in the arbitration.

1. The term 'close family member' refers to a spouse, sibling, child, parent or life partner.
2. The term 'affiliate' encompasses all companies in one group of companies including the parent company.
3. For the removal of doubts, it is clarified that it may be the practice in certain specific kinds of arbitration, such as maritime or commodities arbitration, to draw arbitrators from a small, specialised pool. If in such fields it is the custom and practice for parties frequently to appoint the same arbitrator in different cases, this is a relevant fact to be taken into account while applying the rules set out above.

16.18 Disqualifications for appointment as arbitrator (Seventh Schedule)

As per section 12(5), any person whose relationship, with the parties or counsel or the subject-matter of the dispute, falls under any of the categories specified in the Seventh Schedule, shall be ineligible to be appointed as an arbitrator. The categories specified in the Seventh Schedule are as follows:

(A) Arbitrator's relationship with the parties or counsel

1. The arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party.
2. The arbitrator currently represents or advises one of the parties or an affiliate of one of the parties.
3. The arbitrator currently represents the lawyer or law firm acting as counsel for one of the parties.
4. The arbitrator is a lawyer in the same law firm which is representing one of the parties.
5. The arbitrator is a manager, director or part of the management, or has a similar controlling influence, in an affiliate of one of the parties if the affiliate is directly involved in the matters in dispute in the arbitration.
6. The arbitrator's law firm had a previous but terminated involvement in the case without the arbitrator being involved himself or herself.
7. The arbitrator's law firm currently has a significant commercial relationship with one of the parties or an affiliate of one of the parties.
8. The arbitrator regularly advises the appointing party or an affiliate of the appointing party even though neither the arbitrator nor his or her firm derives a significant financial income therefrom.
9. The arbitrator has a close family relationship with one of the parties and in the case of companies with the persons in the management and controlling the company.
10. A close family member of the arbitrator has a significant financial interest in one of the parties or an affiliate of one of the parties.
11. The arbitrator is a legal representative of an entity that is a party in the arbitration.
12. The arbitrator is a manager, director or part of the management, or has a similar controlling influence in one of the parties.
13. The arbitrator has a significant financial interest in one of the parties or the outcome of the case.
14. The arbitrator regularly advises the appointing party or an affiliate of the appointing party, and the arbitrator or his or her firm derives a significant financial income therefrom.

(B) Relationship of the arbitrator to the dispute

15. The arbitrator has given legal advice or provided an expert opinion on the dispute to a party or an affiliate of one of the parties.
16. The arbitrator has previous involvement in the case.

(C) Arbitrator's direct or indirect interest in the dispute

17. The arbitrator holds shares, either directly or indirectly, in one of the parties or an affiliate of one of the parties that is privately held.
18. A close family member of the arbitrator has a significant financial interest in the outcome of the dispute.
19. The arbitrator or a close family member of the arbitrator has a close relationship with a third party who may be liable to recourse on the part of the unsuccessful party in the dispute.

1. The term 'close family member' refers to a spouse, sibling, child, parent or life partner.
2. The term 'affiliate' encompasses all companies in one group of companies including the parent company.
3. For the removal of doubts, it is clarified that it may be the practice in certain specific kinds of arbitration, such as maritime or commodities arbitration, to draw arbitrators from a small, specialised pool. If in such fields it is the custom and practice for parties frequently to appoint the same arbitrator in different cases, this is a relevant fact to be taken into account while applying the rules set out above.

16.19 Types of arbitration procedures

1. **Ad hoc arbitration**
   (a) Ad hoc arbitration is arbitration agreed to by the parties themselves without recourse to an Institution.
   (b) In ad hoc arbitration, the procedure of arbitration is agreed to by the parties in the arbitration agreement.
   (c) In the absence of any agreement between the parties with respect to the procedure of arbitration, the procedure of arbitration is laid down by the arbitral tribunal.
   (d) Ad hoc arbitration can be domestic arbitration or international commercial arbitration.
2. **Institutional arbitration**
   (a) The arbitration agreement may provide that any dispute between the parties shall be referred to a particular institution (termed as 'arbitral institution').
   (b) Generally, arbitral institutions include in their panel a wide range of experts drawn from various professions, trade and business. Their impartiality is ensured by the Arbitration Committee of the institution which takes care that persons are chosen for their knowledge, experience, impartiality and integrity.
   (c) The arbitral institutions lay down their own Rules which supplement the provisions contained in the Act.
   (d) There exist many arbitral institutions like Delhi International Arbitration Centre (DIAC), Indian Council of Arbitration (ICA), International Chamber of Commerce (ICC), Construction Industry Arbitration Council (CIAC), Federation of Indian Chamber of Commerce & Industry (FICCI), World Intellectual Property Organisation (WIPO), the International Centre for Alternative Dispute Resolution (ICADR) and London Court of International Arbitration (LCIA).
   (e) Institutional arbitration can be domestic arbitration or international commercial arbitration.

Theoretical Questions from CS Examinations

Q 16.19A. What is ad hoc arbitration? [CS (Executive) Dec. 2014]

16.20 Number of arbitrators (Section 10)

1. The parties are free to determine the number of arbitrators, provided that such number shall not be an even number.
2. If the parties fail to determine the number of arbitrators, the arbitral tribunal shall consist of a sole arbitrator.

16.21 Appointment of arbitrators (Section 11)

1. **Nationality**

   A person of any nationality may be appointed as an arbitrator. Thus, an arbitrator may be of a nationality other than the nationality of any or all of the parties.

   The parties may agree that –
   (a) only a person of a particular nationality shall be appointed as an arbitrator; or
   (b) a person of a particular nationality shall not be appointed as an arbitrator.

   Simply speaking, unless otherwise agreed by the parties, a person of any nationality may be appointed as an arbitrator.

2. **Procedure for appointment**

The parties are free to agree on a procedure for appointing the arbitrator(s).

3. **Situation where no procedure for appointment is agreed between the parties**

In case of arbitration with 3 arbitrators, if the parties fail to agree on a procedure for appointing the arbitrator(s), then –

(a) each party shall appoint one arbitrator; and

(b) the two appointed arbitrators shall appoint the third arbitrator, who shall act as the presiding arbitrator.

4. **Situation where no procedure for appointment is agreed between the parties and there is a failure to appoint the arbitrator within 30 days**

In case of arbitration with 3 arbitrators, if the parties fail to agree on a procedure for appointing the arbitrator(s), and –

(a) any party fails to appoint an arbitrator within 30 days from the receipt of a request to do so from the other party; or

(b) the two appointed arbitrators fail to agree on the third arbitrator within 30 days from the date of their appointment,

then, the appointment shall be made, upon request of a party, by –

(i) the Supreme Court or any person or institution designated by the Supreme Court (in case of international commercial arbitration); or

(ii) the High Court or any person or institution designated by the High Court (in case of domestic arbitration).

Any appointment of an arbitrator made by the Supreme Court or any person or institution designated by the Supreme Court or the High Court or any person or institution designated by the High Court shall be final, and no appeal shall lie against such appointment.

5. **Situation where no procedure for appointment is agreed between the parties, a sole arbitrator is to be appointed and there is a failure to appoint the sole arbitrator within 30 days**

If the case is of arbitration with a sole arbitrator, but the parties fail to agree on a sole arbitrator within 30 days from receipt of a request by one party from the other party, then, the appointment shall be made, upon request of a party, by –

(i) the Supreme Court or any person or institution designated by the Supreme Court (in case of international commercial arbitration); or

(ii) the High Court or any person or institution designated by the High Court (in case of domestic arbitration).

Any appointment of an arbitrator made by the Supreme Court or any person or institution designated by the Supreme Court or the High Court or any person or institution designated by the High Court shall be final, and no appeal shall lie against such appointment.

Examples on sections 10 and 11.

Example 1. The arbitration agreement between Mr. A and Mr. B is silent with respect to number of arbitrators. As per section 10, there shall be a sole arbitrator. Mr. A and Mr. B agree to appoint Mr. C as the sole arbitrator. The appointment of Mr. C as the sole arbitrator is in accordance with the provisions of section 11.

Example 2. The arbitration agreement between Mr. A and Mr. B provides that there shall be 3 arbitrators. As per section 10, the number of arbitrators shall be 3. Mr. A and Mr. B could not agree on appointment of arbitrators. Mr. A appoints Mr. C as the arbitrator, Mr. B appoints Mr. D as the arbitrator, and Mr. C and Mr. D mutually consent for the appointment of Mr. E as the third arbitrator. The appointments of Mr. C and Mr. D as the arbitrators and of Mr. E as the third arbitrator are in accordance with the provisions of section 11.

Example 3. The arbitration agreement between Mr. A and Mr. B provides that there shall be 3 arbitrators. As per section 10, the number of arbitrators shall be 3. Mr. A and Mr. B could not agree on appointment of arbitrators. Mr. A appoints Mr. C as the arbitrator. Mr. A requests Mr. B to appoint an arbitrator, but Mr. B does not appoint the arbitrator within 30 days of such request. Mr. A makes a request to the High Court to appoint the arbitrators. As per section 11, the appointment of arbitrators shall be made by the High Court or any person or institution designated by the High Court.

Example 4. The arbitration agreement between Mr. A and Mr. B provides that there shall be 3 arbitrators. As per section 10, the number of arbitrators shall be 3. Mr. A and Mr. B could not agree on appointment of arbitrators. Mr. A appoints Mr. C as the arbitrator, Mr. B appoints Mr. D as the arbitrator, but Mr. C and Mr. D could not mutually agree for the appointment of the third arbitrator. Mr. A makes a request to the High Court to appoint the arbitrators. As per section 11, the appointment of arbitrators shall be made by the High Court or any person or institution designated by the High Court.

Example 5. The arbitration agreement between Mr. A and Mr. B is silent with respect to number of arbitrators. As per section 10, there shall be a sole arbitrator. Mr. A proposes Mr. C as the sole arbitrator to which Mr. B did not agree. Mr. A makes a request to the High Court to appoint the sole arbitrator. As per section 11, the appointment of sole arbitrator shall be made by the High Court or any person or institution designated by the High Court.

16.22 Duties of the arbitrator

1. **Equal treatment of parties (Section 18)**

   (a) It is the duty of the arbitrator to treat all the parties equally.

   (b) It is the duty of the arbitrator to give a full opportunity to every party to present his case.

   An arbitrator should be fair and absolutely impartial. He should have no interest in the subject matter of the dispute or in any of the parties and should not act as an advocate of the party appointing him. He should have no bias. He should not accept any gifts which may affect the fair determination of the matters submitted to arbitration.

2. **Timely disposal of arbitration proceedings**

   One of the basic objectives of the Act is 'expeditious justice'. So, it is the duty of the arbitrator to dispose of the arbitration proceedings as expeditiously as possible. An arbitrator cannot perennially adjourn the arbitration proceedings.

3. **Maintain confidentiality**

   It is the duty of the arbitrator and of each party to keep confidentiality of the arbitral proceedings. All evidences and documents produced before the arbitrator and even oral submissions made by the parties before the arbitrator have to be kept confidential. The confidentiality of information is one of the key advantages of arbitration because of which many people avoid litigation through court proceedings and instead prefer arbitration.

   Notwithstanding anything contained in any other law for the time being in force, the arbitrator, the arbitral institution and the parties to the arbitration agreement shall maintain confidentiality of all arbitral proceedings except award where its disclosure is necessary for the purpose of implementation and enforcement of award (Section 42A).

4. **Arbitral award (Section 31)**

   (a) An arbitral award shall be made in writing.

   (b) The arbitral award shall be signed by the members of the arbitral tribunal. In arbitral proceedings with more than one arbitrator, the signatures of the majority of all the members of the arbitral tribunal shall be sufficient so long as the reason for any omitted signature is stated.

   (c) The arbitral award shall state the reasons upon which it is based, unless –

   (i) the parties have agreed that no reasons are to be given; or

   (ii) the award is an arbitral award on agreed terms under section 30, *viz.* a settlement award, *i.e.* an arbitral award which records the terms and conditions agreed between the parties as a result of settlement between the parties during the course of arbitral proceedings.

   (d) The arbitral award shall state its date and the place of arbitration and the award shall be deemed to have been made at that place.

   (e) After the arbitral award is made, a signed copy shall be delivered to each party.

5. **Decision by majority (Section 29)**

   In arbitral proceedings with more than one arbitrator, any decision of the arbitral tribunal shall be made by a majority of all its members.

6. **No unilateral communication**

   An arbitrator should avoid any unilateral communication (*viz.* private discussion) with any party. If a party shares any document or information with an arbitrator, he should share such document or information with the other parties and other arbitrators. This ensures that every party has complete knowledge of the arbitral proceedings and all relevant information so that each party can prepare its case.

7. **Disclosure of independence and devotion of sufficient time to arbitration**

   Every arbitrator has to make a written disclosure (in the form specified in the Sixth Schedule) of any circumstances which are likely to –

   (a) give rise to justifiable doubts as to his independence or impartiality;

   (b) affect his ability to devote sufficient time to the arbitration and in particular his ability to complete the entire arbitration within a period of 12 months.

8. Notice to the parties

An arbitrator should give to each party proper notice of every hearing. Also, a reasonable opportunity to present the case should be given to each party.

The arbitrator is entitled to proceed *ex parte* if the party to whom reasonable notice has been given does not attend the hearing.

9. Compliance of legal requirements etc.

(a) An arbitrator has to comply with the provisions of this Act and all other laws which concern the subject matter of the dispute.

(b) He should not disregard the principles of natural justice. He must have scrupulous regard to the ends of justice.

(c) He should decide the dispute referred to him in a judicious manner and not capriciously or whimsically.

(d) He should strictly follow the arbitral procedure.

(e) He should adjudicate only such disputes as have been submitted to him by the parties.

16.23 Termination of arbitrator (Sections 12, 13 and 14)

1. Withdrawal by the arbitrator [Section 14(1)(b)]

(a) An arbitrator may withdraw from his office, *i.e.* the arbitrator may leave his office voluntarily.

(b) The Act does not contain any provision with respect to withdrawal, except that the Act entitles the arbitrator to withdraw from his office. Thus, an arbitrator, who resigns from his office may or may not specify the reasons for such resignation.

(c) An arbitrator does not perform any public duty, and so he cannot be forced to continue as arbitrator against his will.

2. Mutual consent of parties [Section 14(1)(b)]

The parties may, with mutual consent, agree to end the mandate of the arbitrator, *i.e.* the parties may mutually decide to terminate the arbitrator.

3. Inability of the arbitrator to perform [Section 14(1)(a)]

(a) The mandate of the arbitrator shall terminate if –

(i) he becomes unable to perform his functions (*e.g.* by reason of physical incapacity, serious illness, loss of nationality as stipulated in the arbitration agreement, etc.); or

(ii) for any reason, he fails to act without undue delay (*e.g.* by reason of his active involvement in his own business, loss of interest in the subject matter of the dispute, etc.).

(b) If a controversy arises as to whether the mandatory of the arbitrator has terminated or not as per section 14(1)(a), any party may apply to the court, and the court shall decide the same.

4. Completion of arbitral proceedings etc.

The mandate of the arbitrator comes to an end in the following cases:

(a) When the arbitral proceedings are terminated by the final arbitral award of the arbitral tribunal (Section 32).

(b) If the arbitral award is not made within 12 months from the date of completion of pleadings under section 23 (Section 29A).

5. Appointment of arbitrator is challenged (Section 12 and section 13)

(a) As per section 12(3), the appointment of a person as arbitrator may be challenged if –

(i) circumstances exist that give rise to justifiable doubts as to his independence or impartiality; or

(ii) he does not possess the qualifications agreed to by the parties.

However, a party may challenge an arbitrator appointed by him, or in whose appointment he has participated, only for reasons of which he becomes aware after the appointment has been made.

(b) A party who intends to challenge an arbitrator shall, within 15 days after becoming aware of any circumstances referred to in section 12(3), send a written statement of the reasons for the challenge to the arbitral tribunal.

(c) The appointment of the arbitrator whose appointment is challenged shall be terminated if –
   (i) he withdraws from his office; or
   (ii) the other party agrees to the challenge.

(d) If the arbitrator whose appointment is challenged does not withdraw from his office and the other party does not agree to the challenge, the challenge is unsuccessful, and so the arbitral tribunal shall continue the arbitral proceedings and make an arbitral award. However, the party who had challenged the appointment of the arbitrator shall have a right to make an application to the Court for setting aside such an arbitral award in accordance with section 34.

Consequences of termination of arbitrator

Termination of the mandate of the arbitrator does not mean termination of arbitration agreement. The effect of the termination is that a vacancy is created in the office of the arbitrator, and a substitute arbitrator shall be appointed in accordance with the same provisions as were applicable to the appointment of the arbitrator who has been terminated (Section 15).

Example 1. The arbitration agreement between Mr. A and Mr. B provides that there shall be 3 arbitrators. Mr. A appoints Mr. C as the arbitrator, Mr. B appoints Mr. D as the arbitrator, and Mr. C and Mr. D mutually consent for the appointment of Mr. E as the third arbitrator. However, afterwards the appointment of Mr. C was terminated. As per section 15 read with section 11, the substitute arbitrator in place of Mr. C shall be appointed by Mr. A.

Example 2. The arbitration agreement between Mr. A and Mr. B provides that there shall be 3 arbitrators. Mr. A appoints Mr. C as the arbitrator, Mr. B appoints Mr. D as the arbitrator, and Mr. C and Mr. D mutually consent for the appointment of Mr. E as the third arbitrator. However, afterwards the appointment of Mr. C was terminated. Mr. A does not make the appointment of the substitute arbitrator in place of Mr. C. Mr. B makes a request to the High Court to appoint the substitute arbitrator in place of Mr. C. As per section 15 read with section 11, the appointment of substitute arbitrator shall be made by the High Court or any person or institution designated by the High Court.

16.24 Time limit for arbitral award (Section 29A)

1. **Time limit without any extension**
   (a) The award in matters other than international commercial arbitration shall be made by the arbitral tribunal within a period of 12 months from the date of completion of pleadings under section 23.
   (b) The award in the matter of international commercial arbitration may be made as expeditiously as possible and endeavour may be made to dispose of the matter within a period of 12 months from the date of completion of pleadings under section 23.

2. **Extension of time by the mutual consent of the parties**
   The parties may, by mutual consent, extend the time period of 12 months by a further period not exceeding 6 months.

3. **Entitlement to additional fees if the award is made within 6 months**
   If the award is made within 6 months from the date the arbitrator(s) received written notice of his / their appointment, the arbitral tribunal shall be entitled to receive such amount of additional fees as the parties may agree.

4. **Situation where award is not made within the time limit**
   (a) If the award is not made within 12 months or any extension thereof, the mandate of the arbitrator(s) shall terminate.
   (b) However, the mandate of the arbitrator(s) shall not terminate if the Court extends the period.
   (c) The court may grant such extension if an application in this regard is made by any of the parties.
   Where an application for extension is made to the court, the period during which such application remains pending, the mandate of the arbitrator shall continue.
   (d) The court may grant such extension either prior to or after the expiry of such period.
   (e) While extending the period, if the Court finds that the proceedings have been delayed for the reasons attributable to the arbitral tribunal, then, it may order reduction of fees of arbitrator(s) by not exceeding 5% for each month of such delay.
   The arbitrator shall be given an opportunity of being heard, before the fees is reduced.
   (f) The extension may be granted only for sufficient cause and on such terms and conditions as may be imposed by the Court.
   (g) While extending the period, it shall be open to the Court to substitute one or all of the arbitrators.

(h) Where one or all of the arbitrators are substituted, the arbitral proceedings shall continue –
   (i) from the stage already reached;
   (ii) on the basis of the evidence and material already on record.

16.25 Kinds of arbitral award

1. **Final award [Section 31(6)]**
   (a) An award given by the arbitral tribunal which disposes of all the issues submitted to arbitration is termed as final award.
   (b) A final award finally resolves the disputes between the parties that were submitted to arbitration.
   (c) The final award determines the rights and obligations of the parties in definite terms, with respect to the issues submitted to arbitration, so that no further adjudication is required.
2. **Interim award [Section 31(6)]**
   (a) If an award made by the arbitral tribunal resolves one or more, but not all the issues submitted to arbitration, and as a result, the certain rights and obligations of the parties remain unsettled, then the award is termed as interim award.
   (b) An interim award may be made with respect to any matter on which a final award can be made.
   (c) An interim award is generally integrated into and forms part of the final award.
3. **Settlement award (Section 30)**
   (a) The arbitral tribunal may encourage the parties to settle the disputes, and for this purpose the arbitral tribunal may use mediation, conciliation or other procedures at any time during the arbitral proceedings.
   (b) If, during the arbitral proceedings, the parties agree to settle the dispute themselves, instead of having the dispute adjudicated by the arbitrator, then –
      (i) the arbitral tribunal shall terminate the arbitral proceedings; and
      (ii) the arbitral tribunal may, if requested by the parties, record the settlement in the form of an arbitral award containing the agreed terms and conditions of settlement.
   (c) Such an arbitral award shall have the same status and effect as any other arbitral award.
4. **Additional award [Section 33(4), (5), (6) and (7)]**
   (a) Where a party is of the opinion that certain claim was presented in the arbitral proceedings but such claim has been omitted in the arbitral award, such party may request the arbitral tribunal to make an additional arbitral award.
   (b) The request to make the additional arbitral award can be made within 30 days of receipt of the arbitral award.
   (c) The party making a request for the additional arbitral award shall give notice of the same to the other party.
   (d) If the arbitral tribunal considers the request for the additional arbitral award to be justified, it shall make the additional arbitral award within 60 days from the receipt of such request.
   (e) The arbitral tribunal may extend, if necessary, the period of time within which it shall make an additional arbitral award.
   (f) The provisions of section 31 shall apply to the additional award.
5. **Correction award [Section 33(1), (2), (3) and (7)]**
   (a) After an arbitral award has been made by the arbitral tribunal, if the arbitral tribunal is satisfied that there is any computation errors, any clerical or typographical errors or any other errors of a similar nature occurring in the award, it is empowered to correct such error.
   (b) The provisions of section 31 shall apply to a correction of the arbitral award.

Theoretical Questions from CS Examinations

Q 16.25A. Making of an additional award by arbitral tribunal. Comment. [CS (Executive) Dec. 2012]

16.26 Requirements for an arbitral award (Sections 29 and 31)

1. **Written (Section 31)**

   An arbitral award shall be made in writing.

2. **Decision by majority (Section 29)**

   In arbitral proceedings with more than one arbitrator, any decision of the arbitral tribunal shall be made by a majority of all its members.

3. **Signed (Section 31)**

   (a) The arbitral award shall be signed by the members of the arbitral tribunal.

   (b) In arbitral proceedings with more than one arbitrator, the signatures of the majority of all the members of the arbitral tribunal shall be sufficient so long as the reason for any omitted signature is stated.

4. **Reasons to be stated (Section 31)**

   The arbitral award shall state the reasons upon which it is based, unless –

   (a) the parties have agreed that no reasons are to be given; or

   (b) the award is an arbitral award on agreed terms under section 30, *viz.* a settlement award, *i.e.* an arbitral award which records the terms and conditions agreed between the parties as a result of settlement between the parties during the course of arbitral proceedings.

5. **Date and place of arbitration to be mentioned (Section 31)**

   The arbitral award shall state its date and the place of arbitration and the award shall be deemed to have been made at that place.

6. **Delivery of copy of award to the parties (Section 29)**

   After the arbitral award is made, a signed copy shall be delivered to each party.

7. **Clear and certain**

   (a) The arbitral award should set out the arbitral tribunal's decision unambiguously, clearly and completely, *e.g.* in case of a monetary award, it must be clear as to what amount is to be paid, to whom the amount is to be paid, who is duty bound to pay the amount, the time within which the amount is to be paid, etc.

   (b) It must not be some expression of hope, expectation, opinion, suggestion or recommendation.

   (c) The award must be convincing, persuasive and of consistent reasoning.

   (d) The award must not leave any opportunity for re-opening the issues covered.

   (e) It should clearly spell out the rights and obligations of all the parties.

8. **Enforceability**

   (a) The award must be one which is capable of being enforced.

   (b) An award must not impose a burden on a party which is impossible or illegal to perform.

9. **Must not conflict with the public policy**

   (a) An arbitral award must not conflict with the public policy of India.

   (b) As per Explanation I to section 34(2), an award shall be in conflict with the public policy of India, only if, –

      (i) the making of the award was induced or affected by fraud or corruption or was in violation of section 75 or section 81; or

      (ii) it is in contravention with the fundamental policy of Indian law; or

      (iii) it is in conflict with the most basic notions of morality or justice.

   (c) As per Explanation II to section 34(2), the test as to whether there is a contravention with the fundamental policy of Indian law shall not entail a review on the merits of the dispute.

   (d) An arbitral award may be set aside by the Court if it conflicts with the public policy of India.

Theoretical Questions from CS Examinations

Q 16.26A. Discuss the essential ingredients of arbitral award. [CS (Executive) Dec. 2005]

Q 16.26B. What are the essentials of an arbitral award? [CS (Executive) Dec. 2008]

Q 16.26C. What is an 'arbitral award' under the Arbitration and Conciliation Act, 1996? Explain. [CS (Executive) June 2015]

16.27 Setting aside the arbitral award (Section 34)

1. **Application for setting aside the arbitral award**
   (a) An application for setting aside the arbitral award may be made by any party to the Court.
   (b) Such application may be made within 3 months from the date such party had received the arbitral award.
   (c) If the Court is satisfied that the applicant was prevented by sufficient cause from making the application within the said period of 3 months, it may entertain the application within a further period of 30 days, but not thereafter.
   (d) Such application may be made by a party only after issuing a prior notice to the other party.

2. **Grounds for setting aside an arbitral award**
   An arbitral award may be set aside by the Court only if –
   (a) the party making the application establishes on the basis of the record of the arbitral tribunal that –
      (i) a party was under some incapacity (e.g. one of the parties was a minor or of unsound mind); or
      (ii) the arbitration agreement is not valid; or
      (iii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or
      (iv) the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration; or

      If the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the arbitral award which contains decisions on matters not submitted to arbitration may be set aside.

      (v) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties; or
   (b) the Court finds that –
      (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law for the time being in force; or
      (ii) the arbitral award is in conflict with the public policy of India.

      An award shall be deemed to be in conflict with the public policy of India, only if, –
      (i) the making of the award was induced or affected by fraud or corruption or was in violation of section 75 or section 81; or
      (ii) it is in contravention with the fundamental policy of Indian law; or
      (iii) it is in conflict with the most basic notions of morality or justice.

3. **Disposal of application**
   An application for setting aside the arbitral award shall be disposed of expeditiously, and in any event, within a period of 1 year from the date on which the notice was served upon the other party.

Theoretical Questions from CS Examinations

Q 16.27A. On what grounds may an award be challenged before the court under the provisions of Arbitration and Conciliation Act, 1996? [CS (Executive) Dec. 2005]

Q 16.27B. Mention the grounds under which arbitral award may be challenged before court under the provisions of Arbitration and Conciliation Act, 1996. [CS (Executive) June 2006]

Q 16.27C. Write a short note on setting aside of an arbitral award. [CS (Executive) June 2010]

Q 16.27D. What are the grounds on which an arbitral award may be challenged before the Court? [CS (Executive) June 2012]

Q 16.27E. Enumerate the grounds on which an arbitral award may be challenged before the Court? [CS (Executive) Dec. 2013]

Practical Problems from CS Examinations

Whether an application can be made for setting aside the arbitral award on the ground that notice of the arbitral proceedings was not given to a party?

P 16.27A. Anil moves an application for setting aside the arbitral award on the ground that he was not given a proper notice of the arbitral proceedings and thereby not being able to present his case. He furnishes sufficient proof and pleads before the court that he received the arbitral award just 15 days back. Decide with reasons –

(i) Whether Anil will succeed in his prayer; and

(ii) Whether the law of limitation will be a bar in his case. [CS (Executive) Dec. 2006, Dec. 2010]

Ans. The given problem relates to section 34 of the Arbitration and Conciliation Act, 1996.

Section 34 contains the ground on the basis of which an arbitral award can be challenged in the Court and then, the Court is empowered to pass an order setting aside the arbitral award.

One of the grounds contained in section 34 is: "Where the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case."

In the given case, Anil has challenged the arbitral award on the ground that he was not given proper notice of the arbitral proceedings. This ground, as explained above, is one of the grounds on which an arbitral award can be challenged in the Court.

The questions asked in the given problem are answered as under:

(i) Anil will succeed in his prayer since he has challenged the arbitral award on such ground as is covered under section 34.

(ii) As per section 34, an application for setting aside the arbitral award may be made by a party within 3 months from the date such party had received the arbitral award.

In the given case, Anil has made the application within 15 days of receipt of the arbitral award. Thus, Anil has made the application well in time. Accordingly, the application made by Anil is not time-barred. In other words, the law of limitation shall not be a bar in his case.

16.28 Consequences where an application is made for setting aside an arbitral award

When an arbitral award is challenged before the court under section 34 (*viz.* an application is made to the court for setting aside the arbitral award), following are the possible outcomes:

1. **Setting aside of the arbitral award**

   The court may set aside the arbitral award on any of the grounds contained in section 34, *e.g.* corruption or misconduct of the arbitrator, a party has been guilty of fraudulent concealment or wilful deception. Setting aside the arbitral award is also termed as 'annulment of the arbitral award'.

   An application for setting aside the arbitral award cannot be termed as an appeal since in an appeal the substantive correctness of the contents of the decision is considered while in an application for setting aside the arbitral award the court does not focus on the correctness of the decision but rather more narrowly considers whether, regardless of errors in application of law or determination of facts, the decision resulted from a legitimate process ***[National Highways Authority of India* v *Oriental Structural Engineers Pvt. Ltd.]***.

2. **Confirmation of the arbitral award**

   The court may make an order that none of the grounds for setting aside the arbitral award is attracted, and accordingly the application for setting aside the arbitral award is rejected. This amounts to confirmation of the arbitral award by the court.

In ***National Highways Authority of India* v *Oriental Structural Engineers Pvt. Ltd.***, the court observed that while under the Arbitration Act, 1940, the courts were empowered to modify the arbitral award or to remit back the arbitral award to the arbitral tribunal for reconsideration, but all this was removed under the Arbitration and Conciliation Act, 1996, *i.e.* under the Arbitration and Conciliation Act, 1996, the courts have no power to modify the arbitral award or to remit back the arbitral award to the arbitral tribunal for reconsideration. The law has been overhauled so as to expedite the whole process.

The same decision was given in ***M.M.T.C* v *Vicnivass Agency***.

Under the Arbitration Act, 1940 the Courts were empowered to modify the arbitral award (under section 15 of the Arbitration Act, 1940) and remit back the arbitral award to the arbitral tribunal for reconsideration (under section 16 of the Arbitration Act, 1940). However, under the Arbitration and Conciliation Act, 1996 the court has no such powers.

However, under the Arbitration and Conciliation Act, 1996, a power is conferred upon the arbitral tribunal itself to correct any computation errors or clerical or typographical or similar errors (Section 33 of the Arbitration and Conciliation Act, 1996).

16.29 Finality of arbitral awards (Section 35)

An arbitral award shall be final and binding on –

(a) all the parties; and

(b) any person claiming under any party.

The provisions of section 35 are subject to the provisions contained in Part I of the Act (consisting of sections 2 to 43).

Theoretical Questions from CS Examinations

Q 16.29A. Write a short note on finality of arbitral award. [CS (Executive) Dec. 2007]

16.30 Enforcement of arbitral award (Section 36)

1. **When is an arbitral award enforced?**

   An arbitral award shall be enforced in accordance with the provisions of the Code of Civil Procedure, 1908, in the same manner as if it were a decree of the court, where –

   (a) the time for making an application for setting aside the arbitral award under section 34 has expired; or

   (b) the application for setting aside the arbitral award has been rejected.

2. **Effect of filing application for setting aside the arbitral award**

   Where an application to set aside the arbitral award has been filed in the Court under section 34, –

   (a) it does not make the award unenforceable;

   (b) it does not result in a stay on the operation of the award.

   The Court has the discretion to grant a stay on the operation of an award if a separate application is made to the court for that purpose. While granting the stay, the court may impose such terms and conditions as the court may deem fit. The reasons for granting the stay shall be recorded in writing by the court.

3. **Power of the court to grant stay of operation of the arbitral award**

   When an application is filed for stay of the operation of the arbitral award, the Court may, subject to such conditions as it may deem fit, grant stay of the operation of such award for reasons to be recorded in writing.

16.31 Introduction to conciliation

1. The term 'conciliation' has not been defined under the Act.
2. Conciliation is the one of the commonly used methods of Alternative Dispute Resolution.
3. The term 'conciliation' means a voluntary, confidential and flexible process by which the parties to a dispute seek to mutually settle their dispute with the assistance of a neutral third party.

16.32 Features of conciliation

1. **Voluntary proceedings**

   The conciliation proceeding are of voluntary nature, *i.e.* when a party initiates conciliation by sending a written notice to the other party, the other party may or may not accept such invitation Even where both the parties mutually agree to resolve the dispute by conciliation, any party may afterwards withdraw from the conciliation proceedings.

2. **Non-judicial proceedings**

   The conciliation proceedings are in the nature of non-judicial proceedings.

3. **Non-adjudicatory proceedings**

   Both, litigation and arbitration, are means of adjudication, *i.e.* the court as well as the arbitrator pronounce his verdict / order / arbitral award which is imposed on the parties.

   However, conciliation is a process in which the parties settle their disputes with mutual consent. Conciliation is different from litigation and arbitration where the decisions are imposed on the parties. In litigation, mutual consent of the parties is not required for the court to make an order. Similarly, in arbitration, mutual consent of the parties is not required for the arbitral tribunal to make an arbitral award.

4. **Non-adversary proceedings**

In litigation as well as in arbitration, each party aims to prove himself as right and the other party as wrong. Each party perceives the other party as its opponent / contestant. The party in whose favour the court / arbitral tribunal makes the decision / arbitral award is considered to be the winner and the other party is considered to be the loser. This win-loss feeling often results in bitterness in relationship between the parties.

However, the conciliation proceedings are non-adversary in nature, *i.e.* no party tries to prove himself as right and the other party as wrong. There is no claimant or plaintiff in conciliation proceedings. In conciliation, the parties explore all possible options to amicably settle the dispute. Thus, in conciliation, the focus is not on winning and losing, but is to find a solution which acceptable to both the parties.

5. **Flexibility in procedure**

The procedure for conduct of conciliation proceedings is flexible. The conciliator has the discretion to adopt such procedure which would ensure speedier and inexpensive conduct of proceedings.

6. **Binding effect of settlement agreement**

If the conciliation is successful, a settlement agreement is signed by the parties. The settlement agreement is final and binding on the parties. It has the same status and effect as if it is an arbitral award. Just like an arbitral award, the settlement agreement shall be enforced in the same manner as if it were a decree of the court.

7. **Role of the conciliator**

The main function of the conciliator is to assist the parties to reach an amicable settlement. The conciliator does not decide for the parties, but assists the parties in generating options in order to find a solution that is compatible for both of them. Also, the conciliator makes proposals for settlement of the dispute by formulating and reformulating the terms of a possible settlement.

8. **Duties of the conciliator**

A conciliator is obliged to –

(a) act in an independent and impartial manner; and

(b) abide by the principles of objectivity, fairness and justice.

9. **Confidentiality**

The conciliator and the parties shall keep confidential –

(a) all matters relating to the conciliation proceedings; and

(b) the settlement agreement.

10. **Bar on arbitral or judicial proceedings**

During the pendency of conciliation proceedings, a party is debarred from initiating arbitral or judicial proceedings on the same dispute, except such proceedings as are necessary for preserving his rights.

Theoretical Questions from CS Examinations

Q 16.32A. Conciliation is informal process in which the conciliator, the third party, tries to bring the disputants to agreement. Comment.
[CS (Executive) June 2007]

16.33 - Difference between mediation and conciliation

Basis of distinction	*Mediation*	*Conciliation*
1. Applicable law	The provisions relating to mediation are contained in section 89 of the Code of Civil Procedure, 1908.	The provisions relating to conciliation are contained in section 61 to 81 of the Arbitration and Conciliation Act, 1996.
2. Result	If mediation is successful, it results in a binding contract between the parties.	If conciliation is successful, it results in a settlement agreement between the parties.
3. Effect of failure to perform the terms and conditions	Failure to perform the terms and conditions of the mediation contract results in breach of contract.	Failure to perform the terms and conditions of the settlement agreement has the same consequences as in case of breach of arbitral award. Accordingly, the settlement agreement can be enforced as a decree of the court.

4. ***Role of mediator / conciliator***	Mediator plays a facilitative role. He guides the parties towards a workable solution. However, the solution should come from the parties. Thus, the role of the mediator is passive.	The conciliator plays an active role in bringing about a settlement agreement. He makes proposals for settlement of the dispute by formulating and reformulating the terms of a possible settlement.
5. ***Confidentiality***	Mediation proceedings are subject to confidentiality as provided in the Code of Civil Procedure, 1908.	Conciliation proceedings and settlement agreement shall be kept confidential by the conciliator as well as by the parties.

16.34 Difference between arbitration and conciliation

Basis of distinction	***Arbitration***	***Conciliation***
1. ***Definition***	'Arbitration' means any arbitration whether or not administered by permanent arbitral institution [Section 2(a)].	The term conciliation has not been defined in the Act.
2. ***Meaning***	Arbitration means submission of a dispute between the parties to one or more neutral persons, who is / are appointed by the parties to adjudicate the dispute.	Conciliation means a voluntary, confidential and flexible process by which the parties to a dispute seek to mutually settle their dispute with the assistance of a neutral third party.
3. ***Requirement of prior written agreement***	Any dispute between the parties shall be submitted to arbitration only if the parties have agreed in writing to submit the dispute to arbitration.	Even if there is no written agreement between the parties with respect to conciliation, any of the parties to the dispute may send a written notice to the other inviting it for conciliation.
4. ***Binding / voluntary***	If there is an arbitration agreement between the parties, no party can initiate the litigation through the court, and the dispute shall be resolved only through arbitration.	The conciliation proceeding are of voluntary nature, *i.e.* even during conciliation proceedings, a party may withdraw from the conciliation proceedings, and approach the court.
5. ***Imposing of decision on the parties***	Arbitration is one of the means of adjudication of disputes, *i.e.* the arbitrator makes the arbitral award which is binding on the parties.	In conciliation, the parties settle their disputes with mutual consent. The conciliator cannot impose any decision on any party.
6. ***Adversary or non-adversary proceedings***	In arbitration, each party aims to prove himself as right and the other party as wrong. Each party perceives the other party as its opponent / contestant.	The conciliation proceedings are non-adversary in nature, *i.e.* no party tries to prove himself as right and the other party as wrong.
7. ***Role of the arbitrator / conciliator***	The arbitrator or arbitral tribunal considers all the evidences, documents and information submitted to him by each party, and determines the dispute (*viz.* resolves the dispute) by applying the applicable laws.	The main function of the conciliator is to assist the parties to reach an amicable settlement.
8. ***Number of arbitrators / conciliators***	In arbitration, appointment of even number of arbitrators is not permissible.	There can be two conciliators in conciliation.
9. ***Evidence and witnesses***	The arbitrator has the authority to examine evidences and witnesses.	A conciliator does not have the authority to examine evidences and witnesses.

Theoretical Questions from CS Examinations

Q 16.34A. Distinguish between arbitration and conciliation. [CS (Executive) Dec. 2012, Dec. 2014]

16.35 Applicability and scope of conciliation (Section 61)

1. The provisions relating to conciliation are contained in Part III of the Act, consisting of sections 61 to 81.
2. Part III of the Act shall apply to conciliation of disputes arising out of legal relationship, whether contractual or not and to all proceedings relating to conciliation.

The provisions contained in Part III of the Act shall not apply where –
(a) any law for the time being in force provides that the provisions contained in Part III shall not apply;
(b) the dispute is of such a nature which, by virtue of any law for the time being in force, cannot be submitted to conciliation;
(c) the parties have agreed that the provisions contained in Part III shall not apply.

16.36 Number of conciliators (Section 63)

1. **Such number as agreed between the parties, but not exceeding three**

   The parties have the freedom to agree on the number of conciliators. However, in no case the number of conciliators shall be more than 3. Thus, the parties may agree that there shall be a sole conciliator or that the number of conciliator(s) shall be 2 or 3.
2. **Situation where there is no agreement between the parties**

   In case the parties do not agree on the number of conciliators, there shall be one conciliator.
3. **Conciliators to act jointly**

   Where there is more than one conciliator, all the conciliators shall act jointly.

16.37 Appointment of conciliators (Section 64)

1. **Manner of appointment of conciliator(s) by the parties**

   The appointment of conciliator(s) shall be made as follows:
   (a) In conciliation proceedings with 1 conciliator, the parties may mutually agree on the name of a sole conciliator.
   (b) In conciliation proceedings with 2 conciliators, each party may appoint 1 conciliator;
   (c) In conciliation proceedings with 3 conciliators, each party may appoint 1 conciliator and the parties may agree on the name of the third conciliator who shall act as the presiding conciliator.
2. **Appointment of conciliator(s) with the assistance of any other person**

   Parties may take the assistance of a suitable institution or person in connection with the appointment of conciliators, and in particular, –
   (a) a party may request such an institution or person to recommend the names of suitable individuals to act as conciliator; or
   (b) the parties may agree that the appointment of one or more conciliators be made directly by such an institution or person.

   In recommending or appointing individuals to act as conciliator, the institution or person shall ensure that conciliator is independent and impartial.

16.38 Submission of statements to conciliator (Section 65)

1. **Request by the conciliator to parties to submit written statements**
   (a) When a conciliator is appointed, he may request each party to submit to him a brief written statement describing the general nature of the dispute and the points at issue.
   (b) Each party shall send a copy of such statement to the other party.
2. **Request by the conciliator to parties to submit further written statements, etc.**
   (a) The conciliator may request each party to submit to him –
   (i) a further written statement of his position;
   (ii) the facts and grounds in support of his position;
   (iii) any documents and other evidence that such party deems appropriate.
   (b) The party shall send a copy of such statement, documents and other evidence to the other party.

3. **Request by the conciliator to parties to submit additional information**

   At any stage of the conciliation proceedings, the conciliator may request a party to submit to him such additional information as he deems appropriate.

In sections 65 to 81, the term 'conciliator' applies to a sole conciliator, 2 or 3 conciliators, as the case may be.

16.39 Bar on arbitral or judicial proceedings (Section 77)

During the pendency of conciliation proceedings, a party is debarred from initiating arbitral or judicial proceedings on the same dispute.

However, a party may initiate arbitral or judicial proceedings where, in his opinion, such proceedings are necessary for preserving his rights.

16.40 Role of conciliator (Section 67)

1. The conciliator shall assist the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute.
2. The conciliator shall be guided by principles of objectivity, fairness and justice.

   The conciliator shall take into account –
   (a) the rights and obligations of the parties;
   (b) the usage of the trade concerned;
   (c) the circumstances surrounding the dispute; and
   (d) any previous business practices between the parties.
3. The conciliator may conduct the conciliation proceedings in such a manner as he considers appropriate.

   The conciliator shall take into account –
   (a) the circumstances of the case;
   (b) the wishes the parties may express;
   (c) any request by a party that the conciliator hear oral statements; and
   (d) the need for a speedy settlement of the dispute.
4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute.

   Such proposals need not be in writing and need not be accompanied by a statement of the reasons therefor.

16.41 Stages in settlement agreement (Sections 67, 72, 73 and 74)

1. **Initiation (Section 67 and section 72)**

   In the process of conciliation, an attempt is made to resolve the dispute and arrive at a settlement. To arrive at a settlement, a proposal is made, which if agreed to by all the parties to the dispute results in a settlement agreement. The proposal for settlement agreement may be initiated in any of the following ways:

   (a) The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute. Such proposals need not be in writing and need not be accompanied by a statement of the reasons therefor (Section 67).

   (b) Each party may submit to the conciliator suggestions for the settlement of the dispute. The submission of suggestions may be made by a party –
      (i) on his own initiative; or
      (ii) at the invitation of the conciliator (Section 72).
2. **Settlement agreement (Section 73)**

   (a) When it appears to the conciliator that a settlement is possible which may be acceptable to the parties, he shall formulate the terms of a possible settlement and submit them to the parties for their observations. After receiving the observations of the parties, the conciliator may reformulate the terms of a possible settlement in the light of such observations.

(b) If the parties agree on the terms and conditions of the settlement, a written agreement is prepared containing such terms and conditions. This written agreement is termed as settlement agreement. The settlement agreement is signed by all the parties. If requested by the parties, the conciliator may draw up, or assist the parties in drawing up, the settlement agreement.

(c) When the parties sign the settlement agreement, it shall be final and binding on the parties.

(d) The conciliator shall authenticate the settlement agreement and furnish a copy thereof to each of the parties.

3. **Enforcement of settlement agreement (Section 74)**

The settlement agreement shall have the same status and effect as if it is an arbitral award. Just like an arbitral award, the settlement agreement shall be enforced in accordance with the provisions of the Code of Civil Procedure, 1908, in the same manner as if it were a decree of the court.

16.42 Confidentiality of information (Sections 70 and 75)

1. **Disclosure of information by the conciliator to the other party (Section 70)**

When the conciliator receives factual information concerning the dispute from a party, he shall disclose the substance of that information to the other party so that the other party may have the opportunity to present any explanation which he considers appropriate.

2. **No disclosure of information by the conciliator to the other party (Section 70)**

When a party gives any information to the conciliator subject to a specific condition that it be kept confidential, the conciliator shall not disclose that information to the other party.

3. **Duty of the conciliator and the parties to keep confidentiality (Section 75)**

(a) Notwithstanding anything contained in any other law for the time being in force, the conciliator and the parties shall keep confidential –

(i) all matters relating to the conciliation proceedings; and

(ii) the settlement agreement.

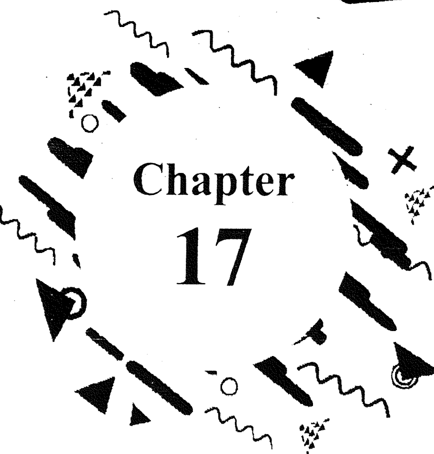
(b) However, disclosure may be made if it becomes necessary for the purposes of implementation and enforcement of the settlement agreement.

16.43 Role of conciliator in other proceedings (Section 80)

1. The conciliator shall not act as an arbitrator or as a representative or counsel of a party in any arbitral or judicial proceeding in respect of a dispute that is the subject of the conciliation proceedings.
2. The conciliator shall not be presented by the parties as a witness in any arbitral or judicial proceedings.

The parties to the dispute may agree otherwise.

The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015



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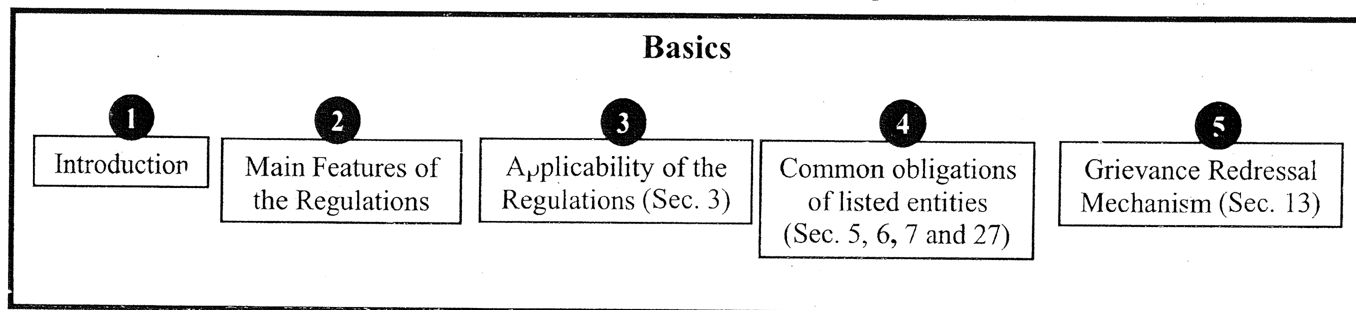

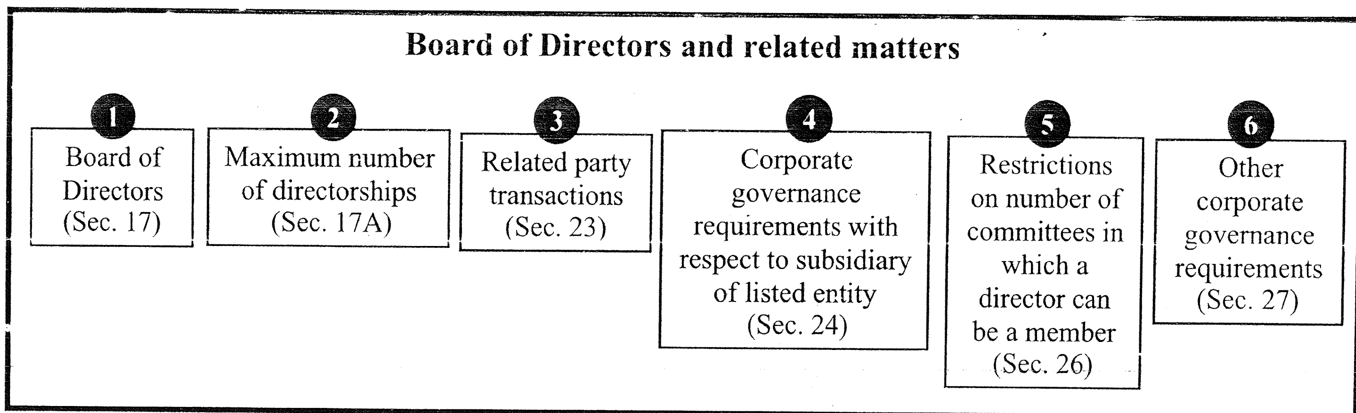

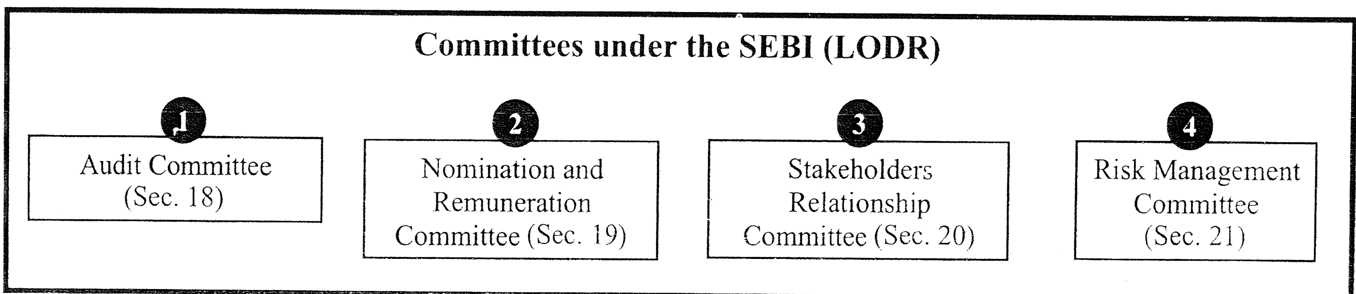

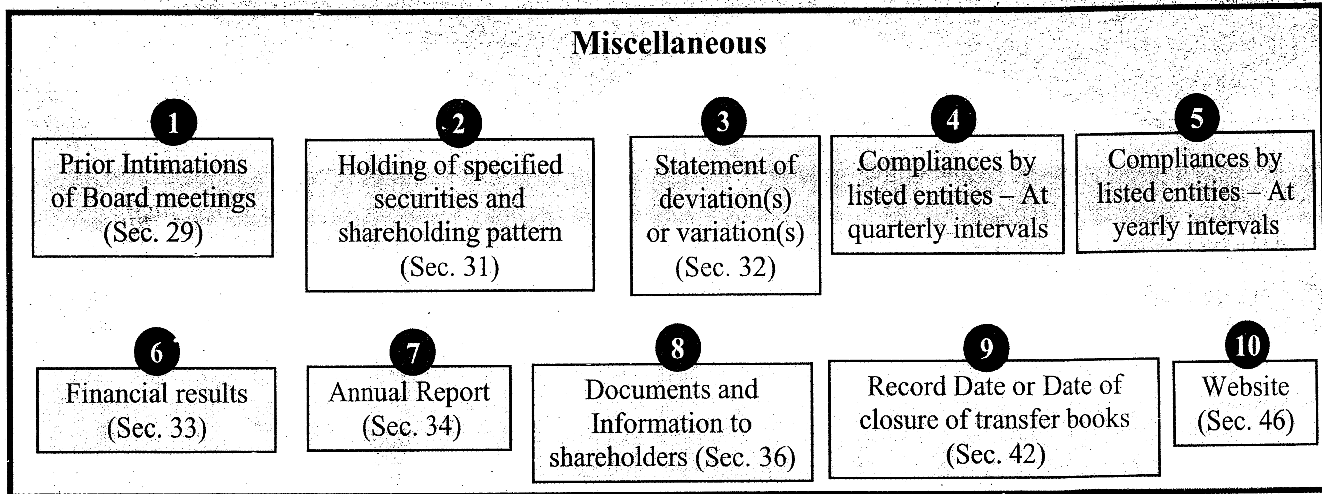

Notes:

1. In this Chapter, unless otherwise specified, any reference to any Regulation means reference to the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (also referred to as 'SEBI (LODR) Regulations, 2015' or 'Regulations').
2. In this Chapter, the term 'Board' wherever used, refers to the Securities and Exchange Board of India established under the Securities and Exchange Board of India Act, 1992.
3. In this Chapter, the Author has discussed all such Regulations as have been amended in the recent past even though some of these Regulations were not contained in the latest Study Material issued by ICAI. This is so because the Author is not sure as to which Regulations will be included by ICAI in the RTP applicable for May 2021 Exams. The students are advised to concentrate more on such Regulations included in this Book as may be included by ICAI in the latest Study Material read with RTP applicable for May 2021 Exams.

17.1 Introduction

The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 have been divided into 12 Chapters (*viz.* Chapter I to XII) and 9 Schedules (*viz.* Schedule I to IX).

17.2 Main Features of the Regulations

1. SEBI (LODR) Regulations, 2015 apply to all listed entities, and not just listed companies. Thus, body corporates which are not companies, are also covered by these Regulations.
2. SEBI (LODR) Regulations, 2015 contain the broad principles with respect to disclosures and obligations of the listed entities.
3. The provisions contained in the SEBI (LODR) Regulations, 2015 have been aligned with the provisions contained in the Companies Act, 2013. Also, related provisions have been aligned and provided at one place.
4. The Regulations contain the pre-issue obligations as well as the post-issue obligations of the listed entities.
5. The Regulations consolidates the existing listing agreements for different segments of the capital market into one single document across various types of securities listed on the stock exchanges. However, provisions relating to specific type of securities have been contained in separate Chapters of these Regulations.
6. Compliance of these Regulations by the listed entities (*e.g.* timely and accurate disclosures, discharging of enormous responsibilities by the compliance officer, Board of directors etc., constitution of various committees and their roles and responsibilities, vigil mechanism, whistle blower mechanism, etc.) would ensure better corporate governance and protect the rights of the stakeholders.

7. The Regulations specify a shortened version of the Listing Agreement which a listing entity is required to execute at the time of listing of its securities.
8. SEBI (LODR) Regulations, 2015 have replaced the erstwhile Listing Agreement and all the circulars stipulating or modifying the provisions of the Listing Agreement.
9. Non-compliance of these Regulations would amount to contravention of the provisions of the SEBI Act, 1992 and accordingly the consequential penal provisions of the SEBI Act, 1992 would become applicable.
10. The Regulations contain –
    (i) Substantive provisions (as contained in the main body of the Regulations); and
    (ii) Procedural requirements and details (as contained in the Schedules).

17.3 Applicability of the Regulations (Regulation 3)

Unless otherwise provided, SEBI (LODR) Regulations, 2015 shall apply to the listed entity whose any of the following designated securities are listed on one or more recognised stock exchange:

(a) Specified securities listed on main board or SME Exchange or institutional trading platform

(b) Non-convertible debt securities, non-convertible redeemable preference shares, perpetual debt instrument, perpetual non-cumulative preference shares

(c) Indian depository receipts

(d) Securitised debt instruments

(da) Security receipts

(e) Units issued by mutual funds

(f) Any other securities as may be specified by the Board.

SEBI (LODR) Regulations, 2015 were notified in the Official Gazette on 2nd September, 2015 and came into force on the 90th day from the date of their publication in the Official Gazette, *viz.* with effect from 1st December, 2015.

17.4 Common obligations of listed entities (Regulations 5, 6, 7 and 27)

1. **General obligation of compliance (Regulation 5)**

   It shall be the duty of the listed entity to ensure that the following persons comply with such responsibilities or obligations, as have been assigned to them under these Regulations:
   (i) Key Managerial Personnel
   (ii) Directors
   (iii) Promoters
   (iv) Any other person dealing with listed entity.

2. **Appointment of the Compliance Officer (Regulation 6)**

   A listed entity shall appoint a qualified company secretary as the compliance officer.

   As per Regulation 30, the listed entity shall disclose any change in the compliance officer, to stock exchange(s) as soon as reasonably possible but not later than 24 hours from such change. If such disclosure is made after 24 hours, the listed entity shall, along with such disclosure, provide explanation for delay.

3. **Responsibilities of the Compliance Officer (Regulation 6)**

   (i) The compliance officer shall ensure that the listed entity complies with the all such regulatory provisions as are applicable to the listed entity. The compliance has to be in letter as well as in spirit.
   (ii) The compliance officer shall co-ordinate with the Board, recognised stock exchange(s) and depositories.
   (iii) The compliance officer shall report to the Board, recognised stock exchange(s) and depositories with respect to compliance with rules, regulations and other directives of these authorities.

(iv) The compliance officer shall ensure that the correct procedures have been followed that would result in the correctness, authenticity and comprehensiveness of the information, statements and reports filed by the listed entity under these regulations.

(v) The compliance officer shall monitor the e-mail address of grievance redressal division as designated by the listed entity for the purpose of registering complaints by investors.

Role of the compliance officer as per other Regulations

1. **To sign the compliance certificate w.r.t. share transfer facility (Regulation 7)**
   (i) Every listed entity is required to submit a compliance certificate to the recognised stock exchange(s), certifying that the listed entity has ensured that all activities in relation to share transfer facility are maintained either in house or by Registrar to an issue and share transfer agent registered with the Board.
   (ii) Such certificate shall be duly signed by both the compliance officer of the listed entity and the authorised representative of the share transfer agent, wherever applicable.
   (iii) Such certificate shall be submitted to the recognised stock exchange(s) within 1 month of end of each half of the financial year.

2. **To sign the compliance report on corporate governance (Regulation 27)**
   (i) Every listed entity is required to submit a quarterly compliance report on corporate governance to the recognised stock exchange(s).
   (ii) The quarterly compliance report shall be submitted within 15 days from close of the quarter.
   (iii) The quarterly compliance report shall be signed either by the compliance officer or the chief executive officer of the listed entity.

4. **Share Transfer Agent (Regulation 7)**
   (i) The listed entity shall, either –
      (a) appoint a share transfer agent; or
      (b) manage the share transfer facility in-house.
   (ii) Where the listed entity manages the share transfer facility in-house, and the total number of holders of securities of the listed entity exceeds 1 lakh, the listed entity shall either –
      (a) register with the Board as a Category II share transfer agent; or
      (b) appoint Registrar to an issue and share transfer agent who is registered with the Board.

17.5 Grievance Redressal Mechanism (Regulation 13)

1. **Duty to redress investor complaints**
   The listed entity shall ensure that adequate steps are taken for expeditious redressal of investor complaints.

2. **Duty to register on SCORES platform**
   The listed entity shall ensure that it is registered on the SCORES platform, in order to handle investor complaints electronically in the manner specified by the Board.

3. **Duty to file a statement containing number of investor complaints**
   (i) The listed entity shall file with the recognised stock exchange(s) a statement containing –
      (a) number of investor complaints pending at the beginning of the quarter;
      (b) number of investor complaints received during the quarter;
      (c) number of investor complaints disposed of during the quarter; and
      (d) number of investor complaints remaining unresolved at the end of the quarter.
   (ii) The statement shall be filed on a quarterly basis, within 21 days from the end of each quarter.
   (iii) The statement shall be placed, on quarterly basis, before the Board of directors of the listed entity.

17.6 Board of Directors (Regulation 17)

1. **Composition of Board of directors**
   The composition of Board of directors of the listed entity shall be as follows:
   (a) The Board of directors shall have an optimum combination of executive and non-executive directors with at least 1 woman director and not less than 50% of the Board of directors shall comprise of non-executive directors.

(b) The Board of directors of top 500 listed entities shall have at least 1 independent woman director by April 1, 2019 and the Board of directors of top 1,000 listed entities shall have at least 1 independent woman director by April 1, 2020.

(c) Where the Chairperson of the Board of directors is a non-executive director, at least 1/3rd of the Board of directors shall comprise of independent directors.

(d) Where the listed entity does not have a regular non-executive Chairperson, at least half of the Board of directors shall comprise of independent directors.

(e) Where the regular non-executive Chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of Board of director or at one level below the Board of directors, at least half of the Board of directors of the listed entity shall consist of independent directors.

For the purpose of this clause, the expression 'related to any promoter' shall have the following meaning:

(i) If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;

(ii) If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.

(f) The Board of directors of top 1,000 listed entities (with effect from April 1, 2019) and top 2,000 listed entities (with effect from April 1, 2020) shall comprise of not less than 6 directors.

(g) Where the listed company has outstanding SR equity shares, at least half of the Board of directors shall comprise of independent directors.

(h) No listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of 75 years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

(i) With effect from April 1, 2022, top 500 listed entities shall ensure that the Chairperson of the Board of such listed entity shall –

(i) be a non-executive director;

(ii) not be related to the Managing Director or the Chief Executive Officer as per the definition of the term 'relative', as defined under the Companies Act, 2013.

This requirement shall not apply to the listed entities which do not have any identifiable promoters as per the shareholding pattern filed with stock exchanges.

2. Meetings of Board of directors

(a) The Board of directors shall meet at least 4 times a year, with a maximum time gap of 120 days between any 2 meetings.

(b) The quorum for every meeting of the Board of directors of top 1,000 listed entities with effect from April 1, 2019 and of top 2,000 listed entities with effect from April 1, 2020 shall be 1/3rd of its total strength or 3 directors, whichever is higher, including at least 1 independent director.

(c) The participation of directors by video conferencing or by other audio-visual means shall also be counted for the purposes of quorum.

3. Functions to be performed by the Board of directors

(a) The Board of directors shall periodically review compliance reports pertaining to all laws applicable to the listed entity, prepared by the listed entity as well as steps taken by the listed entity to rectify instances of non-compliances.

(b) The Board of directors of the listed entity shall satisfy itself that plans are in place for orderly succession for appointment to the Board of directors and senior management.

(c) The Board of directors shall lay down a code of conduct for all members of Board of directors and senior management of the listed entity.

(d) The code of conduct shall suitably incorporate the duties of independent directors as laid down in the Companies Act, 2013.

(e) The statement to be annexed to the notice as referred to in section 102 of the Companies Act, 2013 for each item of special business to be transacted at a general meeting shall also set forth clearly the recommendation of the Board to the shareholders on each of the specific items.

4. Remuneration of directors

(a) The Board of directors shall recommend all fees or compensation, if any, paid to non-executive directors, including independent directors and shall require approval of shareholders in general meeting.

(b) The approval of shareholders shall specify the limits for the maximum number of stock options that may be granted to non-executive directors, in any financial year and in aggregate.

(c) The approval of shareholders by special resolution shall be obtained every year, in which the annual remuneration payable to a single non-executive director exceeds 50% of the total annual remuneration payable to all non-executive directors, giving details of the remuneration thereof.

(d) The requirement of obtaining approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 2013 for payment of sitting fees.

(e) Independent directors shall not be entitled to any stock option.

(f) The fees or compensation payable to executive directors who are promoters or members of the promoter group, shall be subject to the approval of the shareholders by special resolution in general meeting, if –

(i) the annual remuneration payable to such executive director exceeds Rs. 5 crore or 2.5% of the net profits of the listed entity (calculated as per section 198 of the Companies Act, 2013), whichever is higher; or

(ii) where there is more than 1 such director, the aggregate annual remuneration to such directors exceeds 5% of the net profits of the listed entity.

The approval of the shareholders shall be valid only till the expiry of the term of such director.

5. Compliance certificate to be provided to the Board of directors

The chief executive officer and the chief financial officer shall provide the compliance certificate to the Board of directors.

6. Risk assessment and minimization procedures

(a) The listed entity shall lay down procedures to inform members of Board of directors about risk assessment and minimization procedures.

(b) The Board of directors shall be responsible for framing, implementing and monitoring the risk management plan for the listed entity.

7. Performance evaluation of independent directors

(a) The evaluation of independent directors shall be done by the entire Board of directors which shall include –

(i) performance of the directors; and

(ii) fulfilment of the independence criteria as specified in these Regulations and their independence from the management.

(b) In the above evaluation, the directors who are subject to evaluation shall not participate.

1. Manner of determining top 500, 1,000 and 2,000 entities

Top 500, 1,000 and 2,000 entities shall be determined on the basis of market capitalisation, as at the end of the immediately previous financial year.

2. Non-applicability of Regulation 17 during insolvency resolution process [Regulation 15(2A)]

The provisions contained in regulation 17 shall not be applicable during the insolvency resolution process period in respect of a listed entity which is undergoing corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016.

However, the role and responsibilities of the Board of directors as contained in regulation 17 shall be fulfilled by the interim resolution professional or resolution professional in accordance with sections 17 and 23 of the Insolvency and Bankruptcy Code, 2016.

17.7 Maximum number of directorships (Regulation 17A)

The directors of listed entities shall comply with the following conditions with respect to the maximum number of directorships, including any alternate directorships that can be held by them at any point of time.

(a) A person shall not be a director in more than 8 listed entities with effect from April 1, 2019 and in not more than 7 listed entities with effect from April 1, 2020.

(b) A person shall not serve as an independent director in more than 7 listed entities.

(c) Any person who is serving as a whole time director or managing director in any listed entity shall not serve as an independent director in more than 3 listed entities.

For this purpose, the count for the number of listed entities on which a person is a director or independent director shall be only those whose equity shares are listed on a stock exchange.

17.8 Committees under the SEBI (LODR) Regulations, 2015

1. Audit Committee (Regulation 18)
2. Nomination and Remuneration Committee (Regulation 19)
3. Stakeholders Relationship Committee (Regulation 20)
4. Risk Management Committee (Regulation 21)

Non-applicability of Regulations 18, 19, 20 and 21 during insolvency resolution process [Regulation 15(2B)]

The provisions contained in regulations 18, 19, 20 and 21 shall not be applicable during the insolvency resolution process period in respect of a listed entity which is undergoing corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016.

However, the roles and responsibilities of the committees specified in regulations 18, 19, 20 and 21 shall be fulfilled by the interim resolution professional or resolution professional.

17.9 Audit Committee (Regulation 18)

1. **Mandatory constitution of the audit committee**

   It is mandatory for every listed entity to constitute a qualified and independent audit committee.

2. **Composition of the audit committee**

   (i) The audit committee shall have a minimum 3 directors as members of the audit committee.

   (ii) 2/3rd of the members of the audit committee shall be independent directors.

   In case of a listed entity having outstanding SR equity shares, all the members of the audit committee shall be independent directors.

   (iii) All the members of the audit committee shall be financially literate.

   For this purpose, 'financially literate' shall mean the ability to read and understand basic financial statements.

   (iv) At least 1 member of the audit committee shall have accounting or related financial management expertise.

   For this purpose, a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

   (v) The Chairperson of the audit committee shall be an independent director.

   (vi) The Chairperson of the audit committee shall be present at the Annual General Meeting to answer the queries of the shareholders.

   (vii) The Company Secretary shall act as the secretary of the audit committee.

(viii) The audit committee, at its discretion, may invite at the meetings of the audit committee –

(a) the finance director;

(b) head of the finance function;

(c) head of internal audit;

(d) a representative of the statutory auditor; and

(e) any other such executives.

3. Conduct of meetings of the audit committee

(i) The audit committee shall meet at least 4 times in a year.

(ii) Not more than 120 days shall elapse between 2 meetings of the audit committee.

(iii) The quorum for the meetings of the audit committee meeting shall be higher of –

(a) 2 members; or

(b) 1/3rd of the members of the audit committee.

The quorum shall be present only if at least 2 independent directors are present.

4. Powers and functions of the audit committee

The audit committee shall have the powers to –

(i) investigate any activity within its terms of reference;

(ii) seek information from any employee;

(iii) obtain outside legal or other professional advice; and

(iv) secure attendance of outsiders with relevant expertise, if it considers necessary.

Practical Problems from CA Examinations

Whether the audit committee already constituted can continue after listing of securities?

P 17.9A. The composition of audit committee of M/s MKBTC Limited an unlisted public company, as on 31-3-2019, comprised of 7 directors including 4 independent directors. The majority of the members of the audit committee has the ability to read and understand the financial statements but none of them has accounting or related financial management expertise. The company listed its securities in a recognized stock exchange in the month of August 2019. Referring to the regulations of Securities and Exchange Board of India (Listing Obligation and Disclosure Requirements) Regulations 2015, decide whether the existing audit committee can continue after listing of its securities? [CA (Final) Nov. 2019]

Ans. The given problem relates to Regulation 18 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

The legal position

1. As per Regulation 18, the composition of the audit committee of a listed entity shall be as follows:

(i) The audit committee shall have a minimum 3 directors as members of the audit committee.

(ii) 2/3rd of the members of the audit committee shall be independent directors. In case of a listed entity having outstanding SR equity shares, all the members of the audit committee shall be independent directors.

(iii) All the members of the audit committee shall be financially literate. For this purpose, 'financially literate' shall mean the ability to read and understand basic financial statements.

(iv) At least 1 member of the audit committee shall have accounting or related financial management expertise. For this purpose, a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

(v) The Chairperson of the audit committee shall be an independent director.

The given case and analysis of the case

2. Before M/s MKBTC was listed, it had an audit committee consisting of 7 directors, out of which 4 directors were independent directors. The majority of members of the audit committee had the ability to read and understand the financial statements. However, no member of the audit committee had any accounting or related financial management expertise.
3. Once M/s MKBTC is listed, it shall have to ensure that the composition of its audit committee is in compliance with the provisions of Regulation 18.

Conclusions

4. The audit committee constituted by M/s MKBTC cannot continue after it is listed, and so the audit committee needs to be reconstituted in compliance of the provisions contained in Regulation 18, since –
   (i) after listing, it must have at least 5 directors (i.e. 2/3rd of 7) as independent directors, whereas it has only 4 independent directors;
   (ii) after listing, all the members of the audit committee must be financially literate (i.e. ability to read and understand basic financial statements), whereas only majority of its members are financially literate;
   (iii) after listing, at least 1 member of the audit committee must have accounting or related financial management expertise, whereas no member of the audit committee has accounting or related financial management expertise.

   Also, M/s MKBTC shall ensure that the Chairperson of the audit committee is an independent director.

17.10 Nomination and Remuneration Committee (Regulation 19)

1. **Mandatory constitution of the Nomination and Remuneration Committee**

   It is mandatory for the Board of directors of every listed entity to constitute a Nomination and Remuneration Committee.

2. **Composition of the Nomination and Remuneration Committee**

   (i) The committee shall comprise of at least 3 directors.

   (ii) All the directors of the committee shall be non-executive directors.

   (iii) At least 50% of the directors shall be independent directors.

   In case of a listed entity having outstanding SR equity shares, 2/3rd of the members of the Nomination and Remuneration Committee shall be independent directors.

   (iv) The Chairperson of the committee shall be an independent director.

   (v) The Chairperson of the listed entity, whether executive or non-executive, may be appointed as a member of the Nomination and Remuneration Committee, but he shall not chair the Nomination and Remuneration Committee.

3. **Meetings of the Committee**

   The Nomination and Remuneration Committee shall meet at least once in a year.

4. **Quorum for meetings**

   The quorum for a meeting of the Nomination and Remuneration Committee shall be either 2 members or 1/3rd of the members of the committee, whichever is greater. including at least 1 independent director in attendance.

5. **Presence of the Chairperson at the AGM**

   The Chairperson of the nomination and remuneration committee may be present at the Annual General Meeting to answer the shareholders' queries, but he shall have the discretion to decide as to who shall answer the queries.

17.11 Stakeholders Relationship Committee (Regulation 20)

1. **Mandatory constitution of the Stakeholders Relationship Committee**

   It is mandatory for every listed entity to constitute a Stakeholders Relationship Committee.

2. **Composition of the Stakeholders Relationship Committee**

   (i) The Chairperson of the Committee shall be a non-executive director.

(ii) The Board of directors shall decide other members of the Stakeholders Relationship Committee.

(iii) At least 3 directors, with at least 1 being an independent director, shall be members of the Committee.

In case of a listed entity having outstanding SR equity shares, 2/3rd of the members of the Stakeholders Relationship Committee shall be independent directors.

3. Role of the Stakeholders Relationship Committee

The Stakeholders Relationship Committee shall specifically look into various aspects of interest of shareholders, debenture holders and other security holders.

4. Meetings of the Committee

The Stakeholders Relationship Committee shall meet at least once in a year.

5. Presence of the Chairperson at the AGM

The Chairperson of the Stakeholders Relationship Committee shall be present at the Annual General Meetings to answer queries of the security holders.

17.12 Risk Management Committee (Regulation 21)

1. Mandatory constitution of Risk Management Committee by certain companies

It shall be mandatory for a listed entity to constitute the Risk Management Committee only if it is covered within top 500 listed entities, determined on the basis of market capitalisation, as at the end of the immediately previous financial year.

2. Composition of the Risk Management Committee

(i) Senior executives of the listed entity may be appointed as the members of the Risk Management Committee. However, the majority of members of the Risk Management Committee shall consist of members of the Board of directors.

In case of a listed entity having outstanding SR equity shares, 2/3rd of the members of the Risk Management Committee shall be independent directors.

(ii) Only a director of the listed entity can be appointed as the Chairperson of the Risk management committee.

3. Role and responsibilities of the Risk Management Committee

(i) The Board of directors of the listed entity shall define the role and responsibilities of the Risk Management Committee.

(ii) The Board of directors of the listed entity may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit. Such function shall specifically cover cyber security.

4. Meetings of the Committee

The risk management committee shall meet at least once in a year.

17.13 Related party transactions (Regulation 23)

1. Policy to be formulated

The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the Board of directors and such policy shall be reviewed by the Board of directors at least once in every 3 years and updated accordingly.

Determining materiality

1. A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds 10% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

2. Where a transaction involves payments to a related party with respect to brand usage or royalty, then, with effect from 1st July, 2019, such transaction shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceed 5% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

2. Approvals required for related party transactions

(i) All related party transactions shall require prior approval of the audit committee.

(ii) Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to certain conditions.

(iii) In case, a transaction is a material related party transaction, –

(a) it shall require approval of the shareholders through a resolution; and

(b) the related party shall not vote to approve such resolution.

Where a resolution plan is approved under section 31 of the Insolvency and Bankruptcy Code, 2016, no approval of the shareholders shall be required if the same is disclosed to the recognized stock exchanges within 1 day of the resolution plan being approved.

3. Approval required for related party transactions entered into prior to coming into force of these Regulations

All existing material related party contracts or arrangements entered into prior to the date of notification of these Regulations and which may continue beyond such date shall be placed for approval of the shareholders in the first general meeting subsequent to notification of these regulations.

4. Disclosures

The listed entity shall submit within 30 days from the date of publication of its standalone and consolidated financial results for the half year, disclosures of related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges and publish the same on its website.

17.14 Corporate governance requirements with respect to subsidiary of a listed entity (Regulation 24)

1. Requirements with respect to Board of directors of unlisted material subsidiary

At least 1 independent director on the Board of directors of the listed entity shall be a director on the Board of directors of an unlisted material subsidiary, whether incorporated in India or not.

For the purpose of Regulation 24, the term 'material subsidiary' shall mean a subsidiary, whose income or net worth exceeds 20% of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

2. Review of financial statements and minutes of Board meetings of unlisted subsidiary

(i) The audit committee of the listed entity shall also review the financial statements, in particular, the investments made by the unlisted subsidiary.

(ii) The minutes of the meetings of the Board of directors of the unlisted subsidiary shall be placed at the meeting of the Board of directors of the listed entity.

3. Disclosures of significant transactions or arrangements of unlisted subsidiary

The management of the unlisted subsidiary shall periodically bring to the notice of the Board of directors of the listed entity, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary.

For this purpose, the term 'significant transaction or arrangement' shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the unlisted subsidiary for the immediately preceding accounting year.

4. Requirements for reduction of shareholding below 50% in material subsidiary

(i) Except by passing a special resolution in its general meeting, a listed entity shall not –

(a) dispose of shares in its material subsidiary resulting in reduction of its shareholding (either on its own or together with other subsidiaries) to less than 50%; or

(b) cease the exercise of control over the subsidiary.

(ii) However, special resolution shall not be required where such divestment is made –

(a) under a scheme of arrangement duly approved by a Court/Tribunal; or

(b) under a resolution plan duly approved under section 31 of the Insolvency and Bankruptcy Code, 2016 and such an event is disclosed to the recognized stock exchanges within 1 day of the resolution plan being approved.

5. **Requirements for sale of assets of the material subsidiary exceeding 20%**

(i) Selling, disposing and leasing of assets exceeding 20% of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution.

(ii) However, special resolution shall not be required where such divestment is made –

(a) under a scheme of arrangement duly approved by a Court/Tribunal; or

(b) under a resolution plan duly approved under section 31 of the Insolvency and Bankruptcy Code, 2016 and such an event is disclosed to the recognized stock exchanges within 1 day of the resolution plan being approved.

17.15 Restrictions on number of committees in which a director can be a member (Regulation 26)

1. **Limit on membership and chairmanship of committees**

(a) A director shall not be a member in more than 10 committees.

(b) A director shall not act as Chairperson of more than 5 committees across all listed entities in which he is a director.

(i) The limit of the committees on which a director may serve in all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies and companies under section 8 of the Companies Act, 2013 shall be excluded.

(ii) For the purpose of determination of limit, Chairpersonship and membership of the Audit Committee and the Stakeholders' Relationship Committee alone shall be considered.

2. **Duty of director to inform his committee positions to the listed entity**

Every director shall inform the listed entity about the committee positions he or she occupies in other listed entities and notify changes as and when they take place.

17.16 Other corporate governance requirements (Regulation 27)

1. **Compliance with discretionary requirements**

The listed entity may, at its discretion, comply with requirements as specified in Part E of Schedule II (*e.g.* the internal auditor may report directly to the audit committee; the listed entity may appoint separate persons to the post of Chairperson and managing director or chief executive officer; the listed entity may move towards a regime of financial statements with unmodified audit opinion).

2. **Filing of compliance report on corporate governance**

(i) The listed entity shall submit a quarterly compliance report on corporate governance to the recognised stock exchange(s).

(ii) The quarterly compliance report shall be in the format as specified by the Board from time to time.

(iii) The quarterly compliance report shall be submitted within 15 days from close of the quarter.

(iv) Details of all material transactions with related parties shall be disclosed along with the quarterly compliance report.

(v) The quarterly compliance report shall be signed either by the compliance officer or the chief executive officer of the listed entity.

17.17 Prior intimations of Board meetings (Regulation 29)

1. **Intimation for certain specified events**

The listed entity shall give prior intimation to the stock exchange(s) about the meeting of the Board of directors in which any of the following proposals is due to be considered:

(a) Issue of convertible securities

(b) Fund raising by way of further public offer, rights issue, American Depository Receipts / Global Depository Receipts / Foreign Currency Convertible Bonds, Qualified Institutions Placement, debt issue, preferential issue or any other method

(c) Proposal for buy-back of securities

(d) Proposal for voluntary delisting by the listed entity from the stock exchange(s)

(e) Declaration / recommendation of dividend

(f) The proposal for declaration of bonus shares.

The intimation shall be given at least 2 working days in advance, excluding the date of the intimation and date of the Board meeting.

2. **Intimation of Board meeting for considering the financial results**

The listed entity shall give prior intimation to the stock exchange(s) about the meeting of the Board of directors in which financial results (*viz.* quarterly, half yearly, or annual, as the case may be) are to be considered.

The intimation shall be given at least 5 working days in advance, excluding the date of the intimation and date of the Board meeting.

3. **Intimation of Board meeting for considering certain alterations**

The listed entity shall give intimation to the stock exchange(s) about the meeting of the Board of directors in which any of the following proposals is due to be considered:

(a) Any alteration in the form or nature of any of its securities that are listed on the stock exchange or in the rights or privileges of the holders thereof.

(b) Any alteration in the date on which, the interest on debentures or bonds, or the redemption amount of redeemable shares or of debentures or bonds, shall be payable.

The intimation shall be given at least 11 working days in advance, excluding the date of the intimation and date of the Board meeting.

17.18 Holding of specified securities and shareholding pattern (Regulation 31)

1. **Submission of shareholding pattern etc.**

(i) The listed entity shall submit to the stock exchange(s) a statement showing –

(a) holding of securities; and

(b) shareholding pattern.

(ii) The above statement shall contain the information separately for each class of securities.

(iii) The statement shall be in the format specified by the Board from time to time.

(iv) The statement shall be submitted within the following timelines:

(a) 1 day prior to listing of its securities on the stock exchange(s);

(b) On a quarterly basis, within 21 days from the end of each quarter; and

(c) Within 10 days of any capital restructuring of the listed entity resulting in a change exceeding 2% of the total paid-up share capital.

In case of listed entities which have listed their specified securities on SME Exchange, the above statements shall be submitted on a half yearly basis within 21 days from the end of each half year.

2. **Promoters' shareholding to be in dematerialized form**

The listed entity shall ensure that 100% of shareholding of promoter(s) and promoter group is in dematerialized form and the same is maintained on a continuous basis in the manner as specified by the Board.

3. Compliance of circulars and directions

The listed entity shall comply with circulars or directions issued by the Board from time to time with respect to maintenance of shareholding in dematerialized form.

4. Disclosure of entities falling under promoter and promoter group

All entities falling under promoter and promoter group shall be disclosed separately in the shareholding pattern appearing on the website of all stock exchanges having nationwide trading terminals where the specified securities of the entity are listed, in accordance with the formats specified by the Board.

17.19 Statement of deviation(s) or variation(s) (Regulation 32)

1. Submission of statements w.r.t. public issues, right issues, preferential issues, etc.

(i) The listed entity shall submit the following statement(s) to the stock exchange:

(a) With respect to every public issue, rights issue, preferential issue etc., the statement shall contain the deviations, if any, in the use of proceeds from the objects stated in the offer document or explanatory statement annexed to the notice of the general meeting, as applicable;

(b) With respect to every public issue, rights issue, preferential issue etc., the statement shall contain category wise variation (capital expenditure, sales and marketing, working capital etc.) between projected utilisation of funds made by it in its offer document or explanatory statement annexed to the notice of the general meeting, as applicable and the actual utilisation of funds.

(ii) The statements shall be submitted on quarterly basis.

(iii) The statements shall be continued to be given till such time the issue proceeds have been fully utilised or the purpose for which these proceeds were raised has been achieved.

2. Disclosures of variations in the annual report

The listed entity shall furnish an explanation for the variations in the directors' report in the annual report.

3. Disclosures of utilisation of funds raised through preferential allotment, etc.

Where a listed entity has raised funds through preferential allotment or qualified institutions placement, it shall disclose every year, the utilisation of such funds during that year in its Annual Report until such funds are fully utilised.

17.20 Compliances by listed entities – At quarterly intervals

1. Duty to file a statement containing number of investor complaints (Refer Regulation 13)
2. Submission of compliance report on corporate governance (Refer Regulation 27)
3. Submission of shareholding pattern etc. (Refer Regulation 31)
4. Submission of statements w.r.t. public issues, right issues, preferential issues, etc. (Refer Regulation 32)
5. Submission of quarterly financial results (Refer Regulation 33)

17.21 Compliances by listed entities – At yearly intervals

1. Submission of annual audited standalone financial results for the financial year, within 60 days from the end of the financial year (Refer Regulation 33).
2. Submission of the annual report to the stock exchange on or before the day of commencement of dispatch to the shareholders (Refer Regulation 34).
3. Annual report to be sent to the shareholders not less than 21 days before the Annual General Meeting (Refer Regulation 36).

17.22 Financial results (Regulation 33)

1. Manner of preparation of financial results

The financial results shall be prepared on the basis of accrual accounting policy and shall be in accordance with uniform accounting practices adopted for all the periods.

2. Manner of approval and authentication of financial results

(i) The quarterly financial results submitted shall be approved by the Board of directors.

(ii) While placing the financial results before the Board of directors, the chief executive officer and chief financial officer of the listed entity shall certify that the financial results do not contain any false or misleading statement or figures and do not omit any material fact which may make the statements or figures contained therein misleading.

(iii) The financial results submitted to the stock exchange shall be signed by the Chairperson or managing director, or a whole time director or in the absence of all of them; it shall be signed by any other director of the listed entity who is duly authorized by the Board of directors to sign the financial results.

3. Submission of financial results

(i) The listed entity shall submit quarterly and year-to-date standalone financial results to the stock exchange within 45 days of end of each quarter, other than the last quarter.

(ii) In case the listed entity has subsidiaries, the listed entity shall also submit quarterly / year-to-date consolidated financial results.

(iii) The quarterly and year-to-date financial results may be either audited or unaudited.

(iv) The listed entity shall submit annual audited standalone financial results for the financial year, within 60 days from the end of the financial year, along with the audit report and Statement on Impact of Audit Qualifications (applicable only for audit report with modified opinion). However, in case of audit report with unmodified opinion(s), the listed entity shall furnish a declaration to that effect to the Stock Exchange(s) while publishing the annual audited financial results.

Difference in legal provisions as compared to the legal provisions included in the Study Material issued by ICAI

The requirement with respect to submission of standalone financial results, as contained in the Study Material issued by ICAI is as under:

"Listed entity shall submit audited standalone financial results for the financial year, along with the audit report and either Form A (for audit report with unmodified opinion) or Form B (for audit report with modified opinion) within 60 days from end of Financial Year."

By SEBI (LODR) (Amendment) Regulations, 2016, w.e.f. 01.04.2016, the words ***"The listed entity shall submit audited standalone financial results for the financial year, within sixty days from the end of the financial year along with the audit report and either Form A (for audit report with unmodified opinion) or Form B (for audit report with modified opinion)"*** *were replaced by the words* ***"The listed entity shall submit annual audited standalone financial results for the financial year, within sixty days from the end of the financial year along with the audit report and Statement on Impact of Audit Qualifications (applicable only for audit report with modified opinion)"***.

The implications of the amendment made by SEBI (LODR) (Amendment) Regulations, 2016 are as follows:

1. The requirement of filing Form A or Form B along with the annual financial results has been dispensed with.
2. In case of Audit Reports with modified opinions (*i.e.* Qualified Audit Reports), a Statement on Impact of Audit Qualifications is required to be submitted.

It is evident that the amendment made by SEBI (LODR) (Amendment) Regulations, 2016 has not been incorporated by ICAI in the Study Material.

The students are advised not to put any query to the Author of this Book in this regard. The students may, if they deem fit, inquire in this regard from the Board of Studies, ICAI.

(v) The listed entity shall also submit the audited or limited reviewed financial results in respect of the last quarter alongwith the results for the entire financial year, with a note stating that the figures of last quarter are the balancing figures between audited figures in respect of the full financial year and the published year-to-date figures up to the third quarter of the current financial year.

(vi) The listed entity shall also submit as part of its standalone and consolidated financial results for the half year, by way of a note, statement of cash flows for the half year.

(vii) The listed entity shall ensure that, for the purposes of quarterly consolidated financial results, at least 80% of each of the consolidated revenue, assets and profits, respectively, shall have been subject to audit or in case of unaudited results, subjected to limited review.

(viii) The listed entity shall disclose, in the results for the last quarter in the financial year, by way of a note, the aggregate effect of material adjustments made in the results of that quarter which pertain to earlier periods.

4. **Duty of the statutory auditor**

The statutory auditor of a listed entity shall undertake a limited review of the audit of all the entities/companies whose accounts are to be consolidated with the listed entity as per AS 21 in accordance with guidelines issued by the Board on this matter.

17.23 Annual report (Regulation 34)

1. **Submission of the annual report**

The listed entity shall submit to the stock exchange and publish on its website –

(a) a copy of the annual report sent to the shareholders along with the notice of the annual general meeting not later than the day of commencement of dispatch to its shareholders;

(b) in the event of any changes to the annual report, the revised copy along with the details of and explanation for the changes shall be sent not later than 48 hours after the annual general meeting.

2. **Contents of the annual report**

The annual report shall contain the following:

(a) Audited financial statements, *i.e.* balance sheets, profit and loss account etc., and Statement on Impact of Audit Qualifications as stipulated in Regulation 33, if applicable

(b) Consolidated financial statements audited by its statutory auditors

(c) Cash flow statement presented only under the indirect method as prescribed in Accounting Standard-3 or Indian Accounting Standard 7, as applicable

(d) Directors report

(e) Management discussion and analysis report

(f) Business responsibility report describing the initiatives taken by them from an environmental, social and governance perspective, in the format as specified by the Board from time to time (this disclosure is required only for the top 1,000 listed entities based on market capitalization, calculated as on March 31 of every financial year).

Other disclosures

The annual report shall contain all other disclosures –

(a) as specified in the Companies Act, 2013; and

(b) as specified in Schedule V of these Regulations.

17.24 Documents and information to shareholders (Regulation 36)

1. **Time limit for sending annual report to shareholders**

The listed entity shall send annual report to the holders of securities, not less than 21 days before the Annual General Meeting.

2. **Manner of sending annual report**

The listed entity shall send the annual report in the following manner to the shareholders:

(a) Soft copies of full annual report to all those shareholder(s) who have registered their email address(es) either with the listed entity or with any depository.

(b) Hard copy of statement containing the salient features of all the documents, as prescribed in section 136 of Companies Act, 2013 or rules made thereunder to those shareholder(s) who have not so registered.

(c) Hard copies of full annual reports to those shareholders, who request for the same.

3. **Disclosures in case of appointment or reappointment of directors**

In the case of appointment of a new director or re-appointment of a director, the shareholders must be provided with the following information:

(a) A brief resume of the director

(b) Nature of his expertise in specific functional areas

(c) Disclosure of relationships between directors *inter-se*

(d) Names of listed entities in which the person also holds the directorship and the membership of Committees of the Board of directors

(e) Shareholding of non-executive directors.

17.25 Record date or date of closure of transfer books (Regulation 42)

1. **Intimation of record date in certain cases**

The listed entity shall intimate the record date for the following events to all the stock exchange(s) where it is listed or where stock derivatives are available on the stock of the listed entity or where listed entity's stock form part of an index on which derivatives are available:

(a) Declaration of dividend

(b) Issue of right shares or bonus shares

(c) Issue of shares for conversion of debentures or any other convertible security

(d) Shares arising out of rights attached to debentures or any other convertible security

(e) Corporate actions like mergers, de-mergers, splits, etc.

(f) Such other purposes as may be specified by the stock exchange(s).

Time limit for giving intimation

The intimation shall be given to the stock exchange(s) by the listed entity at least 7 working days (excluding the date of intimation and the record date) before the record date. The intimation shall specify the purpose of the record date.

However, in the case of rights issues, the listed entity shall give notice in advance of at least 3 working days (excluding the date of intimation and the record date).

2. **Time limit for recommending or declaring dividend**

The listed entity shall recommend or declare all dividend and/or cash bonuses at least 5 working days (excluding the date of intimation and the record date) before the record date fixed for the purpose.

3. **Time gap between two record dates**

The listed entity shall ensure the time gap of at least 30 days between two record dates.

17.26 Website (Regulation 46)

1. **Mandatory to maintain a functional website**

(a) The listed entity shall maintain a functional website containing the basic information about the listed entity.

(b) The listed entity shall ensure that the contents of the website are correct.

2. **Mandatory dissemination of certain information**

The listed entity shall disseminate the following information under a separate section on its website:

(a) Details of its business

(b) Terms and conditions of appointment of independent directors

(c) Composition of various committees of Board of directors

(d) Code of conduct of Board of directors and senior management personnel

(e) Details of establishment of vigil mechanism / Whistle Blower policy

(f) Criteria of making payments to non-executive directors, if the same has not been disclosed in annual report

(g) Policy on dealing with related party transactions

(h) Policy for determining 'material' subsidiaries

(i) Details of familiarization programmes imparted to independent directors

(j) The email address for grievance redressal and other relevant details

(k) Contact information of the designated officials of the listed entity who are responsible for assisting and handling investor grievances

(l) Financial information including complete copy of the annual report including balance sheet, profit and loss account, directors report, corporate governance report etc.

(m) Shareholding pattern

(n) Details of agreements entered into with the media companies and / or their associates, etc.

(o) New name and the old name of the listed entity for a continuous period of 1 year, from the date of the last name change.

(p) All credit ratings obtained by the entity for all its outstanding instruments, updated immediately as and when there is any revision in any of the ratings.

(q) Separate audited financial statements of each subsidiary of the listed entity in respect of a relevant financial year, uploaded at least 21 days prior to the date of the annual general meeting which has been called to *inter alia* consider accounts of that financial year.

3. Updation of changes in the contents of the website

The listed entity shall update any change in the content of its website within 2 working days from the date of such change in content.