PAPER – 5

BUSINESS LAWS & ETHICS

CMA INTERMEDIATE

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I really liked your classes, especially the practical linkages explained with amazing graphics. The full subject test serieshelped a lot in improving my writing speed and presentation skills.

Sundar Sri Renganathan B (AIR 33)

I took Accounting from IndigoLearn and the classes were really good. They emphasized on conceptual clarity over getting things done quickly, which is really vital to score good marks in practical papers. Other resources like Notes, Quizzes and Forum was beneficial too.

Dwarakesh

Thank you IndigoLearn team for the guidance and support throughout the past few months. I had great conceptual clarity in all the subjects and the revision classes by Suraj Sir were very helpful. Study planner and Free resources were very useful. Thank you Team IndigoLearn.

Yug Manoj Kumar Bhattad

I have cleared my CA Foundation examination with the total of 286. And this was not possible without the efforts and support of IndigoLearn. The way of teaching with utmost conceptual clarity is the best thing at Indigolearn.

Prakash Bhatt

Superb, one stop solution for All CA and Accountancy students they serve real Education at very very reasonable price

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Good experience, unlimited views helped a lot in last one month preparation. Looking forward for

Bhagyasree Chougule

It was only because of Indigolearn that my concepts became very clear, and I was able to crack the exam. I wasn't 100% prepared I needed more practice but luckily I got through. I'm definitely choosing IndigoLearn for group 2 preparation. A big thanks!

Mohd Thayyab

Theoretical subjects made easier through story based examples and charts. Concept clarity 100%. Fully exam+practical oriented classes will help not only to retain the concepts during exams but for the longer duration.

Lalit Chetan Sanpal

Indigolearn has been fantastic and brilliant. Helped me alot in my preparations. I cleared both the groups in first attempt with your brilliant classes and notes. Thanks to all the faculties, coordinators, forum admins and everyone at Indigolearn. Really grateful. Will go for CA Finals at Indigolearn For sure. Thank you so much Indigolearn.

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Abishek M

I'd like to thank IndigoLearn for all the support they've provided me with. Modules were great. They were time saving and straight to the point. I extensively used the materials provided before exams, they were so helpful. Also I'd appreciate them for providing unlimited views as I kept looking into the maths modules till the end.

Munnur Nandini Sree

Accounting classes I have taken from IndigoLearn. Now I feel that it's a great choice that I have made (after seeing my result) because only in Accounting I got exemption. Thank you IndigoLearn.

Harshita G

Thank u so much IndigoLearn for your guidance. This is only possible because of u people.... For my finals also my journey will continue with IndigoLearn.

Bharathsha PS

I purchased Economics, IT, FM, EIS and Audit from Indigolearn. All your classes are superb and anyone can easily crack the CA exams. What makes u special is your classes help us to understand the concepts very well.Special thanks to the FM faculty, I studied only 2 chapters in economics,and still managed to score excemption in the 8th paper.

Nayi Mihir kumar

This platform is very helpful in all activity like mcq practise, notes, teaching activities, revisions and the forum interaction with all students which I like the most. If anybody want to clear their exams in first attempt then IndigoLearn is the best platform for them. My all regards to IndigoLearn. Thank you so much.

Rajalaxmi
CA Inter

Can't believe I cleared.Sathya Sir, Suraj Sir, Yogita Mam ... thanks to all my faculties. Basically an Eng student with zero accounts knowledge. Thanks IndigoLearn for making me clear in first attempt.

Priyanka Udeshi

All the faculties have excellent knowledge of the subject and deliver it in very crisp & effective manner. Also, quick response at Forums never let any of my doubts go unresolved no matter how small they were. Thank you once again to all the teachers & staff at IndigoLearn!

Naveen Kumar T

It been a great journey with indigo learn team. Thanks to all the facilities and forum friends who support me a lot.

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Index Page #

Chapter 1: The Indian Contract Act, 1872

- Unit 1: Nature of Contracts 1
- Unit 2: Consideration 23
- Unit 3: Other Essential Elements of a Contract 32
- Unit 4: Performance of a Contract 59
- Unit 5: Breach of Contract And Its Remedies 64
- Unit 6: Contingent and Quasi Contracts 73
- Unit 7: Contract of Indemnity And Guarantee 83
- Unit 8: Bailment And Pledge 93
- Unit 9: Agency 107

Chapter 2: The Sale of Goods Act, 1930

- Unit 1: Formation of the Contract of Sale 122
- Unit 2: Conditions & Warranties 136
- Unit 3: Transfer Of Ownership And Delivery Of Goods 150
- Unit 4: Unpaid Seller 168

Chapter 3: The Partnership Act, 1932

- Unit 1: General Nature of Partnership 183
- Unit 2: Relations of Partners 196
- Unit 3: Registration And Dissolution Of A Firm 214

Chapter 4: The Limited Liability Partnership Act, 2008 226

Chapter 5: The Companies Act, 2013 253

Chapter 6: The Negotiable Instruments Act, 1881 502

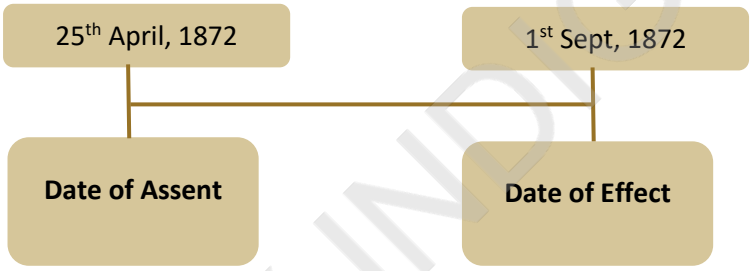
CH-1: UNIT 1 – NATURE OF CONTRACTS

Learning Outcomes –

- Agreement vs. Contract
- Essential elements of a contract.
- Types of contracts.
- Offer and acceptance
- Rules of communication of offer and acceptance
- Modes of revocation of offer

1. Introduction

The Law of Contract is the most important branch of mercantile law. It has an impact on trade, commerce and industry.



Preamble of the Act:
It is an Act to define and amend certain parts of the law relating to contract.

- The Indian Contract Act, 1872 codifies the legal principles that govern 'contracts'. The basically identifies the ingredients of a legally enforceable valid contract in addition to dealing with special type of contractual relationships.

2. Important terms

2.1 Contract

Definition as per Section 2(h):
It defines contract as – "An agreement enforceable by law."

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- Enforceability by law means giving rise to legal obligation. Domestic and Social obligations are

> Contract = Agreement + Enforceability by law

out of scope of the Contract Act, as they are not legally enforceable.

2.2 Agreement
2.3 Promise

3. Types of Agreement

Definition as per Section 2(e):

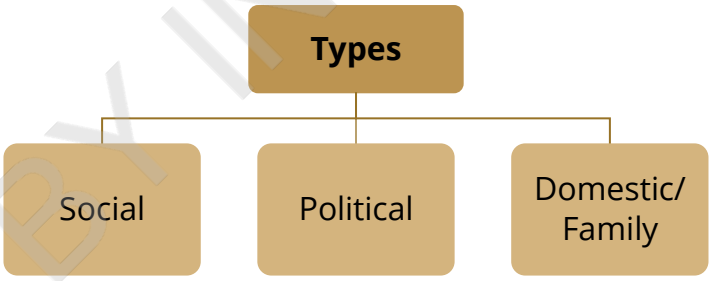
It defines Agreement as "every promise and every set of promises, forming the consideration for each other."

Definition as per Section 2(b):

Promise means "when a person to whom proposal is made signifies his assent on that proposal, the proposal becomes accepted. Accepted proposal becomes a promise."

> Agreement = Promise *(Accepted proposal)* + Consideration

> Promise = Offer/Proposal + Acceptance



4. Difference between Agreement and Contract

Basis of Difference	Agreement	Contract
Enforceability by law	May not be legally enforceable	Legal enforceability
Definitions	Section 2(e) Every promise or set of promises forming consideration for each other (Offer + Acceptance)	Section 2(h) An agreement enforceable by law (Agreement + Legal Enforceability)

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Scope	It is wider term including both legal and social agreement	It is used in narrow sense due to its legal enforceability
Nature	All agreements are not contracts	All contracts are agreement

All Contracts are Agreements, but all Agreements are not Contracts

- Contract = Agreement + Enforceability by law. Thus, for a Contract, there should first be an Agreement.
- Agreements that do not give rise to contractual obligations are not Contracts.

> A invites B for his son's wedding. B accepts the invitation. This is a mere agreement, not a Contract, there being **no intention to create legal obligation.**

- Agreements to do an unlawful, immoral or illegal act, like smuggling or murdering a person, cannot be enforceable by law. Such agreements cannot be considered as a Contract.
- Also, certain Agreements are specifically declared Void or Unenforceable. **Example:** Agreements to bet i.e., wagering Agreements, Agreements in restraint of trade, agreements to do an impossible act, etc.

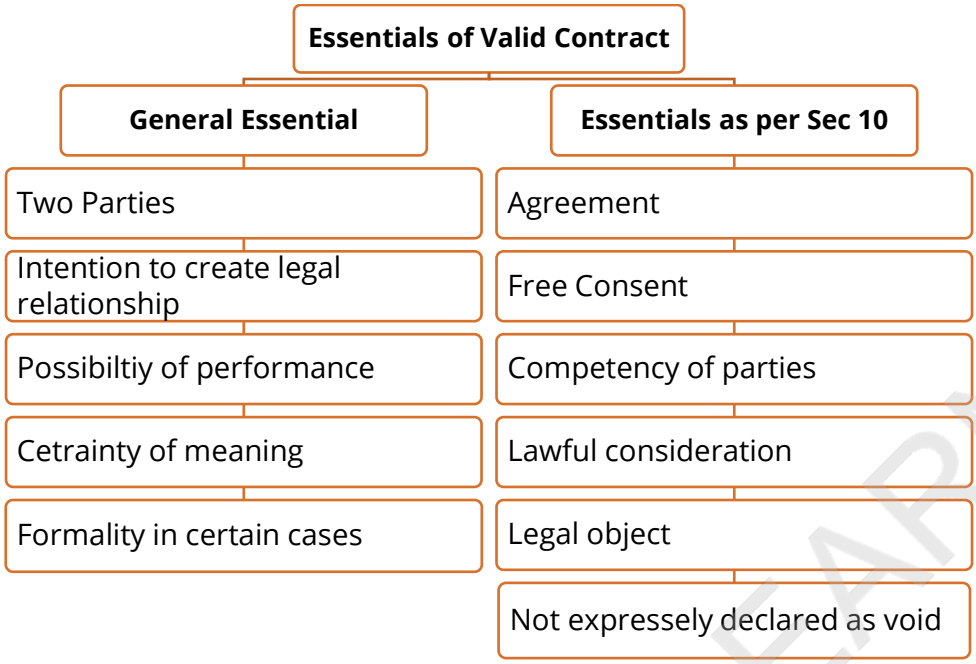
> Hence, **all Agreements are not Contracts**, but **all contracts are** in fact **Agreements.**

5. Essentials of a Valid Contract

- The essential are given in Section 10 but this section is not complete and exhaustive. Therefore, there are some general essentials apart from the essential given in Section 10.

> **Definition as per Section 10:**
> All ***agreements*** are contracts if they are made by the ***free consent*** of the parties ***competent to contract***, for a ***lawful consideration*** and with a ***lawful object*** and are ***not expressly declared to be void***.

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- These essential elements must be present in a contract, if these elements are not present in a contract, then the contract is not valid.
- Both general essentials and elements given in Section 10 shall be present in a contract for it to be a valid contract.

5.1 General Essential Elements

5.1.1 Two Parties

- A person cannot enter into a contract with himself, a contract involves at least two parties.
- A contract can be made by either natural persons or other persons having legal existence.

5.1.2 The identities of the parties shall be ascertainable.

Case Law: State of Gujarat Vs. Ramanlal S & Co

Facts: When on dissolution of a partnership, the assets of the firm were divided among the partners, the sales tax officer wanted to tax this transaction.

Judgement: It was held that it was not a sale. The partners being joint owner of those assets cannot be both buyer and seller.

5.1.3 Parties must be intended to create legal relationship

- There must be an intention on the part of the parties to create legal relationship between them.

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- Social or domestic type of agreements are not enforceable in court of law and hence they do not result into contracts.

5.1.4 Certainty of meaning

- The agreement must be certain, definite and not vague.

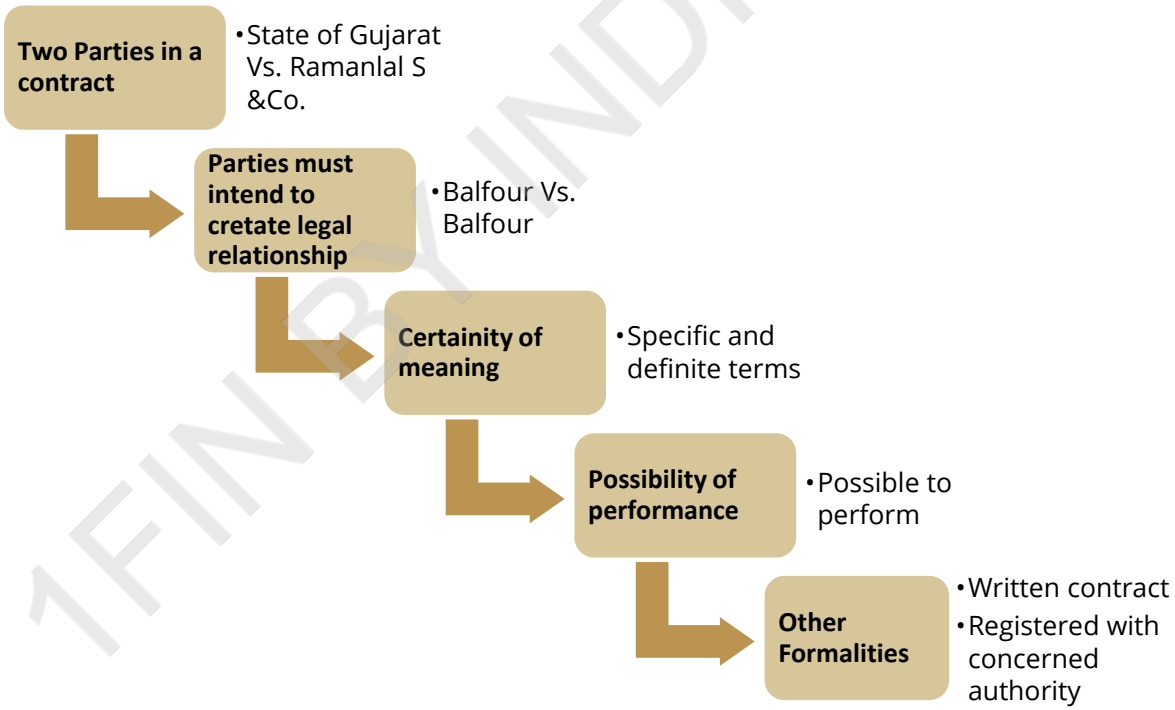
> ***Case Law: Balfour Vs. Balfour***
>
> **Facts:** A husband agreed to pay to his wife certain amount as maintenance every month while he was abroad. Husband failed to pay the promised amount. Wife sued him for the recovery of the amount.
>
> **Judgement:** Wife could not recover the amount as it was a social agreement, and the parties did not intend to create any legal relations.

5.1.5 Possibility of performance

- The terms of agreement should be capable of performance. An agreement to do an act impossible in itself cannot be enforced.

5.1.6 Formalities in certain cases

- A contract may be written or spoken. In case of certain contracts some other formalities have to be complied with to make an agreement legally enforceable.



5.2 Essential elements under section 10

5.2.1 Agreement

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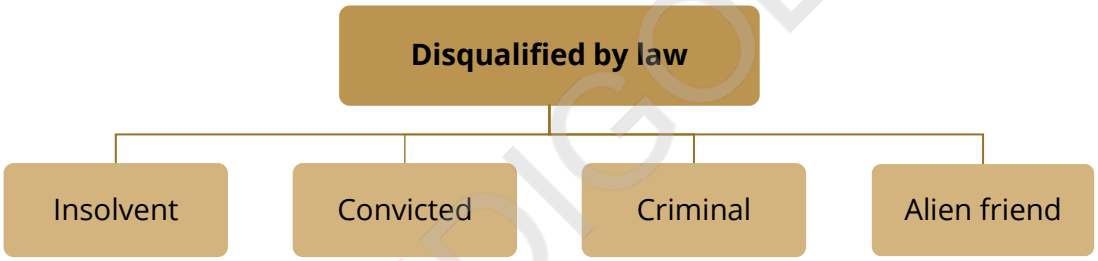
- An Agreement is the first essential element of a valid contract. It is a result of offer and acceptance. A Contract will not come into existence if there's no agreement.

5.2.2 Free Consent

- Consent means agreeing upon the same thing in the same sense. The consent shall be free (i.e.) the parties must willingly enter into the contract.
- Consent is said to be free when it is not caused by Coercion, Undue Influence, Fraud, Misrepresentation or mistake.

5.2.3 Capacity of parties

- Capacity to contract means the legal ability of a person to enter into a valid contract. A person is competent to contract if he satisfies all the given conditions:
  - He attained the age of majority
  - He is a person of sound mind
  - Is not disqualified by law



5.2.4 Lawful Consideration

- A valuable consideration may consist either some right, interest, profit, benefit accruing to one party or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.

Latin Maxim for consideration
"Quid pro quo"

5.2.5 Lawful object

- The object and consideration must be lawful (i.e) it should not be prohibited by law or opposed to public policy.

5.2.6 Not expressly declared to be void

- The agreement entered into must not be which the law declares to be either illegal or void. A void agreement is one without any legal effects.
- For a contract to be valid contract it must not be expressly declared as void by law
- It should not be
  - Immoral
  - Opposed to public policy

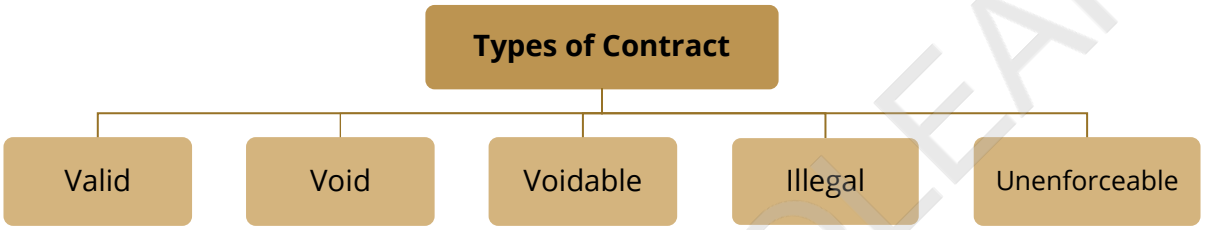
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- Injurious
- Forbidden by law

6. Types of Contract

- Contracts are divided into three types based on the following
  - Validity or enforceability
  - Formation
  - Performance

6.1 Validity or Enforceability



6.1.1 Valid Contract

The Valid Contract is an agreement that is legally binding and enforceable. It must qualify all the essentials of a contract.

6.1.2 Void Contract

Definition:
The ***section 2(j)*** of the Act defines a void contract as "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable".

- A void contract is a contract not enforceable by law
- Contract that is valid at the inception but due to happening of an event the contract becomes void at later date
- A contract that is void since its inception is Void ab initio

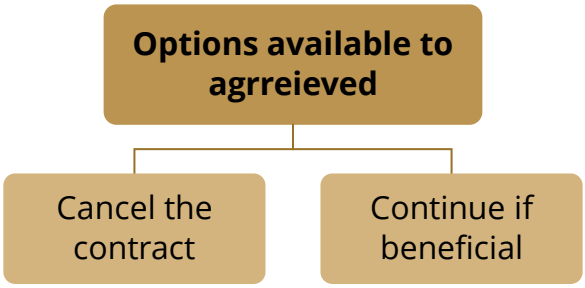
A contract made with minor is ***void ab initio***

Example: Arijit Sigh and Event organizer enter into a contract, where Arijit Singh will give a live performance at a Concert organized by the Event organizer and will receive ₹ 10,00,000 as consideration. Just a day before the concert, Arijit Singh meets with an accident and got his leg fractured. In this situation the contract has now become void since it is no longer enforceable.

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6.1.3 Voidable Contract

- An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.
- A voidable contract is a Valid Contract.
- In a voidable contract, at least one of the parties has to be bound to the terms of the contract.
- The other party is not bound and may choose to repudiate or accept the terms of the contract.



- Consent in a contract is obtained by-
  - Fraud
  - Undue- influence
  - Misrepresentation

Example: Punit points a gun at Hiten's forehead and makes him enter a contract of sale of his house to Punit for Rs. 10,00,000 only. In this situation, Hiten's consent is not free as he is forced to enter into the contract due to the threat to his life. The contract is voidable at Hiten's option.

Difference between Void and Voidable Contract

Void Contract	Voidable Contract
Sec-2(g): Agreement which is not enforceable by law	***Sec-2(i)***: Agreement in which one of the two parties have the option to enforce or rescind it.
Subsequent happening of uncertain events or change in circumstances	Consent is not free
No rights to the parties	Aggrieved party has certain rights
Contract cannot be performed at all	Contract is valid until the aggrieved party does not revoke it

6.1.4 Illegal Contract

- An agreement that leads to one or all the parties breaking a law or not conforming to the norms of the society is deemed to be illegal by the court. A contract opposed to public policy is also illegal.
  Example: Rohit enters into a contract with Rohan and directs him to kill Sanjay for ₹ 1 Lakh. Although this contract has all the essential elements of a valid contract, it is still illegal.

Illegal contracts are ***void ab initio*** since the beginning

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Difference between Void and Voidable Contract

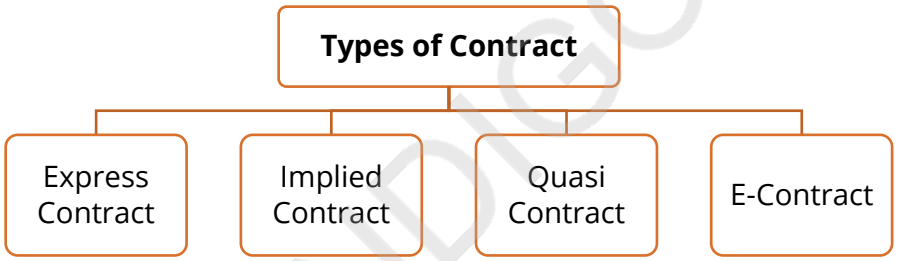
Void Contract	Illegal Contract
Not forbidden by law	Forbidden by law
Contracts are not illegal	Contracts are always void
Parties are not liable for punishment	Parties are liable for punishment
Collateral agreements are enforceable by law	Collateral agreements are also illegal

6.1.5 Unenforceable Contract

- Unenforceable contracts are rendered unenforceable by law due to some technical defect.

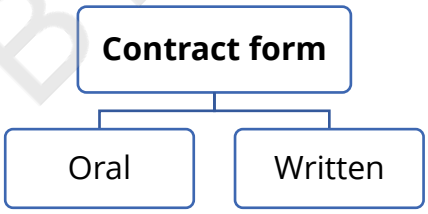
  Example: Raj borrowed ₹ 1 Lakh from Rohan and promised to pay the same back within one year. Rohan filed a case against Raj after six years and court denied the case as the same was barred by limitation. Hence, it became an Unenforceable Contract

6.2 Formation



6.2.1 Express Contract

- The terms of the Express Contract are clearly stated either orally or in writing.
- So, the main aspect of the Express Contract is that the terms of the contract are expressed clearly.



Example: A person proposes to his friend an offer to sell his i-Phone 12 Pro for ₹ 4,500. His friend agrees to buy the phone and gives confirmation over a call. This was an Express Contract.

6.2.2 Implied Contract

- A contract in which the terms of the agreement are not expressed in written or oral form is an implied contract.
- These contracts come into existence by implication.
- This implication is by action or conduct of parties or course of dealing.

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Example: A person boarded a bus that travelled from Kashmir to Kanyakumari. The conductor arrived at his seat and asked to pay fare for the journey. This became an Implied Contract since the person had boarded the bus with an intention to travel.

- **Tacit Contracts:** They are a sub-type of implied contracts; these contracts are inferred by the conduct of the parties without any words spoken or written. It is not a separate type of contract; it falls within the scope of implied contracts.
  Example: A person enters the ATM and inserts the card in order to withdraw money. This is a tacit (silent) Contract by the action of the parties.

6.2.3 Quasi Contract

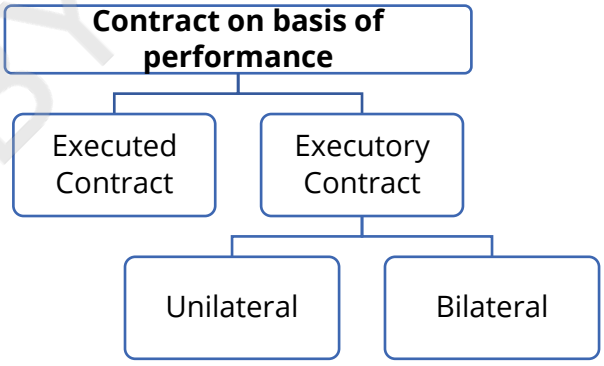
- They are not contracts in the sense that no agreements are made between any of the parties.
- It comes into existence by a court order or under law.
- It is thus enforced by the law which also creates it.
- Most of the times the quasi-contract is created to stop any of the parties from taking unfair advantage of the other.

Example: Finder of lost goods to return the goods to the original owner. This is a Quasi Contract which is imposed by the law

6.2.4 E-Contract

- When a contract is formed by the use of electronic devices and means, it is called an electronic contract or an e-contract.
- The electronic means and devices may include emails, tests, telephones, digital signatures etc. They are also known as the Cyber contracts, the EDI contracts or the Electronic Data Interchange contracts.

6.3 Performance



6.3.1 Executed Contract

- When the parties to the contract perform their obligations under a contract, the contract is executed in nature.

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Example: Mr. A goes to a general store, buys some goods, and pays to the shopkeeper for the goods. This is an Executed Contract where both the parties have performed their respective obligations.

6.3.2 Executory Contract

- In Executory contracts, the consideration is reciprocal promise or obligation.
- Such consideration is to be performed in future only and therefore these contracts are described as executory contracts.
  Example: Mr. A goes to a general store, buys some goods on credit. Mr. A promises to pay to the shopkeeper for the goods after a week. This is an Executory Contract where one party has performed his obligation and other party has not yet performed his obligation.

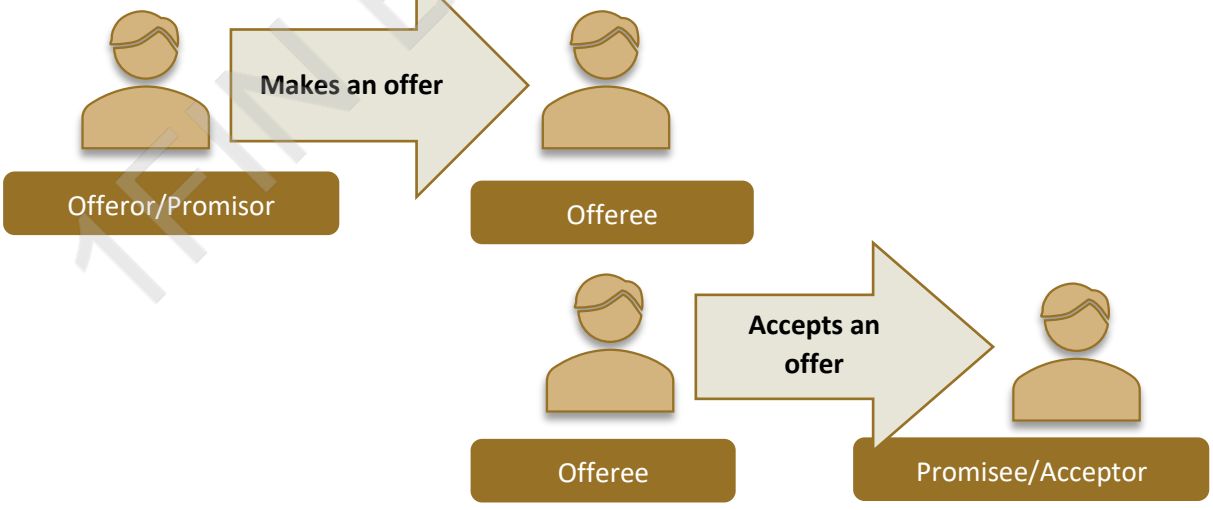
- Executory Contracts are further divided into two types:

Unilateral Contract	Bilateral Contract
It is a one-sided contract, in which one party has performed his duty or obligation and the other party's obligation is outstanding.	It is a contract where the obligation or promise is outstanding on the part of both the parties.

7. Proposal / Offer

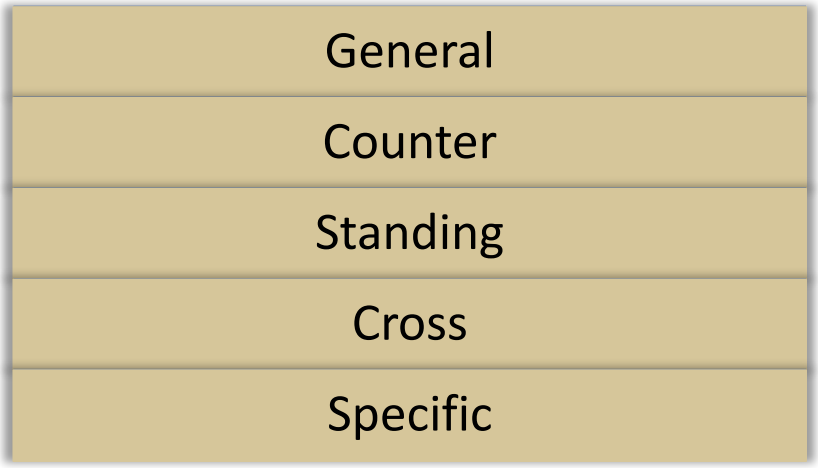
7.1 Definition

Definition as per Section 2(a):
As per this section of the Act, "when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal."



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7.2 Types of Offer



7.2.1 General Offer

- A General Offer is an offer that is made to the public at large. The genesis of a General Offer came about from the Landmark case of Carlill v. Carbolic Smoke Ball Co.

Case Law: Carlill v. Carbolic Smoke Ball Co.

Facts: A company by the name Carbolic Smoke Ball offered through an Advertisement to pay 100 Pounds to anyone who would contract increasing epidemic Influenza, colds or any disease caused by cold after taking its Medicine **according to the prescribed instructions.**
It was also added that 1000 Pounds have been deposited in Alliance bank showing our sincerity in the matter. One customer Mrs. Carlill used the medicine and still contracted Influenza and hence sued the company for the reward. The Defendants gave the argument that the offer was not made with an intention to enter into a legally binding agreement, rather was only to Puff the sales of the company.

Judgement: Setting aside the arguments of the Defendant, the bench stated that in cases of such offers i.e., general offers, there is **no need for communication of acceptance,** anyone who **performs the conditions** of the contract is said to have **communicated his/her acceptance,** and moreover, the money deposited by the Defendant in Alliance Bank clearly shows that they intended to create a legally binding relationship.

7.2.2 Specific/Special Offer

- A Specific offer is an offer that is made to a specific or ascertained person, this type of offer can only be accepted by the person to whom it is made.

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Case Law: Boulton v. Jones,

Facts: wherein the Plaintiff had taken the business of one Brocklehurst, the defendant used to have business with Brocklehurst and not knowing about the change in ownership of business, sent him an order for certain goods. The Defendant came to know about the change only after receiving an invoice, at which point he had already consumed the goods. The Defendant refused to pay the price, as he had a set off against the original owner, for which the plaintiff sued him.

Judgement: The Judges gave a unanimous judgement holding the defendant not liable.

7.2.3 Cross Offer

- When two parties make an identical offer to each other, in ignorance to each other's offer, they are said to make cross offers. Cross offers are not valid offers
  Example: If A makes a proposal to B to sell his car for ₹ 2,00,000 and B, without knowing the proposal of A, makes an offer to purchase the same car at ₹ 2,00,000 from A, it is not an acceptance, as B was not aware of proposal made by A. It is only cross proposal (cross offer).

7.2.4 Counter Offer

- When the offeree offers a qualified acceptance of the offer subject to modifications and variations in terms of the original offer, he is said to have made a counter offer.
- The original offer lapses as a result of a counter offer.
  Example: 'A' offers to sell his plot to 'B' for ₹ 10 lakhs. 'B' agrees to buy it for ₹ 8 lakhs. It amounts to counteroffer. It will result in the termination of the offer of 'A'. If later on 'B' agrees to buy the plot for ₹ 10 lakhs, 'A' may refuse.

7.2.5 Standing Offer

- An Offer which remains open for acceptance over a period of time is called a standing offer. Tenders that are invited for supply of goods is a kind of Standing Offer.

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7.3 Essential of a valid offer

- Capable of creating legal relations
- Certain, definite and not vague
- Communicated to the offeree
- Must be made with a view to obtaining the assent of the other party
- May be conditional
- Should not contain a term the non-compliance of which would amount to acceptance
- May be specific or general
- May be express or implied
- Different from a mere statement of intention, a mere communication of information, a prospectus or advertisement or a statement of price

7.4 Invitation to Offer

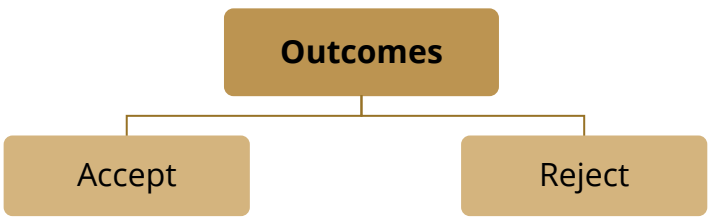
- An invitation to offer is only a circulation of an offer, it is an attempt to induce offers and precedes a definite offer.
- An offer becomes an agreement when accepted.
- On the other hand, an invitation to offer becomes an offer when the public responds to it.
- The main objective of an invitation to offer is to negotiate the terms on which the contract can be made.

Examples:

1) A magazine displaying offer
2) Prospectus of a college given while admission
3) Display of goods for sale in shop windows.
4) An invitation by a company to the public to subscribe for its shares.

- Although Invitation to Offer is not a type of offer per se, it is imperative to distinguish both to even construe what an actual offer is.
- An invitation to offer is an offer to negotiate, an offer to receive offers.
- An offer is a final expression of willingness to get into a contract upon those following terms.

7.4.1 Possible outcomes of an Invitation to Offer



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Offer Vs. Invitation to Offer

	Offer	Invitation to Offer
Definition	***Sec 2(a)*** Expression of willingness to do something or not with an intention to obtain assent of other party	No willingness but information to induce for offers
Intention	Binding on the offeror	No binding factor only inducing
Acceptance	Results in contract	Leads to negotiation and may lead to offer
Precedence	Offer cannot precede invitation to offer	Invitation precedes the offer

Case Law: Harvey vs. Facie

Facts: The plaintiffs through a telegram asked the defendants two questions namely,

(i) Will you sell us Bumper Hall Pen? and

(ii) Telegraph lowest cash price.

The defendants replied through telegram that the "lowest price for Bumper Hall Pen is £ 900". The plaintiffs sent another telegram stating, "we agree to buy Bumper Hall Pen at £ 900". However, the defendants refused to sell the property at the price. The plaintiffs sued the defendants contending that they had made an offer to sell the property at £ 900 and therefore they are bound by the offer.

Judgement: While plaintiffs had asked two questions, the defendant replied only to the second question by quoting the price but reserved their answer with regard to their willingness to sell. The mere statement of the lowest price at which the vendor would sell contained no implied contract to sell to the person who had enquired about the price.

8. Acceptance

8.1 Definition

Definition as per Section 2(b):

As per this section the term acceptance is defined as "When the person to whom the proposal is made signifies his assent thereto, proposal is said to be accepted. The proposal, when accepted, becomes a promise".

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Offeror – Person who makes the proposal / offer
Offeree – Person to whom the proposal / offer is made
Right of Offeree – Only offeree has the right to accept the proposal
Acceptance – when Offeree gives assent / consent to the offer
Acceptor – Offeree becomes acceptor when assent is given

8.2 Rules regarding a Valid Acceptance

8.2.1 Acceptance can be given only by the person to whom offer is made:

- In the case of a specific proposal or offer, it can only be accepted by the person it was made to.
- No third person without the knowledge of the offeree can accept the offer.
- When the proposal is a general offer, then anyone with knowledge of the offer can accept it.

Example: Arjun went to his friend's house, Chandu and made an offer to sell his I-Phone 12 Pro for ₹ 50,000. This was accepted by another person Sonu in Chandu's house, but Arjun refused the contract as it was made to a specific person and had to be accepted by Offeree only.

According to Sir William Anson – **Acceptance is to offer what a lighted match is to a train of gun powder.**

8.2.2 Must be absolute and unqualified

- Acceptance must be unconditional and absolute.
- There cannot be conditional acceptance, that would amount to a counteroffer which nullifies the original offer.

Example: Samar makes an offer to Andi to buy a diamond studded watch for ₹ 1 Lakh. Andi accepts the offer but with a condition that he shall pay ₹ 85,000 only. This became qualified acceptance and hence, not valid.

Case Law: Neale vs. Merret

Facts: M offered to sell his land to N for £280. N replied purporting to accept the offer but enclosed a cheque for £ 80 only. He promised to pay the balance of £ 200 by monthly instalments of £ 50 each.

Judgement: It was held that N could not enforce his acceptance because it was not an unqualified one.

Union of India vs. Bahulal

A offers to sell his house to B for Rs. 1,00,000/-. B replied that, "I can pay Rs. 80,000 for it." The offer of A is rejected by B as the acceptance is not unqualified. B however changes his mind and is prepared to pay Rs. 1,00,000. This is also treated as counteroffer and it is up to A whether to accept it or not.

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8.2.3 Must be communicated

- For a proposal to become a contract, the acceptance of such a proposal must be communicated to the promisor.
- One of the case law here was of **Lalman Shukla** Vs. **Gauri Dutt**

Case Law : Brogden vs. Metropolitan Railway Co.

Facts: B a supplier, sent a draft agreement relating to the supply of coal to the manager of railway Co. viz, Metropolitian railway for his acceptance. The manager wrote the word "Approved" on the same and put the draft agreement in the drawer of the table intending to send it to the company's solicitors for a formal contract to be drawn up. By an oversight the draft agreement remained in drawer.

Judgement: There was no contract as the manager had not communicated his acceptance to the supplier, B.

Case law – Heyworth Vs. Knight

It was concluded that, mere change in the language of communication without any change in substance will not make the acceptance invalid

Case law – Bhagwandas Vs. Girdhari Lal

Courts held that, offer made by an intended offeree without the knowledge of the offer **will not be deemed** to be an acceptance of the offer

8.2.4 Must be in prescribed mode

- Acceptance of the offer must be in the prescribed manner that is demanded by the offeror. If no such manner is prescribed, it must be in a reasonable manner that would be employed in the normal course of business.

  Example: Raghu offered Rohan to purchase his car for ₹ 5,00,000. He asked Rohan to convey his acceptance over a phone call. Rohan sent a WhatsApp message and this mode was not accepted by Raghu as the prescribed mode was Phone call.

8.2.5 Time

Exception – The offeror not objecting any other mode of acceptance

- Acceptance must be given within the specified time limit, if any, and if no time is stipulated, acceptance must be given within the reasonable time and before the offer lapses.

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Example: Ajay offers to sell 100 apples for ₹ 2,000 to Vijay. Vijay does not reply to Ajay within a reasonable time and the apples get rot. Hence, communication of acceptance within a reasonable time is required.

- If there is a time fixed for communication of acceptance, then it must be done within the fixed time
- In case there is no time fixed for communication of acceptance, it must be done within reasonable time
- What is reasonable time is nowhere defined in the law and thus would depend on facts and circumstances of the particular case.

8.2.6 Mere silence is not acceptance

- The acceptance of an offer cannot be implied from the silence of the offeree or his failure to answer, unless the offeree has in any previous conduct indicated that his silence is the evidence of acceptance.

Example: Mr. A offers to sell Mr. B MacBook Pro for ₹ 70,000. Mr. B remains silent and does not respond to the offer. This is a case of mere silence that does not amount to acceptance.

8.2.7 Implied acceptance or Acceptance by Conduct

Case Law: Felthouse vs. Bindley

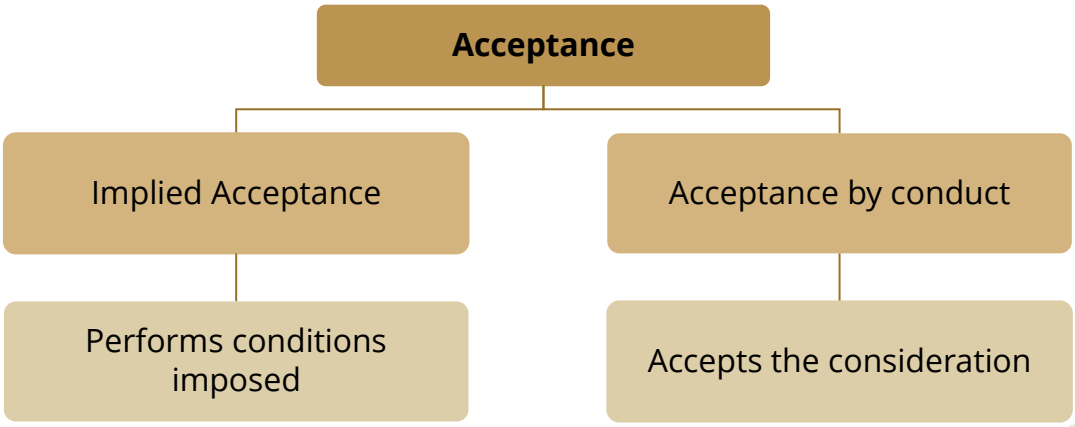
Facts: F (Uncle) offered to buy his nephew's horse for £30 saying "If I hear no more about it, I shall consider the horse mine at £30." The nephew did not reply to F at all. He told his auctioneer, B to keep the particular horse out of sale of his farm stock as he intended to reserve it for his uncle. By mistake the auctioneer sold the horse. F sued him for conversion of his property.

Judgement: F could not succeed as his nephew had not communicated the acceptance to him.

- Section 8 of Indian Contract Act 1872 provides that acceptance by conduct or actions of the promisee is acceptable. So, if a person performs certain actions that communicate that he has accepted the offer, such implied acceptance is permissible.
  Example: A boy offers his sibling ₹ 1,000 for polishing his shoe for the next month. Sibling accepts the money given. This is an implied acceptance that the sibling will polish his shoes for the next month.

Definition as per Section 8:
The performance of the conditions of a proposal, or the acceptance of any consideration for a reciprocal promise which may be offered with a proposal, is an acceptance of the proposal.

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Rules	Case Laws
Acceptance must be communicated only by the person to whom the offer is made	Boulton Vs. Jones
Acceptance must be absolute and unqualified	Neale Vs. Merret Union of India Vs. Bahulal
Acceptance must be communicated	Brogden Vs. Metropolitan Railway Co.
Acceptance must be in prescribed mode	-
Time & reasonable time	-
Mere silence does not amount to acceptance	Felthouse Vs. Bindley
Acceptance can be implied/by conduct	-

9. Communication of Offer and Acceptance

- One important common requirement for both offer and acceptance is their effective communication. Effective and proper communication prevents avoidable revocation and misunderstanding between parties.
- When the contracting parties are face-to-face, there is no problem of communication because there is instantaneous communication of offer and acceptance. In such a case the question of revocation does not arise since the offer and its acceptance are made instantly.
- The difficulty arises when the contracting parties utilize services such as post or email etc, in such cases it becomes very important to ascertain what is the exact time of communication of offer and acceptance.

9.1 Communication of Offer

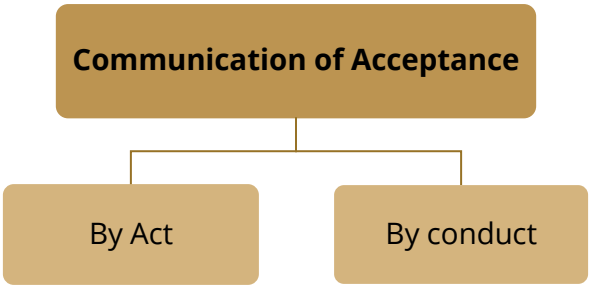
In terms of Section 4 of the Act, the communication of offer is complete when it comes to the knowledge of the person to whom it is made.

Example: A writes to B offering to fix his roof for five thousand rupees. He posts the letter on 2nd July. The letter reaches B on 4th July. So, the communication is said to complete on 4th July. In case B reads the letter on 5th July, then the date of communication of offer will be 5th July as that is the date when the offeree comes to know about the offer.

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9.2 Communication of Acceptance

- Acceptance can be done in two ways, namely



9.2.1 Communication of Acceptance by Act

- This would include communication via words, whether oral or written. So, this will include communication via telephone calls, letters, e-mails, telegraphs, etc.

9.2.2 Communication of Acceptance by Conduct

- The offeree can also convey his acceptance of the offer through some action of his, or by his conduct.

So, say when a person boards a bus, he is accepting to pay the bus fare via his conduct.

In terms of **Section 4** of the Act, communication of acceptance is complete:
a) As **against the proposer,** when it is put in the course of transmission to him so as to be out of the power of the acceptor to withdraw the same;
b) As **against the acceptor,** when it comes to the knowledge of the proposer

Example: A accepts the offer of B via a letter. He posts the letter of acceptance on 10th July and the letter reaches B on 14th. For B (the proposer) the communication of the acceptance is completed on 10th July itself. Whereas from A's point of view communication will be complete on 14th July, when B learns of the acceptance.

Case Laws:
1. Mukul Datta Vs. Indian Airlines
2. Lilly White Vs. R. Mannuswamy

9.3 Communication of Special Conditions

- Sometimes there are situations where there are contracts with special conditions.
- These special conditions are conveyed tacitly and the acceptance of these conditions are also conveyed by the offeree again tacitly or without him even realizing it.

10. Revocation of Offer and Acceptance

- In term of Section 4, communication of revocation (of the proposal or its acceptance) is complete.

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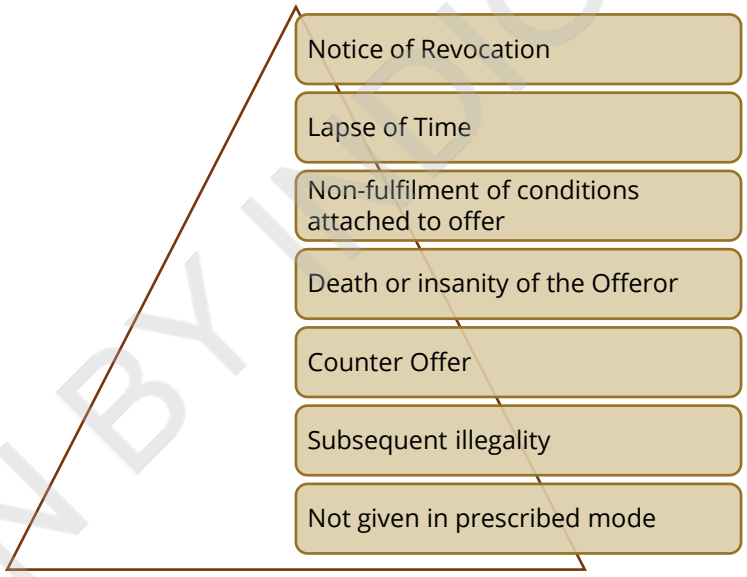
- as against the person **who makes it** (Person making revocation) when it is put into a course of transmission to the person to whom it is made so as to be out of the power of the person who makes it, and
- as against the person to **whom it is made,** when it comes to his knowledge.

- As per Section 5 of the Act, **offer can be revoked** at any time before communication of acceptance is completed as against the offeror.
- As per Section 5 of the Act, **acceptance can be revoked** at any time before the communication of acceptance is complete against the acceptor.

Example: Anil send a letter of offer to Sunil on 10th August, the letter reaches Sunil of 14th August and he reads it on the same day. Sunil posts his letter of acceptance on 17th August. In this case, the communication of acceptance from Anil's point is completed on 17th August, therefore, Anil can revoke his offer at any time before 17th August.

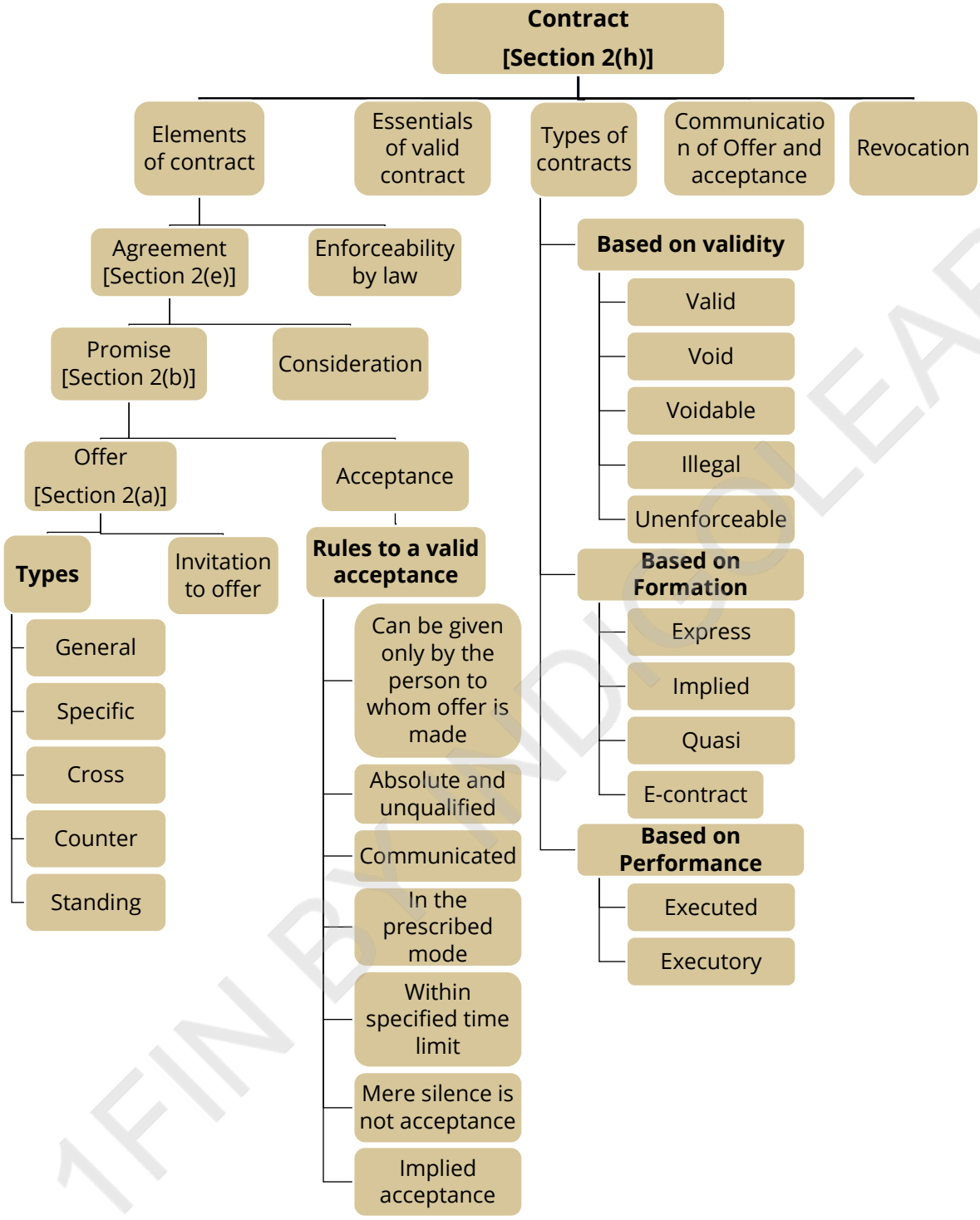
In the above situation, if the letter of acceptance reaches Anil on 20th August, if Sunil wants to revoke his acceptance, he can do so before 20th August (i.e) before the communication of acceptance is complete from Sunil's point of view.

11. Modes of Revocation of Offer



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12. Overview



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CH-1: UNIT 2 – CONSIDERATION

Learning Outcomes –

- Importance of consideration.
- Consideration from a third party.
- Contracts valid without consideration.
- Doctrine of privity to a contract

1. Introduction

Consideration is an **essential element of a valid contract**. Without a consideration no single promise will be enforceable. It is a term used in the sense of ***quid pro quo***, i.e., 'something in return'.

2. What is Consideration?

Definition as per Section 2(d):
When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or abstain from doing something, such an act or abstinence or promise is called consideration for the promise.

Consideration is the **price agreed to be paid** by the promisee for the obligation of the promisor.

- Consideration is an **act** i.e., doing something.

  Example : A college promises students, who will score above 95% for the job in MNC. **Consideration need not to be monetary**. Here the promise for recruitment of candidate will be considered as consideration for the act of students scoring above 95%.

- Consideration **can be abstinence** i.e., abstain from doing something.

  Example : Abhishek promises Bharti not to file a suit against him if she (Bharti) would pay him (Abhishek) ₹ 1,00,000. Here abstinence on the part of Abhishek would constitute consideration against Bharti's payment of ₹ 1,00,000 in favour of Abhishek.

- Consideration must be at the **desire of the promisor.**
- Consideration **may move from promisee or any other person**.
- Consideration may be **past, present, or future**.

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Consideration = Promise / Performance that parties exchange with each other.

Case Law: Misa v. Currie

A **valuable consideration** in the sense of law may consist either in some right, interest, profit or benefit accruing to one party (i.e. promisor) or forbearance, detriment, loss or responsibility given, suffered or undertaken by the other (i.e. the promisee).

3. Legal rules regarding Consideration

3.1 Consideration must move at the desire of the promisor

Consideration must be offered by the promisee or the third party at the desire or request of the promisor.

An act done at the desire of a third party is not a consideration.

Case Law: Durga Prasad v. Baldeo

Facts: D (defendant) promised to pay to P (plaintiff) a certain commission on articles which would be sold through their agency in a market. Market was constructed by P at the desire of the C (Collector), and not at the desire of the D.

Judgement: D was not bound to pay as there was no consideration and hence void.

3.2 Consideration may move from promisee or any other person

In India, consideration may proceed from the promisee or any other person who is not a party to the contract. The words "...promisee or any other person..." in the definition u/s 2(d) makes this proposition clear.

Thus, **there can be a stranger to a consideration but not stranger to a contract.**

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Case Law: Chinnayya vs. Ramayya (1882)

Facts: An old lady made a gift of her property to her daughter with a direction to pay a certain sum of money to the maternal uncle by way of annuity. On the same day, the daughter executed a writing in favour of the brother agreeing to pay annuity. The daughter did not, however, pay the annuity and the uncle sued to recover it.

Judgement: There was sufficient consideration for the uncle to recover the money from the daughter.

3.3 Executed and Executory consideration

- A consideration which **consists in the performance of an act** is said to be **executed**.
- When a consideration consists in a **promise**, it is said to be **executory.**
- **The promise by one party may be the consideration for an act by some other party, and vice versa.**

  Example : A pays ₹5,000 to B and B promises to deliver to him a certain quantity of wheat within a month. Here, the promise by B to deliver the wheat within a month is the consideration for A to pay ₹5,000. Thus, the consideration paid by A is executed, whereas the consideration promised by B is executory.

3.4 Consideration may be past, present, or future

The words "...has done or abstained from doing..." [as contained in Section 2(d)] are a recognition of the doctrine of past consideration.

Example : 'A' performed some services to 'B' at his desire. After a week, 'B' promises to compensate 'A' for the work done by him. This is a **past consideration** and A can sue B for recovering the promised money.

A past consideration may be the motive but cannot be the real consideration of a subsequent promise.

Example : A cash sale of goods is an example of **present consideration.** The consideration is immediately made against delivery of goods.

Example : A agrees to supply wheat bags to B and B agrees to pay for them on a future date. This consideration is the **future consideration.**

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3.5 Consideration need not be adequate

The value of the consideration need not be equal to the value of the promise, act, or abstinence for which it is given. However, consideration must be something which the law considers as having some value.

Example : X promises to sell a house worth ₹6 lacs for ₹1 lacs only, the adequacy of the price in itself shall not render the transaction void, unless the party pleads that transaction takes place under coercion, undue influence, or fraud.

3.6 Performance of what one is legally bound to perform is not consideration

- The performance of an act by a person who is legally bound to perform the same **cannot be consideration** for a contract.
- Such a contract is **void** for want of consideration.
- But **where a person promises to do more that he is legally bound to do,** such a promise provided it is not opposed to public policy, **is a good consideration.**

  Example : A promise to pay money to a witness is void, for it is without consideration.

  A promise to pay a policeman to provide security is void as a policeman is legally bound to provide security.

3.7 Consideration must be real and not illusory

Consideration must be **something to which the law attaches some value**. If it is legally or physically impossible it is not considered valid consideration.

Example : A man promises to discover treasure by magic, bringing the dead person to live again. This transaction can be said to be void as it is illusory.

3.8 Consideration must not be unlawful, immoral, or opposed to public policy

Only presence of consideration is not sufficient **it must be lawful**. Anything which is immoral or opposed to public policy cannot be valued as valid consideration.

Example : ABC Ltd. promises to give job to Mr. X in a Government bank against payment of ₹50,000 is void as the promise is opposed to public policy.



What consideration is lawful, and what not is covered in detail in Unit 3.

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4. Suit by a third party to a contract

4.1 Doctrine of Privity of Contract

Under the Indian Contract Act, 1872, the consideration for an agreement may proceed from a third party. However, such third party cannot sue on the contract**.**

This rule, that stranger to a contract cannot sue is known as a "**doctrine of privity of contract".**

Only a person who is party to a contract can sue on it.

Doctrine of Privity of Contract = Stranger to a contract cannot sue.

However, there are certain **exceptions to the Doctrine of Privity of contract.**

4.2 Exceptions to the Doctrine of Privity of contract

4.2.3 In case of Trust

In case of a trust, the contract is between the settler and the trustee. However, **a beneficiary** can enforce his right under the trust, though he is not a party to the contract.

4.2.4 In case of a Family settlement

- In the case of a family settlement, the **members of family who originally had not been parties to the settlement** may enforce the agreement.
- However, the **terms of settlement must have been reduced into writing**.

  Example : Two brothers X and Y agreed to pay an allowance of ₹20,000 to mother on partition of joint properties. But later they denied to abide by it. It was held that their mother although stranger to contract can require their sons for such allowance in the court of law.

4.2.5 In case of certain Marriage Contracts/Arrangements

In the case of certain marriage contracts/arrangements, a **provision may be made for the benefit of a person**. Such a person may file the suit though he is not a party to the agreement.

Example : Mr. X's wife deserted him for ill-treating her. Mr. X promised his wife's father Mr. Puri that he will treat her properly or else pay her monthly allowance. But she was again ill-treated by her husband. It was held that she has all right to sue Mr. X against the contract made between Mr. X and Mr. Puri even though she was stranger to contract.

4.2.6 In case of Assignment of a Contract

- In the case of assignment of a contract, when the benefit under a contract has been assigned, the **assignee** can enforce the contract
- However, such **assignment should not involve any personal skill**.

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4.2.7 Acknowledgement or Estoppel

Where the **promisor by his conduct acknowledges himself as an agent of the third party**, it would result into a binding obligation towards **third party.**

Example : L gives to M ₹20,000 to be given to N, and M informs N that he is holding the money for him. Afterwards M refuses to pay the money to N. In that case, N will be entitled to recover the same from M.

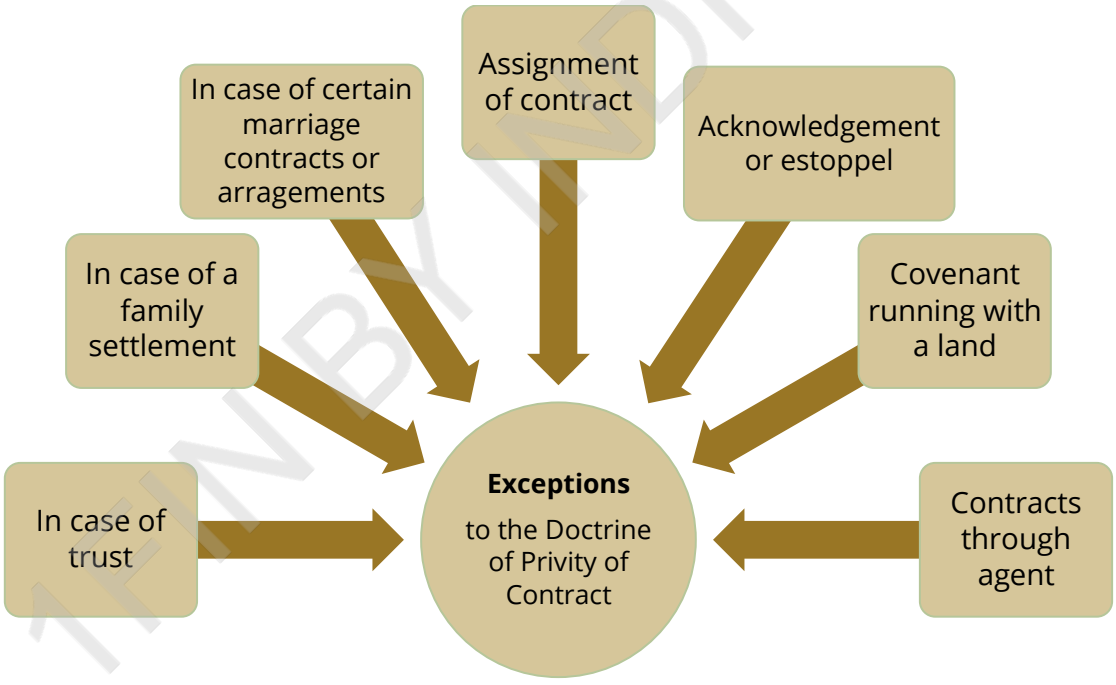
4.2.8 In case of Covenant running with the Land

In the case of covenant running with the land, **the person who purchases land with notice** that the owner of land is bound by certain duties affecting land, the **covenant affecting the land may be enforced by the successor of the seller**.

Example : One owner of the land having two land adjacent to each other. One was agricultural land. He sold the other land containing a condition that it can never be used for Industrial purpose so as to protect the other agricultural land from pollution. Such condition is attached with the land so who so ever is the successor of land has to abide by it. Such are called **restrictive covenants** and all successors are bound to it.

4.2.9 Contracts entered into through an Agent

The **principal** can enforce the contracts entered by his agent where the **agent has acted within the scope of his authority** and in the name of the principal.



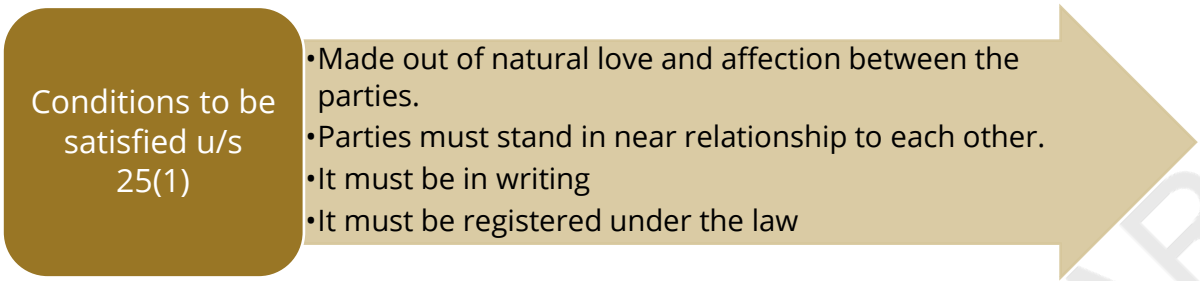
5. Validity of an agreement without consideration

The **general rule** is that an **agreement made without consideration is void (Section 25)**. However, the Indian Contract Act contains **certain exceptions to this rule.**

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In the following cases, the agreement though made without consideration, will be valid and enforceable –

i) **Natural Love and Affection -** A **written and registered** agreement based on **natural love and affection** between the **parties standing in near relation** (e.g., husband and wife) to each other is enforceable even without consideration [**Section 25(1)**].



Example : A husband by a registered deed, promises to bring a diamond necklace for his wife. This agreement is valid, though it is without consideration and can be enforced.

ii) **Compensation for past voluntary services** – A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable [**Section 25(2)**]. However, following conditions need to be satisfied

   a. The services should have been **rendered voluntarily**.

   b. The services must have been **rendered for the promisor**.

   c. The **promisor must be in existence** at the time when services were rendered.

   d. The promisor must have **intended to compensate** the promisee.

Example : Peter finds Sameer's wallet on the road and returns it to him. Sameer is happy to find his lost wallet and promises to pay Peter ₹ 2,000. In this case, too, the no consideration no contract rule does not apply. This contract is a valid contract.

iii) **Promise to pay time barred debt** – Where a promise in **writing, signed** by the person making it or by his authorised agent, is made **to pay a debt barred by limitation,** it is valid without consideration [**Section 25(3)**].

Example : Pratik owes ₹1,00,000 to Hari. He had borrowed the money 5 years ago. However, he never paid a single rupee back. He signs a written promise to pay ₹50,000 to Hari as a final settlement of the loan. In this case, 'the no consideration no contract' rule does not apply either. This is a valid contract.

iv) **Agency** – No consideration is necessary to create an agency [**Section 185**].

v) **Completed gift** – In case of completed gifts, the rule no consideration no contract does not apply [**Explanation (1) to Section 25**]

vi) **Bailment** – Bailment means the **delivery of goods from one person to another for some purpose** [**Section 148**]. Such delivery is made upon a contract that after accomplishment of the purpose, the

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goods will either be returned or disposed of, according to the directions of the person delivering them. **No consideration is required to affect a contract of bailment.**

Example : Mr. Y deposits his goods in the godown of Mr. A for free. Mr. A hand over the keys of his godown to Mr. Y. Mr. Y gets possession of godown but not the ownership. As soon as Mr. Y lifts his goods from godown he is liable to hand over the keys back to Mr. A..

vii) **Charity** – If a **promisee undertakes the liability on the promise** of the person to contribute to charity, there the contract shall be valid.

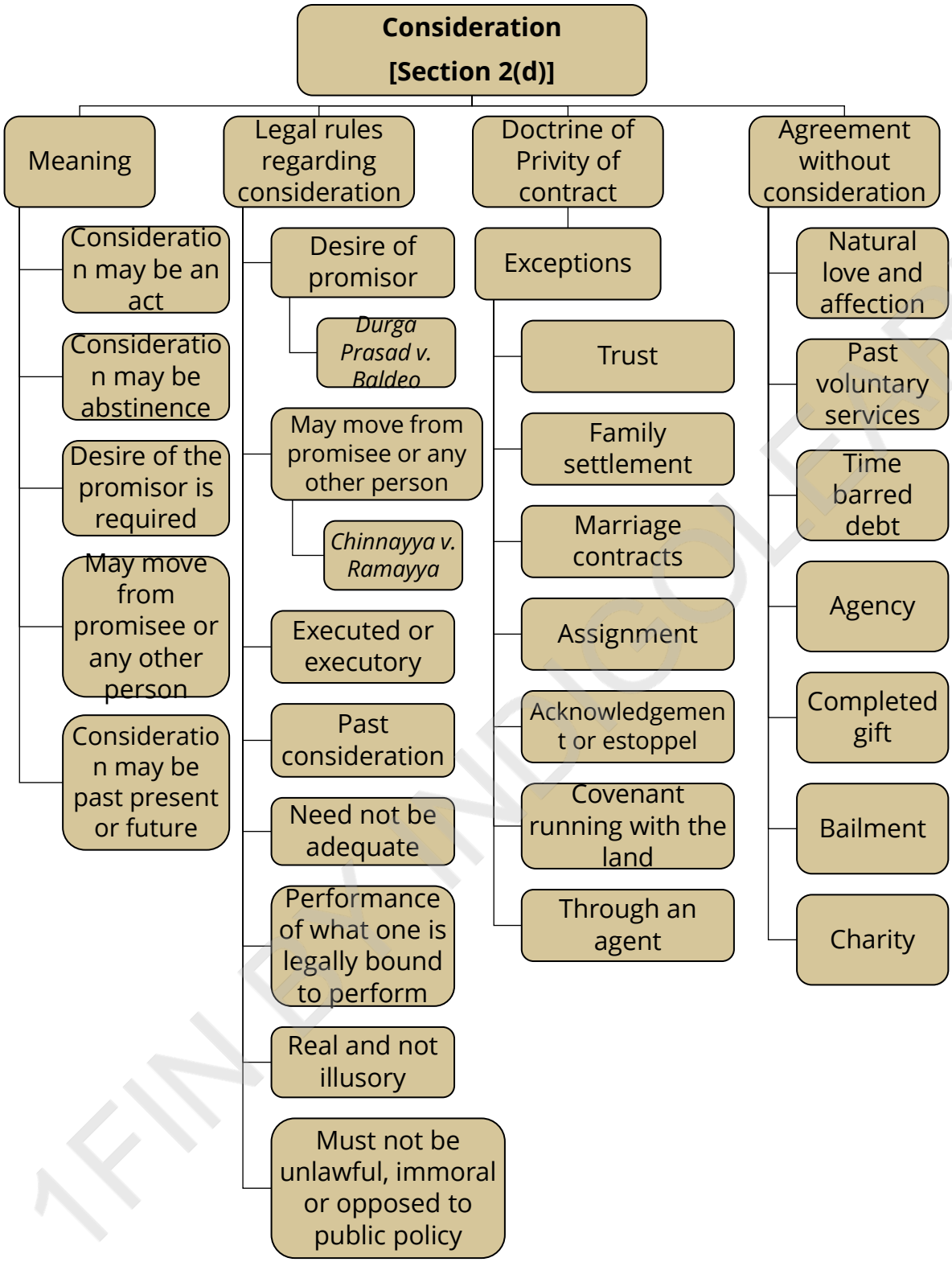
Case Law: Kedarnath v. Gorie Mohammad

Facts: In this case, the defendant had agreed to subscribe ₹100 towards the construction of town hall at Howrah. The Secretary, on the faith of the promise, called for plans and entrusted the work to contractors and undertook liability to pay them. The Defendant refused to pay the promised amount.

Judgement: Though the promise was for a charitable purpose and there was no benefit to the defendant, yet he is liable for the promise made by him.

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6. Summary



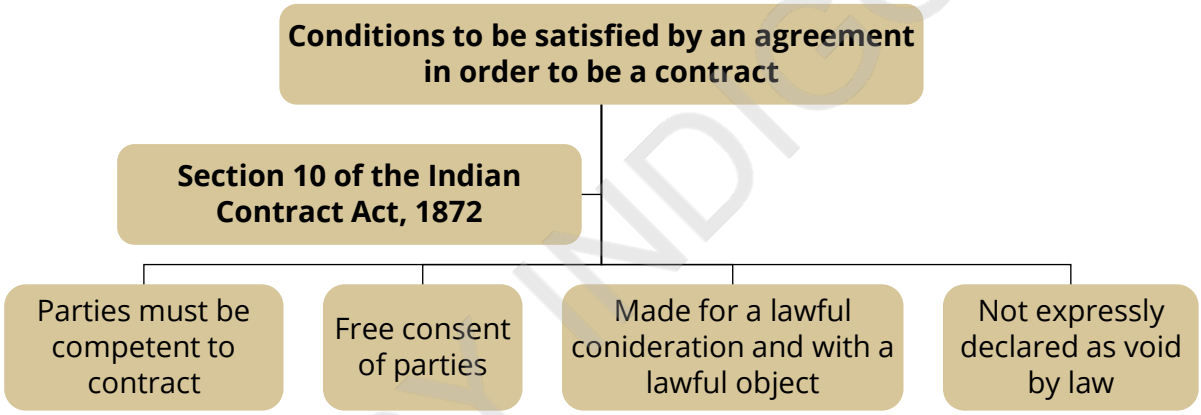
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CH-1: UNIT 3 – OTHER ESSENTIAL ELEMENTS OF A CONTRACT

Learning Outcomes –

- Who is competent to contract.
- Law related to contracting with a minor.
- Concept of *'consensus ad idem'*
- Elements vitiating free consent.
- Circumstances when object and consideration become unlawful.
- Agreements opposed to public policy.

1. Introduction



2. Capacity to Contract

Capacity to contract means **the competence of the parties** to make a contract.

Section 11 of the Indian Contract Act, 1872 states who is competent to contract –

"Every person is competent to contract who is of the **age of majority** according to the law to which he is subject, and who is of **sound mind** and is **not disqualified** from contracting by any law to which he is subject"

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2.1 Age of Majority

The age of majority in India is governed by The Indian Majority Act, 1875. Every person domiciled in India shall **attain the age of majority on the completion of 18 years of age** and not before. The following are the laws relating to minor's agreement/position of minor –

2.1.1 A contract made with or by a minor is void ab-initio

Any agreement with or by a minor is **void from the very beginning.**

Case Law: Mohori Bibi vs. Dharmo Das Ghose (1903)

Facts: A, a minor had borrowed some money from B (a money lender) by mortgaging his house. He became a major a few months later. The moneylender moved to take possession of the minor's house when he defaulted payment.
Judgement: A mortgage by a minor was void and B was not entitled to repayment of money.

2.1.2 No ratification after attaining majority

A minor cannot ratify the agreement on attaining majority **as the original agreement is void ab initio** and a void agreement can never be ratified.

Example : X, a minor makes a promissory note in the name of Y. He cannot ratify it on attaining majority. Also, if he makes a new promissory note in place of old one, here the new promissory note which he executed after attaining majority is also void being without consideration.

2.1.3 Minor can be a beneficiary or can take benefit out of a contract

Though a minor is not competent to contract, he **can be a beneficiary** to the contract i.e., entitled to the benefits of the contract.

2.1.4 A minor can always plead minority

- A minor can always plead minority, **even where he has entered into any contract by falsely representing that he was major.**

Rule of Estoppel cannot be applied against a minor.

Example : A, a minor has falsely induced himself as major and contracted with Mr. X for loan of ₹20,000. When Mr. X asked for the repayment A denied to pay. He pleaded that he was a minor so cannot enter into any contract. It was held that A cannot be held liable for repayment of amount. However, if he has not spent the same, he may be asked to repay it, but the minor shall not be liable for any amount which he has already spent even though he received the same by fraud.

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2.1.5 Liability for necessaries

> **Necessaries** mean those things that are essentially needed by a minor. They do not include luxuries or costly or unnecessary articles.

- A person who supplies the necessities of life to a minor or to any other person whom such minor is legally bound to support is entitled to get **reimbursement**.
- However, there is **no personal liability** of the minor, but **only his property is liable.**
- To render minor's estate liable for necessaries two conditions must be satisfied :
  - The contract must be for **goods which are necessary for life**, and
  - The minor must **not have already a sufficient supply of these** necessaries.

Example : Shruti being a minor purchased a laptop for her online classes of ₹70,000 on credit from a shop. But her assets could pay only ₹20,000. The shop keeper could not hold Shruti personally liable and could recover only amount recoverable through her assets i.e., up to ₹ 20,000.

2.1.6 Enforceability of a contract by guardian

- Where the guardian makes a contract for the minor, which is **within his competence** and which is **for the benefit of the minor**, there will be **valid contract which the minor can enforce.**
- However, all contracts made by guardian on behalf of a minor are not valid.

Example : The guardian of a minor has no power to bind the minor by a contact for the purchase of immovable Property. But a contract entered into by a certified guardian (appointed by the Court) of a minor, with the sanction of the court for the sale of the minor's property, may be enforced by either party to the contract.

2.1.7 No specific performance

No court can allow **specific performance** of a contract with minors because it is void altogether.

2.1.8 No insolvency

- A minor cannot be declared insolvent as a minor cannot incur any liability personally.
- **He can never be held personally liable**. Dues are payable from the personal properties of minor

2.1.9 Partnership

A minor **cannot become a partner in a partnership firm,** but he can be admitted to the benefits of partnership with the **consent of all the partners** [Section 30 of the Indian Partnership Act].

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2.1.10 Minor can be an agent

- A minor can act as an agent and bind the principal
- **But he will not be liable to his principal** for his acts.

A minor can draw, deliver, and endorse negotiable instruments without himself being liable.

Example : A **minor can have an account in the bank**. He can draw a cheque for his purchases. But he shall not be liable for cheque bounces nor can he be sued under court of law for any fraud done from his account.

2.1.11 Minor cannot bind parent or guardian

A minor is not capable of binding his parent or guardian, even for necessaries. They will be held **liable only when the minor acts as their agent.**

Example : Richa, a minor entered into contract of buying a scooty from the dealer and mentioned that her parents will be liable for the payment of scooty. The dealer sent a letter to her parents for money. The parents will not be liable for such payment as the contract was entered by a minor in their absence and out of their knowledge.

2.1.12 Joint contract by minor and adult

In case a joint Contract is made by minor and an adult, the **adult will be liable on the contract and not the minor.**

Case Law: Sain Das vs. Ram Chand

There was a **joint purchase** by two purchasers, one of them was a minor.
It was **held** that the vendor could enforce the contract against the major purchaser and not the minor.

2.1.13 Surety for a minor

When an adult gives a guarantee on behalf of a minor, then **the adult is liable to the third party** as if there is direct contract between the surety and the third party.

Example : Mr. X guaranteed for the purchase of a mobile phone by Krish, a minor. In case of failure for payment by Krish, Mr. X will be liable to make the payment.

2.1.14 Minor as Shareholder

- A minor **cannot become a shareholder** as he is incompetent to contract.
- If by mistake he becomes a member, the company can rescind the transaction and remove his name from register.

A minor may, acting though his lawful guardian become a shareholder by transfer or transmission of fully paid shares to him.

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2.1.15 Liability for torts



A tort is a civil wrong.

A minor is liable for tort unless the tort in reality is a breach of contract.

Example : A minor was held liable for his failure to return certain instruments which he had hired and then passed on to a friend.

Law relating to Minor's Agreement

- Void-ab-initio
- No ratification after becoming major
- Can be a beneficiary
- Can always plead minority
- Minor's property is liable for necessaries of life supplied to him
- Contracts by a guardian enforceable under certain circumstances
- No specific performance
- No insolvency
- Cannot be partner in a partnership firm. But can be beneficiary
- Can be an agent
- Cannot bind parent or guardian
- Joint contract - adult will be liable
- Surety for minor - will be liable
- Cannot be a shareholder
- Minor is liable for torts

2.2 Person of sound mind

Section 12 of the Indian Contract Act, 1872 states who is a person of sound mind –

"A person is said to be of sound mind for the purposes of making a contract if, at the time when he makes it is **capable of understanding** it and of **forming a rational judgement** as to its effect upon his interests."

A contract by a person who is not of sound mind is void.

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Person who is usually of unsound mind, but occasionally of sound mind	He may make a contract when he is of sound mind
Person who is usually of sound mind, but occasionally of unsound mind	He may not contract when he is of unsound mind

2.3 Contract by disqualified persons

- Besides minors and persons of unsound mind, there are also other persons who are disqualified from contracting, partially or wholly. The **contracts by such person are void**.
- Incompetency to contract **may arise from political status, corporate status, legal status, etc**. The following persons fall in this category:
    - Foreign Sovereigns and Ambassadors,
    - Alien enemy, Corporations,
    - Convicts,
    - Insolvent etc.

3. Free Consent

3.1 Consent

Definition of Consent [Section 13]

"Two or more persons are said to consent when they **agree upon the same thing in the same sense."**

- **When parties to a contract make some fundamental error** as to the nature of the transaction, or as to the person dealt with or as to the subject-matter of the agreement, **it cannot be said that they have agreed upon the same thing in the same sense.**

Latin Maxim for 'of same mind' ***"ad idem"***

Example : If two persons enter into an apparent contract concerning a particular person or ship, and it turns out that each of them, misled by similarity of name, had a different person or ship in his mind, no contract would exist between them as they were not ad idem, i.e., of the same mind.

- Consent may be free or not free.

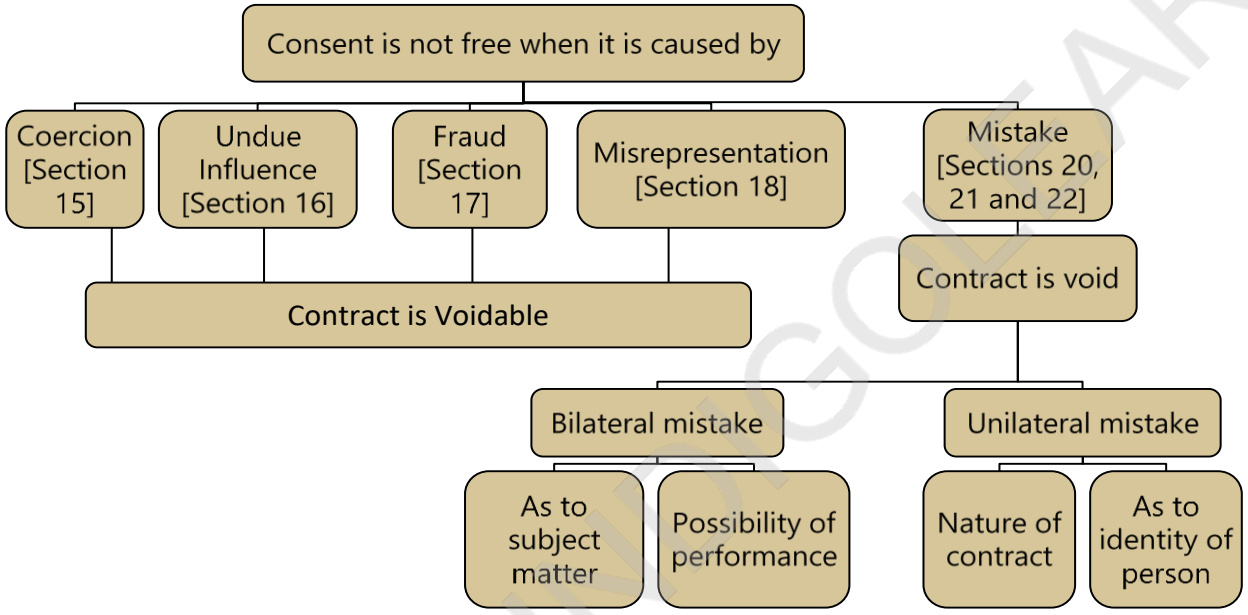
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- **Free consent is necessary for the validity of a contract**.

3.2 Free Consent

Definition of Free Consent [Section 14]

"Consent is said to be free when it is **not caused by Coercion, Undue Influence, Fraud, Misrepresentation, or Mistake**".



4. Elements Vitiating Free Consent

4.1 Coercion [Section 15]

Definition of Coercion [Section 15]

"Coercion' is the **committing, or threatening to commit**, **any act forbidden** by the Indian Penal Code or the unlawful detaining, **or threatening to detain any property**, to the prejudice of any person whatever, with the **intention of causing any person to enter into an agreement**."

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4.1.1 The essential ingredients of Coercion

- ✓ **Committing or threatening to commit any act forbidden** by the Indian Penal Code; or
- ✓ **The unlawful detaining or threatening to detain** any property to the prejudice of any person whatever,
- ✓ The **intention** of **causing any person to enter into an agreement**.
- ✓ It is immaterial whether the India Penal Code is or is not in force at the place where the coercion is employed.

Coercion may proceed from a third party. It may also be directed at a third party.

4.1.2 The effect of Coercion u/s 19

Contract induced by coercion is **voidable** at the option of the party whose consent was so obtained.

If any **benefit** is received in course of this type of contract it should be **restored** by the person cancelling this contract

A **person to whom money has been paid** or anything delivered under coercion must **repay or return** it. (Section 72)

The **burden of proof** in case of coercion is on the aggrieved party i.e., the person on whom coercion has been used.

Example : Where husband obtained a release deed from his wife and son under a threat of committing suicide, the transaction was set aside on the ground of coercion, suicide being forbidden by the Indian Penal Code. The threat of suicide amounts to coercion within Section 15.

4.2 Undue Influence [Section 16]

Definition of Undue Influence [Section 16]

"A contract is said to be induced by 'undue influence' where the relations subsisting between the parties are such that **one of the parties is in a position to dominate the will of the other** and he **uses that position to obtain an unfair advantage** over the other".

4.2.1 The essential ingredients of Undue Influence u/s 16

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i) **Relation between the parties** – A person can dominate other when there is **near relation** between them.

ii) **Position to dominate the will –** The relation between the two parties is such that **one is in a position to dominate the other**. A person is deemed to dominate the will of other in these situations:

a) In case he holds **real and apparent authority** over the other.

b) In case the relationship between them is a **fiduciary relationship**, i.e., a relation of trust and confidence

c) When a person's **mental capacity is temporarily or permanently affected.**

d) Where one of the parties to a contract is in a position to dominate the will of the other and the **contract is apparently unconscionable i.e., unfair.** [Unconscionable bargains are witnessed mostly in money-lending transactions and in gifts.]

Examples :

- **Real and apparent authority :** A father, by reason of his authority over the son can dominate the will of the son.
- **Fiduciary relationship :** By reason of fiduciary relationship, a solicitor can dominate the will of his client and a trustee can dominate the will of the beneficiary.
- **Mental distress :** A doctor is deemed to be in a position to dominate the will of his patient enfeebled by protracted illness.

Case Law: Kirpa Ram vs. Sami-Ud-din Ad. Khan (1903)

Facts: A youth of 18 years of age, spend thrift and a drunkard, borrowed ₹ 90,000 on a bond bearing compound interest at 2% per mensem (p.m.).

Judgement: The **transaction is unconscionable** as the rate of interest charged being so exorbitant

iii) **The object must be to take undue advantage** - The person in a position to influence the will of the other in getting consent, must have the object to take advantage of the other.

Example : A teacher asks her daughter to get married to one of his brilliant students. Both the girl and boy were smart, settled, and intelligent. Here the teacher had a relation which can have influence on both of them. But, as no undue advantage of such influence was taken such contract of marriage is said to be made by free consent.

iv) **Burden of proof** - The **dominant party** will have to prove that they have not used their dominant position to take unfair advantage of the other and induce them to enter a contract.

4.2.2 Power to set aside contract induced by undue influence [Section 19A]

- When consent to an agreement is caused by undue influence, the agreement is a **contract voidable at the option of the party whose consent was so caused**.

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- Such contract may be **set aside either absolutely**, or, if the party who was entitled to avoid it has received any benefit thereunder, **upon such terms and conditions as to the Court may seem just.**

Example : A, a money lender advances ₹ 1,00,000 to B, an agriculturist, and by undue influence induces B to execute a bond for ₹ 2,00,000 with interest at 6 percent per month. The court may set aside the bond, ordering B to repay ₹ 1,00,000 with such interest as may seem just.

Case Study

Facts: A student was induced by his teacher to sell his brand-new car to the latter at less than the purchase price to secure more marks in the examination. Accordingly, the car was sold. The student's father persuaded him to sue his teacher.

Judgement: The student can sue his teacher on the ground of undue influence under the provisions of Indian Contract Act, 1872.

4.2.3 Difference between Coercion and Undue Influence

Nature of action	It involves physical force or threat.	It involves mental pressure.
Involvement of criminal action	It involves committing or threatening to commit an act forbidden by the Indian Penal Code.	No such illegal act is committed, or threat is given.
Relationship between parties	Relationship between parties is not necessary	Some sort of relationship between the parties is necessary
Exercised by whom	Coercion can move from a stranger and can be used upon a stranger	Undue Influence cannot be exercised by a stranger.
Enforceability	The contract is voidable at the option of the aggrieved party.	The contract is either voidable or the court may set it aside or enforce in a modified form.
Position of benefits received	Any benefit already received must be returned once the contract is rescinded.	The court has discretion to direct the aggrieved party to return the benefit in whole or in part.

4.3 Fraud [Section 17]

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Definition of Fraud [Section 17]

'Fraud' **means and includes** any of the following acts **committed by a party to a contract, or with his connivance, or by his agent**, with an **intent to deceive another party** thereto or his agent, or to induce him to enter into the contract:

- the **suggestion, as a fact, of that which is not true**, by one who does not believe it to be true,
- the **active concealment of a fact** by one having knowledge or belief of the fact,
- a **promise made without any intention of performing it**,
- any other **act fitted to deceive**,
- any such act or omission as the **law specially declares** to be fraudulent.

4.3.1 Essential elements of the fraud

- A **false representation or assertion** must be made. However, silence, or an active concealment may also amount to fraud.
- Representation must be **related to a fact**.
- Representation must be **made before the conclusion of the contract** with an **intention to deceive**
- The representation or statement should be made with a **knowledge of its falsity** or without belief in its truth or recklessly not caring whether it is true or false.
- The other party must have been **induced to act upon the representation or assertion.**
- The other party must have **relied upon the representation** and must have been deceived.
- The other party acting on the representation must have consequently **suffered a loss**.

4.3.2 Whether silence amounts to fraud

- **Mere silence** as to facts likely to affect the willingness of a person to enter into a contract **is not fraud**.
- A party to the contract is under **no obligation to disclose the whole truth** to the other party.

'***Caveat Emptor***' i.e., **let the purchaser beware** is rule applicable to contracts.

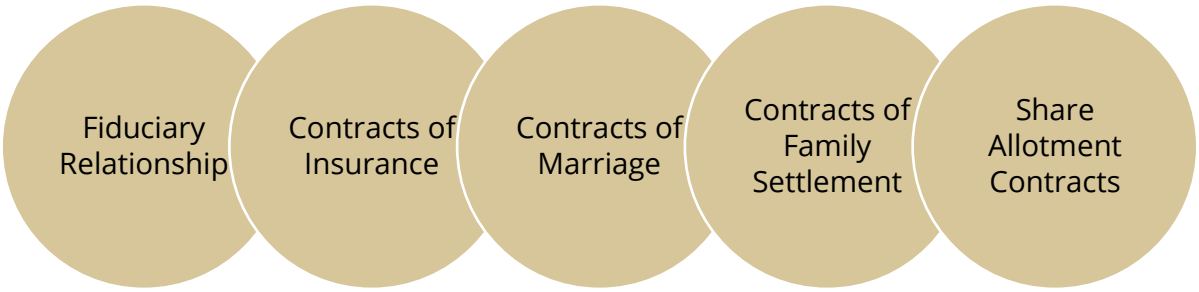
Example : A and B being traders, enter into a contract. A has private information of a change in prices which would affect B's willingness to proceed with the contract. A is not bound to inform B.

- **Exceptions** to this are when –

i) **Duty of the person to speak –** Where the circumstances of the case are such that it is the duty of the person observing silence to speak. For example, in contracts of ***uberrimae fidei*** i.e., **contracts of utmost good faith**.

Following contracts come under this category –

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- **Fiduciary Relationship -** The person in whom confidence is reposed is under a duty to act with utmost good faith and make full disclosure of all material facts concerning the agreement, known to him.

Case Law: Regier V. Campbell Staurt

Facts: A broker was asked to buy shares for client. He sold his own shares without disclosing this fact.

Judgement: The client was entitled to avoid the contract or affirm it with a right to claim secret profit made by broker on the transaction since the relationship between the broker and the client was relationship of utmost good faith.

- **Contracts of Insurance -** In contracts of marine, fire and life insurance, there is an implied condition that full disclosure of material facts shall be made. Otherwise, the insurer is entitled to avoid the contract.
- **Contracts of marriage -** Every material fact must be disclosed by the parties to a contract of marriage *(Hazi Ahmed v. Abdul Gassi)*
- **Contracts of family settlement -** Full disclosure of material facts within the knowledge of the parties is required.
- **Share Allotment contracts -** Persons issuing 'Prospectus' at the time of public issue of shares/debentures by a joint stock company have to disclose all material facts within their knowledge.

ii) **Where the silence itself is equivalent to speech –** Mere silence as to facts likely to affect the willingness of a person to enter into a contract is fraud where his silence is, in itself, equivalent to speech.

Examples :

- A sell, by auction, to B, a horse which A knows to be unsound. A says nothing to B about the unsoundness of the horse. This is not fraud by A.
- B is A's daughter and has just come of age. Here, the relation between the parties would make it A's duty to tell B if the horse is unsound.

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- When B says to A – "If you do not deny it, I shall assume that the horse is sound". A says nothing. Here A's silence is equivalent to speech.

4.3.3 Effect of Fraud upon validity of a contract

The following remedies are available to the party defrauded –

- Rescind the contract within reasonable time
- Sue for damages
- Insist on performance of contract on the condition that he is put in the position in which he would have been if false representation had not been made.

4.4 Misrepresentation [Section 18]

Definition of Misrepresentation [Section 18]

Misrepresentation **means and includes** –

i) the **positive assertion**, in a manner **not warranted by the information** of the person making it, of that **which is not true**, though he **believes it to be true**,

ii) any **breach of duty** which, **without an intent to deceive**, gains an advantage to the person committing it, or anyone claiming under him; by misleading another to his prejudice or to the prejudice of anyone claiming under him,

iii) **causing,** however**, innocently**, a party to an agreement **to make a mistake** as to the substance of the thing which is the **subject of the agreement.**

4.4.1 Essentials of misrepresentation

- Maker of the statement of fact, which is false, **believes it to be true**, even though such fact is not justified by the information he possesses.

  Example : A makes a positive statement to B that C will be made the director of a company. A makes the statement on information derived, not directly from C but from M. B applies for shares on the faith of the statement which turns out to be false. The statement amounts to misrepresentation, because the information received second-hand did not warrant A to make the positive statement to B.

- **Breach of duty** by a person **without the intention to deceive** and such **breach brings an advantage** to him.

  If there is intention to deceive, it becomes fraud.

  Examples :

  - 'A' believed the engine of his motorcycle to be in an excellent condition. 'A' without getting it checked in a workshop, told to 'B' that the motorcycle was in excellent condition. On this

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statement, 'B' bought the motorcycle, whose engine proved to be defective. Here, 'A's statement is misrepresentation as the statement turns out to be false.

- A buy an article thinking that it is worth ₹1000 when in fact it is worth only ₹500. There has been no misrepresentation on the part of the seller. The contract is valid.

- A party **causes, even though done innocently**, the other party to the agreement **to make a mistake as to the subject matter**.

4.4.2 Difference between Fraud and Misrepresentation.

Intention	There's an intention to deceive the other party in case of fraud.	No such intention to deceive the other party in case of misrepresentation.
Knowledge of truth	The person suggesting believes that the statement is untrue.	The person suggesting believes the statement is true, though it is not true.
Recission of the contract and claim of damage	The aggrieved party can repudiate the contract and claim damages.	The aggrieved party can repudiate the contract but cannot claim damages.
Means to discover the truth	The party using the fraudulent act cannot secure or protect himself by saying that the injured party had means to discover the truth.	Party can always plead that the injured party had the means to discover the truth.

4.5 Legal effects of agreements without free consent [Section 19]

- When **consent to an agreement is caused by coercion, fraud or misrepresentation**, the agreement is a contract **voidable** at the option of the party whose consent was so caused.

Example : A, intending to deceive B, falsely represents that 500 maunds of indigo are made annually at A's factory, and thereby induces B to buy the factory. The contract is voidable at the option of B as consent is caused by fraud.

- **Exception**-

  a) If such consent was caused by misrepresentation or by silence amounting to fraud the **contract is not voidable if the party whose consent was so caused had the means of discovering the truth with ordinary diligence**.

  Example : A by a misrepresentation leads B to believe erroneously that 750 tons of sugar is produced per annum at the factory of A. B examines the accounts of the factory, which should have disclosed, if ordinary diligence had been exercised by B, that only 500 tons had been produced. Thereafter B purchases the factory. In the circumstance, B cannot repudiate the contract on the ground of A's misrepresentation.

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b) A **fraud or misrepresentation which did not cause the consent to a contract** of the party on whom such fraud was practiced, or to whom such misrepresentation was made, **does not render a contract voidable.**

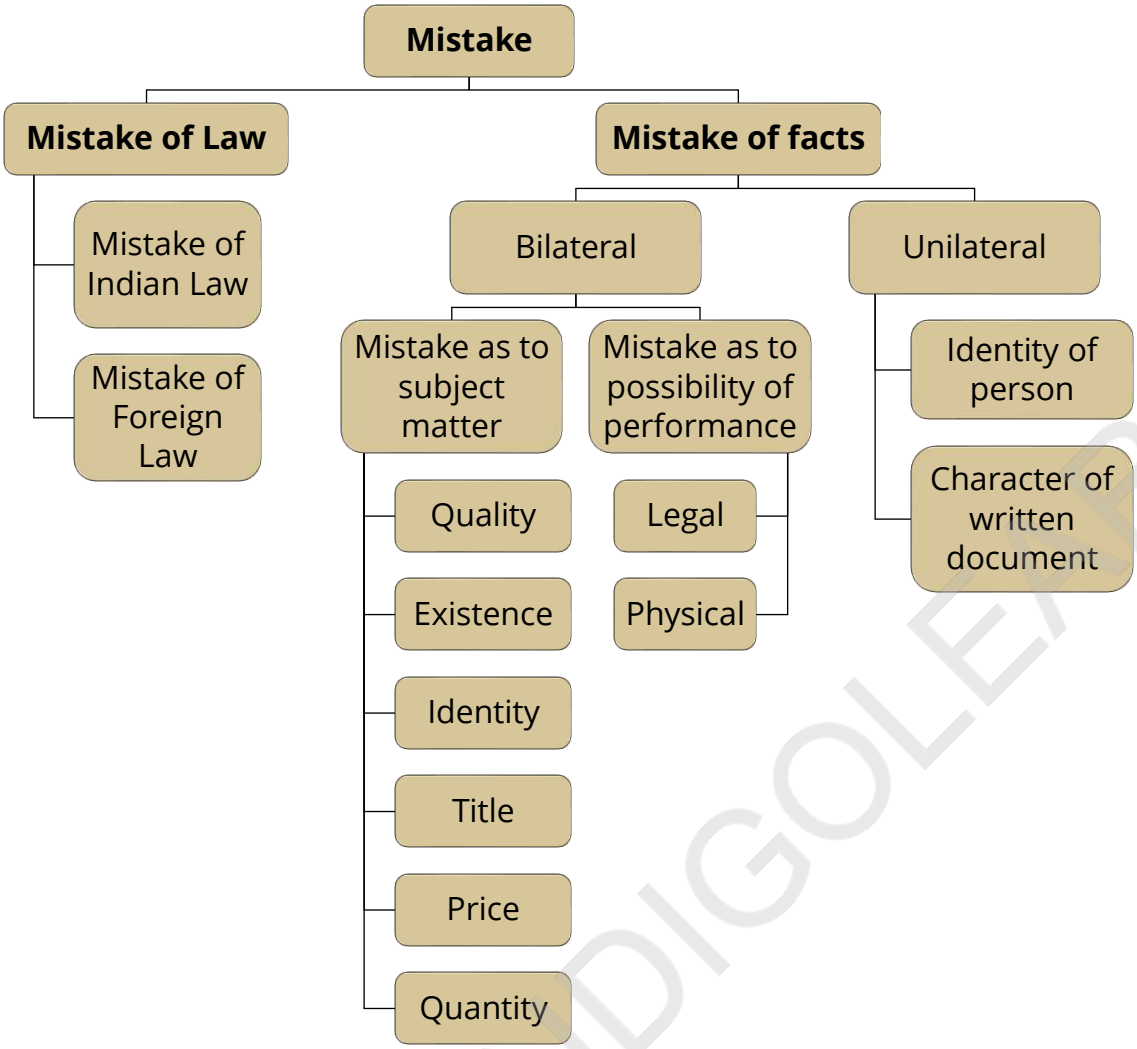
Example : When a seller of specific goods deliberately conceals a fault in order that the buyer may not discover it even if he inspects the goods, but the buyer does not in fact, make any inspection, the buyer cannot avoid the contract, as he is not in fact deceived by the conduct of the seller.

A party to contract, whose consent was so caused by fraud or misrepresentation may, if he thinks fit, insist that the contract shall be performed, and that he shall be **put in the position in which he would have been if the representation made had been true**.

4.6 Mistake

- Mistake may be defined as **innocent or erroneous belief which leads the party to misunderstand the others**.
- Mistake may be **either Bilateral or Unilateral**.
- **Bilateral mistake** – Both the parties to a contract are under a mistake.
- **Unilateral mistake** – Only one party to the contract is under a mistake.

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4.6.1 Mistake of Law

- This mistake may relate to the mistake of the **Indian laws**, or it can be a mistake of **foreign laws**.
- **Mistake of Indian Law –** If the mistake is regarding Indian laws, it **does not render a contract void** as ***Ignoratia Juris Non Excuta*** i.e., ignorance of the law is not a good enough excuse.
- However, if the mistake of law is **caused through the inducement** of another, the contract **may be avoided**.
- **Mistake of Foreign Law –** Mistake of foreign law is **excusable** and is **treated like a mistake of fact**. Contract may be avoided on such mistake.

4.6.2 Mistake of fact

- **Bilateral Mistake –**
    - Where the **contracting parties** misunderstood each other and **are at cross purposes**, there is a **bilateral or mutual mistake**.

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- Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, **the agreement is void.**

- **Unilateral Mistake –**
  - Where **only one party is under mistake**, there is unilateral mistake.
  - Unilateral mistake is not allowed as a defence to avoid a Contract. So, if only one party has made a mistake of fact the contract remains a **valid contract**.

Example : A offers to sell his Ambassador Car to B, who believes that A has only Fiat Car, agrees to buy the car. Here, the two parties are thinking about different subject matter so that there is no real consent, and the agreement is void.

5. Legality of Object and Consideration

Section 23 of the Indian Contract Act, 1872 describes which considerations are lawful and those which are not –

The consideration or object of an agreement is **lawful, unless** –

1. It is **forbidden** by law; or
2. Is of such a nature that, if permitted, it would **defeat the provisions of any law**; or
3. Is **fraudulent**; or
4. **Involves injury** to the person or property of another; or
5. The court regards it as **immoral**; or
6. **Opposed to public policy**.

Every agreement of which the object or consideration is unlawful is void.

Examples :

- 'A' promises to B to abandon a prosecution which he had instituted against B for robbery and B promises in lieu thereof to restore the value of the property robbed. The agreement is void as its object, namely, the stifling of prosecution, is unlawful.
- 'A' promises to obtain for B an employment in the public service and B promises, in return, to pay ₹1,00,000 to A. The agreement is void. The consideration, being opposed to public policy, is unlawful.

5.1 Consideration or object is forbidden by law

- When the object of a contract or the consideration of a contract is **prohibited by law**, then they are **not lawful consideration** or **object** anymore. They then become unlawful in nature. And so, such a contract cannot be valid anymore.
- Unlawful consideration of object includes acts that are **specifically punishable by the law**. This also includes those that the **appropriate authorities prohibit via rules and regulations**.

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But if the rules made by such authorities are not in tandem with the law, then these will not apply.

Example : A licence to cut grass is given to X by the Forest Department under the Forest Act. One of the terms of licence is that the licencee should not assign his interest under the licence without the permission of the Forest Officer, and a fine is prescribed for a breach of this condition. But the observance of the conditions of the licence is not obligatory under the Forest Act. If X in breach of the condition, agrees to assign his interest under the licence to B, that agreement will be valid. Here, the assignment is not prohibited by law, the condition against assignment has been imposed only for administrative purpose or solely for the protection of revenue.

5.2 Consideration or object defeats the provision of law

This means that the contract is trying to **defeat the intention of the law**. If the courts find that the real intention of the parties to the agreement is to defeat the provisions of the law, it will put aside the said contract.

Example : A and B enter into an agreement, where A is the debtor, that B will not plead limitation. This, however, is done to defeat the intention of the Limitation Act, and so the courts can rule the contract as void due to unlawful object.

5.3 Consideration or object is fraudulent

Agreements which are entered into to **promote fraud** are **void**.

Example : A decides to sell goods to B and smuggle them outside the country. This is a fraudulent transaction hence, it is void. Now B cannot recover the money under the law if A does not deliver on his promise.

5.4 Consideration or object defeats any rule for the time being in force in India

If the consideration or the object is **against any rules** in effect in the country for the time being, then they will **not be lawful consideration or objects**. And so, the contract thus formed will not be valid.

5.5 Consideration or object involves injury to the person or property of another

In legal terms, an injury means a **criminal and harmful wrong done to another person**. So, if the object or the consideration of the contract does harm to another person or property, this will amount to unlawful consideration.

Example : An agreement to publish a book that is a violation of another person's copyright would be void. This is because the consideration here is unlawful and injures another person's property, i.e. his copyright.

5.6 Consideration or object is immoral

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If the object or the consideration are **regarded by the court as immoral**, then such contract is not valid.

5.7 Consideration or object is opposed to public policy

For the **betterment of the community**, there are certain restriction on contracts in the name of public policy. But we do not use public policy in a wide sense in this matter. If that was the case it would curtail individual freedom of people to enter into contracts. So, **for the purpose of lawful consideration and object public policy is used in a limited scope**.

Some of the **agreements which are held to be opposed to public policy** are as follows-

5.7.1 Trading with enemy

Entering into an agreement with a person from a country with whom **India is at war** is **void**, as the **object is opposed to public policy**.

Example : India entered in war like situation with China. Mr. A from India entered into contract with China for import of toys. Such contract is void as China is alien enemy of India. The contract if made before such war like situation may be suspended or dissolved.

5.7.2 Stifling Prosecution

- This is a **pervasion of the natural course of law**, and such contracts are void.
- The principle is that **one should not make a trade of felony** (i.e., a serious crime). The compromise of any public offence is generally illegal.
- However, in case of a statutory list of **compoundable offences**, an **agreement to drop proceeding** relating to such offences with or without the permission of the Court, as the case may be, in consideration the accused promising to do something for the complainant, is **not opposed to public policy**.
- In case of an uncompoundable offence, it is **void**.

5.7.3 Maintenance and Champerty

- Maintenance is an agreement in which **a person promises to maintain suit in which he has no interest.**
- Champerty is an agreement in which **a person agrees to assist another in litigation in-exchange of a promise to hand over a portion of the proceeds of the action.**
- The agreement for supplying funds by way of Maintenance or Champerty is **valid unless**
    a) **It is unreasonable** so as to be unjust to other party or
    b) It is **made by a malicious motive**.

Examples : 'A' offer B ₹ 2000, if he sues C for a case which they could have settled mutually under provisions of law, just to annoy C. Such agreement is maintenance agreement.

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- A agrees to pay expenses to B if he sues C and B agrees to pay half of the amount received from result of such suit. This is an agreement of champerty.

5.7.4 Trafficking relating to Public Offices and titles

An agreement to trafficking in public office is opposed to public policy, as it **interferes with the appointment of a person best qualified for the service of the public**. Public policy requires that there should be no money consideration for the appointment to an office in which the public is interested.

Example : Harish paid ₹15,000 to the officer to give his son the job in the Forest department of India. On failure by officer he couldn't recover the amount as such contract amounts to trafficking in public office which is opposed to public policy.

5.7.5 Agreements tending to create monopolies

Agreements having for their object the establishment of monopolies are **opposed to public policy and therefore void.**

Example : XYZ and ABC were only the manufactures of oxygen cylinders in West Bengal. They both entered into contract of supplying the same at very high rates and enjoy the monopoly rates during the COVID-19 period in the country. Such contract is opposed to public policy as they intended to create monopolies.

5.7.6 Marriage brokerage agreements

- An **agreement to negotiate marriage for reward**, which is known as a marriage brokerage contract.
- Such an agreement is **void**, as it is **opposed to public policy**.

> Marriage bureau only provides information and doesn't negotiate marriage for reward; therefore, it is not covered under this point.

5.7.7 Interference with the course of justice

An **agreement whose object is to induce any judicial officer of the State to act partially or corruptly** is void, as it is opposed to public policy. Also, an agreement which contemplates the **use of under-hand means to influence legislation** is void.

5.7.8 Interest against obligation

Agreements which tend to create interest against obligation are **void**.

Examples :

- An agreement by an agent to receive without his principal's consent compensation from another for the performance of his agency is invalid.

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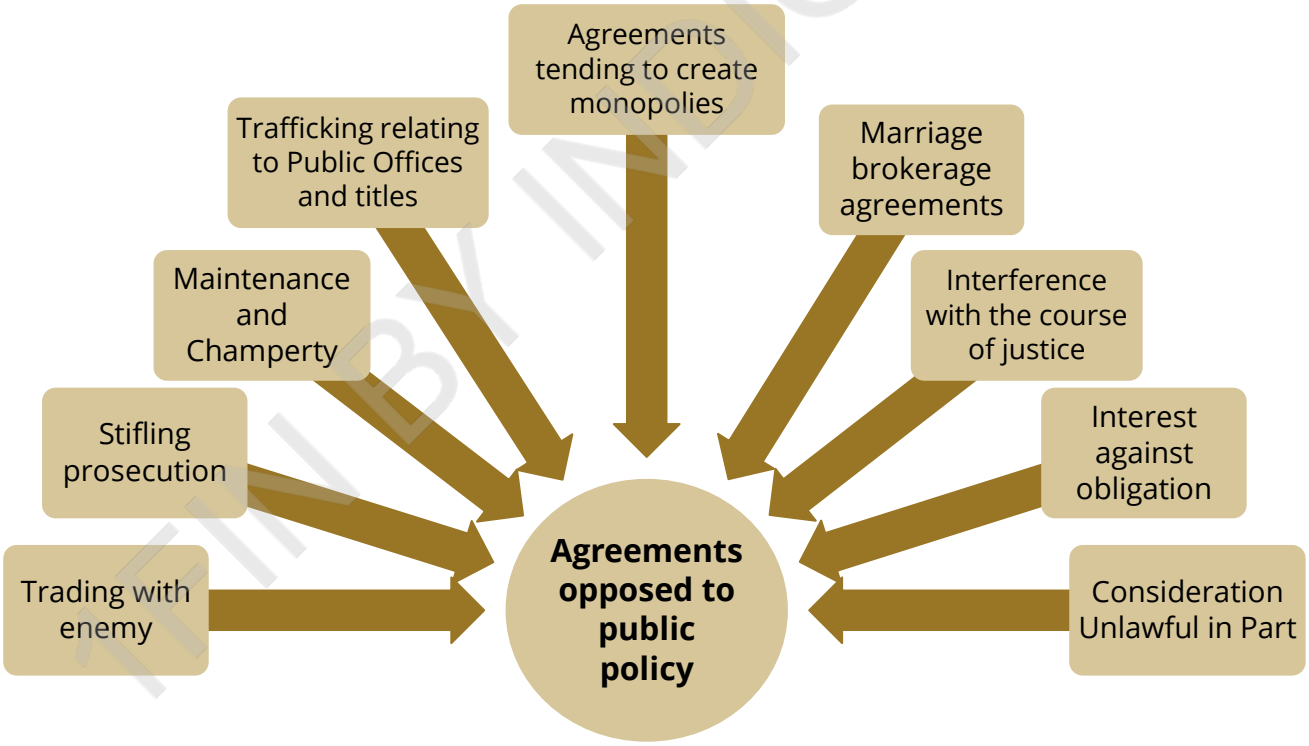
- A, who is the manager of a firm, agrees to pass a contract to X if X pays to A ₹200,000 privately; the agreement is void.

5.7.9 Consideration Unlawful in Part

- By virtue of **Section 24,** if
    - **any part of a single consideration** for one or more objects, or
    - any one **or any part of any one of several considerations for a single object**, is **unlawful**, the agreement is **void**.

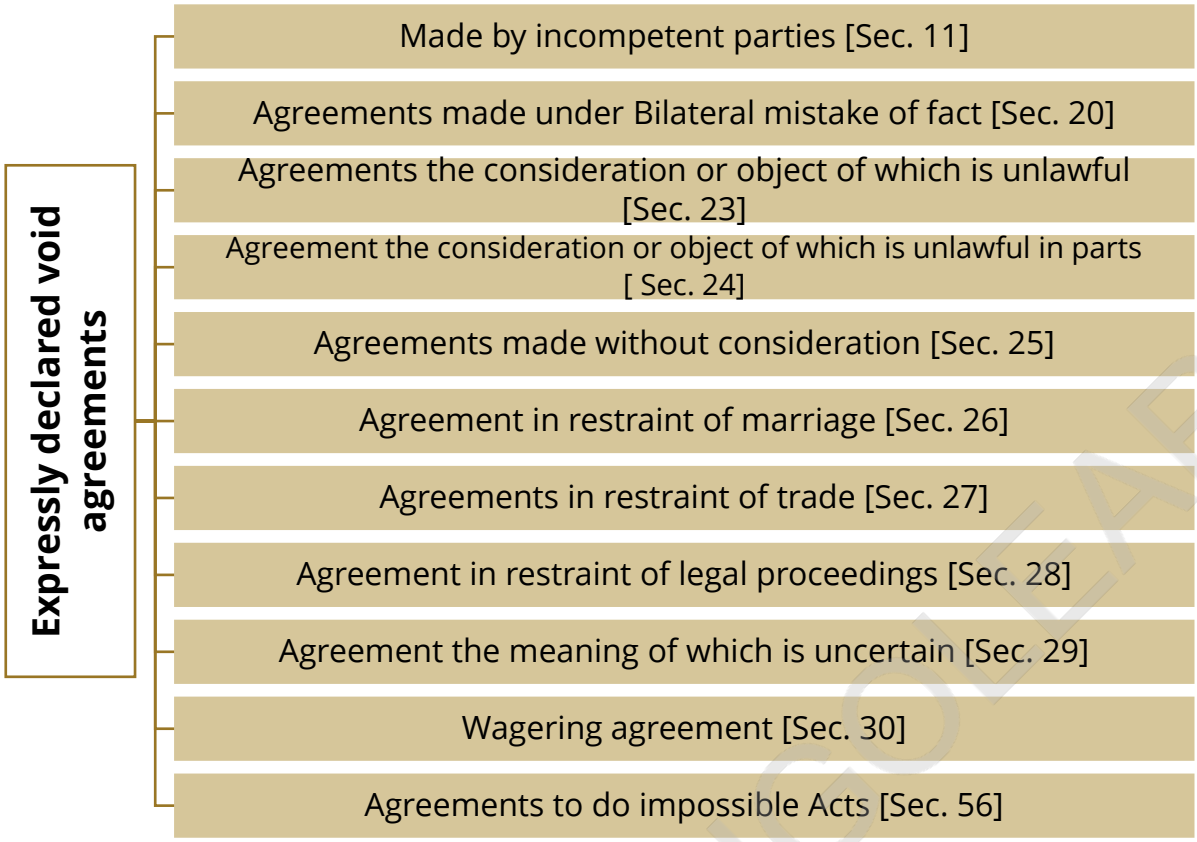
> There is **no promise** for a lawful consideration **if there is anything illegal in a consideration which must be taken as a whole.**

- The **general rule** is that –
    - where the **legal part of a contract can be severed** from the illegal part, the **bad part may be rejected, and the good one can be retained.**
    - But, where the **illegal part cannot be severed**, the contract is **altogether void.**



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6. Void Agreements



6.1 Agreement in restraint of marriage [Section 26]

Every agreement in restraint of marriage of any person other than a minor, is void. So, if a person, being a major, agrees for good consideration not to marry, the promise is not binding and considered as void agreement.

6.2 Agreement in restraint of trade [Section 27]

- An agreement by which any person is restrained from carrying on a trade or practising a legal profession or exercising a business of any kind is an expressly **void agreement**. Such an agreement **violates the constitutional rights of a person**.

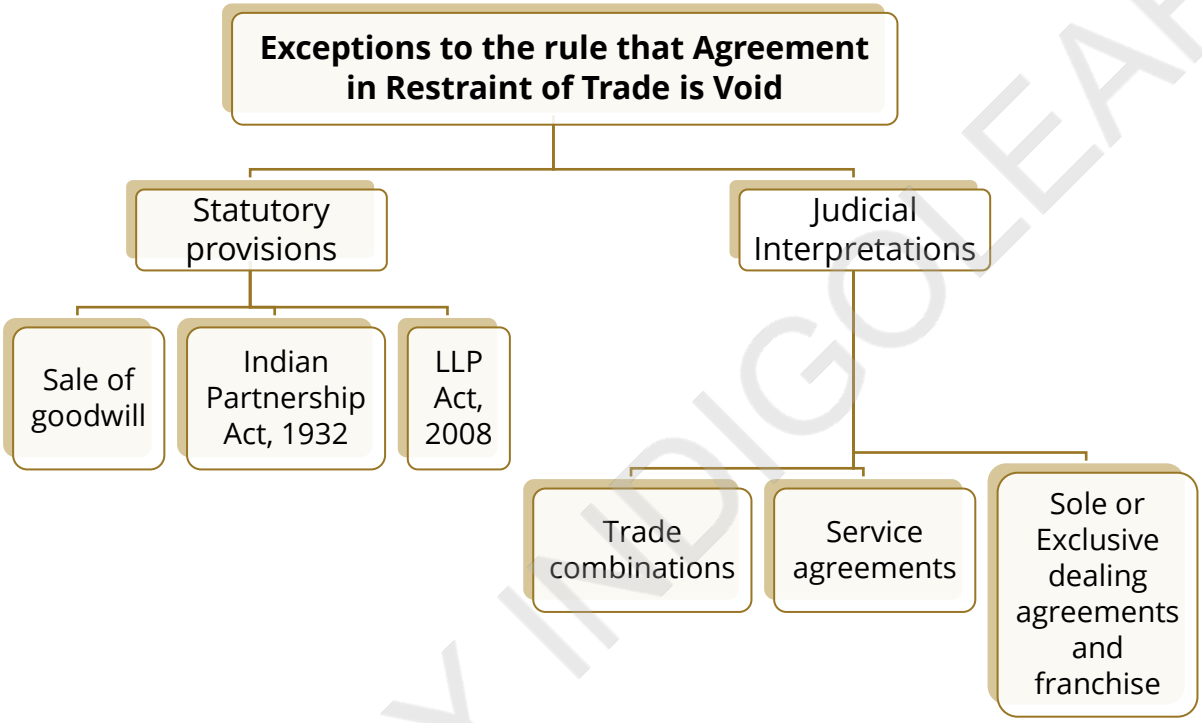
> An **agreement of service** by which an employee binds himself, during the term of his agreement, not to compete with his employer is not in restraint of trade.

- However, there are a **few exceptions** to this rule.
    - **Sale of goodwill –** Where a person sells the goodwill of a business and agrees with the buyer to refrain from carrying on a similar business, within specified local limits, so

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long as the buyer or his successor in interest carries on a like business therein, such an agreement is valid.

- **In case of outgoing partner** – Under Section 36 of the Indian Partnership Act, 1932 if an outgoing partner makes an agreement with the continuing partners that he will not carry on any business similar to that of the firm within a specified period or within specified local limits, such an agreement, thought in restraint of trade, will be valid, if the restrictions imposed are reasonable.
- **Agreement between partners –** Under Section 11 of the Indian Partnership Act, 1932 an agreement between partners not to carry on competing business during the continuance of partnership is valid.



6.3 Agreement in restraint of legal proceedings [Section 28]

- An agreement in restraint of legal proceeding means an **agreement**
  a) **by which any party thereto is restricted absolutely from enforcing his rights under a contract through a Court** or
  b) which **abridges the usual period for starting legal proceedings**.
- A contract of this nature is **void**.
- However, there are certain **exceptions –**
  a) A contract by which the **parties agree that any dispute between them in respect of any subject shall be referred to arbitration** and that only the amount awarded in such arbitration shall be recoverable is a valid contract.

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b) A contract by which the **parties agree to refer to arbitration any question between them** which has already arisen, or which may arise in future, is valid; **but such a contract must be in writing**.

6.4 Agreement - the meaning of which is uncertain [Section 29]

- An agreement, the meaning of which is not certain, is **void**.
- But, where the **meaning thereof is capable of being made certain**, the agreement is **valid**.

Example : A agrees to sell B "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty. But the agreement would be valid if A was dealer only in coconut oil; because in such a case its meaning would be capable of being made certain.

6.5 Wagering agreement [Section 30]

- Wagering agreement is an agreement **involving payment of a sum of money upon the determination of an uncertain event**.
- An agreement by way of a wager is **void**.
- But if **one of the parties has control** over the event, **agreement is not a wager.**

Example : A agrees to pay ₹ 50,000 to B if it rains, and B promises to pay a like amount to A, if it does not rain, the agreement will be by way of wager.



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6.5.1 Transactions similar to Wager (Gambling)

Lottery transactions
• A game of chance. • Where prime motive is gambling - it is wager. • Even a lottery authorised by GOI is wagering - only effect of such sanction is thatperson running the lottery is not punished under IPC
Crossword puzzles and Competitions
• Crossword puzzles in which prizes depend upon the correspondence of the competitor's solution with a previously prepared solution kept with the editor of a newspaper is a lottery and therefore, a wagering transaction**.** • *State of Bombay vs. R.M.D. Chamarbangwala*
Speculative Transactions
• An agreement or a share market transaction where the parties intend to settle the difference between the contract price and the market price of certain goods or shares on a specified day, is a gambling and hence void.
Horse Race Transaction
• A horse race competition where prize payable to the bet winner is less than Rs. 500, is a wager.

Case Law: State of Bombay vs. R.M.D. Chamarbangwala AIR (1957)

Facts: A crossword puzzle was given in magazine. A solved his crossword puzzle and his solution corresponded with previously prepared solution kept with the editor.
Judgement: This was a game of chance and therefore a lottery (wagering transaction).

6.5.2 Transactions resembling with wagering transaction but are not void

a) **Chit fund**: Chit fund **does not come within the scope of wager u/s 30**. In case of a chit fund, a certain number of persons decide to contribute a fixed sum for a specified period and at the end of a month, the amount so contributed is paid to the lucky winner of the lucky draw.

b) **Commercial transactions or share market transactions**: In these transactions **in which delivery of goods or shares is intended to be given or taken**, do not amount to wagers.

c) **Games of skill and Athletic Competition**: Crossword puzzles, picture competitions and athletic competitions where **prizes are awarded on the basis of skill and intelligence** are the games of skill and hence such competition are valid.

According to the **Prize Competition Act, 1955** prize competition in games of skill are **not wagers provided the prize money does not exceed ₹1,000.**

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d) **Contract of insurance**: A contract of insurance is a type of contingent contract and is valid under law and these contracts are **different from wagering agreements.**

6.5.3 Distinction between Contract of Insurance and Wagering Agreement

Meaning	It is a contract to indemnify the loss.	It is a promise to pay money or money's worth on the happening or non- happening of an uncertain event.
Consideration	Essence of insurance contract is the mutual consideration (premium and compensation amount).	There is no consideration between the two parties. There is just gambling for money.
Insurable Interest	Insured party has insurable interest in the life or property sought to be insured.	There is no property in case of wagering agreement. There is betting on other's life and properties.
Contract of Indemnity	Except life insurance, the contract of insurance indemnifies the insured person against loss.	Loser has to pay the fixed amount on the happening of uncertain event.
Enforceability	It is valid and enforceable	It is void and unenforceable agreement.
Premium	Calculation of premium is based on scientific and actuarial calculation of risks.	No such logical calculations are required.
Public Welfare	They are beneficial to the society.	They have been regarded as against the public welfare.

6.6 Agreements to do Impossible Acts [Section 56]

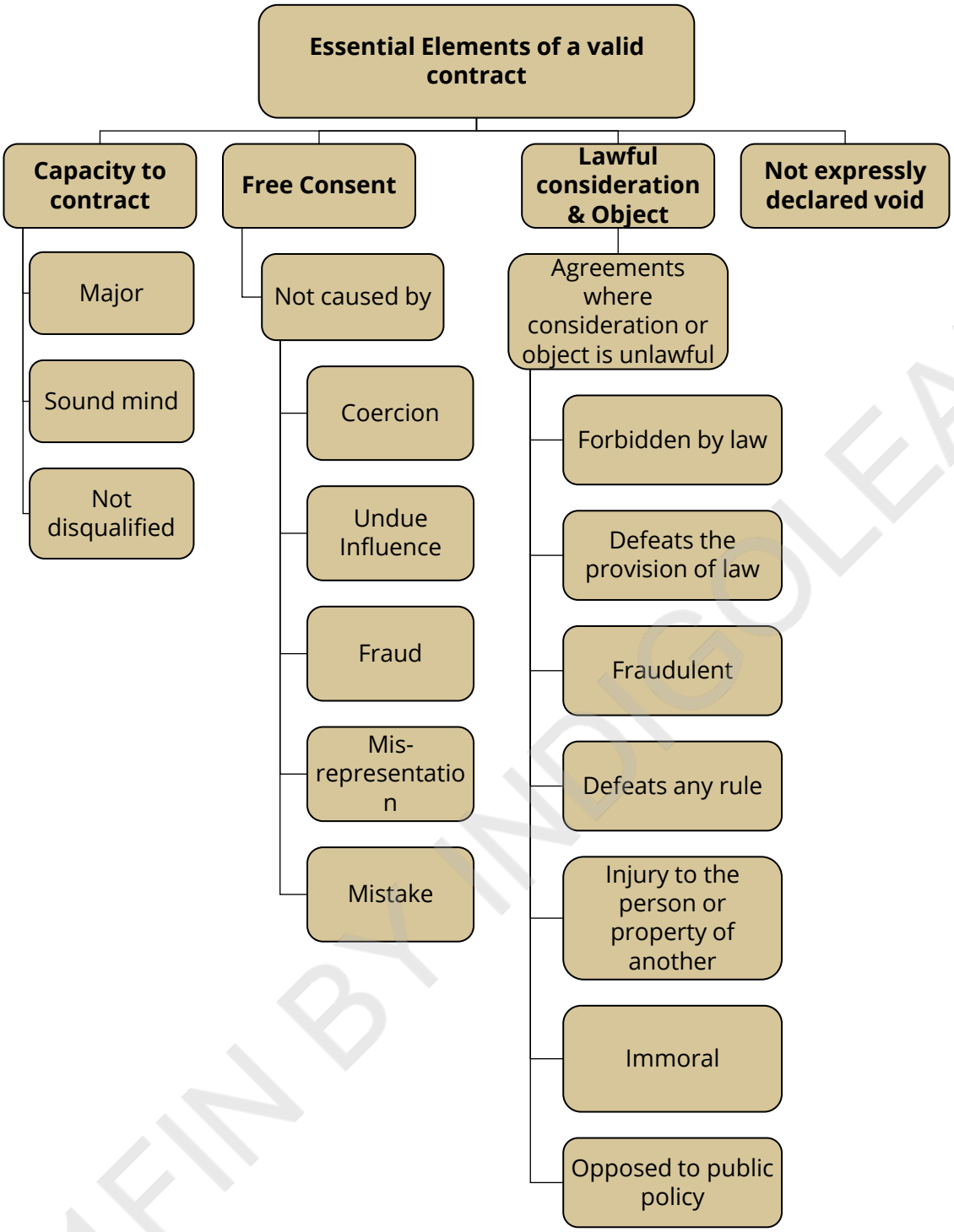
An agreement to do an act impossible in itself is void. Section 56 covers various circumstances under which agreement may be void, since it is impossible to carry it out.



Such agreements are covered in detail in Unit 4 – Performance of Contract.

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7. Overview



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CH-1: UNIT 4 – PERFORMANCE OF CONTRACT

Learning Outcomes –

- Carrying out obligations under a contract.
- Various modes of performance.
- Refusal of performance.
- Joint Promisor Liabilities and
- Joint Promisee Rights
- Appropriation of payments.
- Contracts which need not be performed.

4.1 Joint Promisors

- When two or more persons have made a joint promise, then unless a contrary intention appears by the contract, **all such persons must jointly fulfil the promise.**
- If **any of them dies**, his **legal representatives must, jointly with the surviving promisors,** fulfil the promise.
- If **all of them die**, the **legal representatives of all of them** must fulfil the promise jointly.

Example : 'A', 'B' and 'C' jointly promised to pay ₹6,00,000 to 'D'. Here 'A', 'B' and 'C' must jointly perform the promise. If 'A' dies before performance, then his legal representatives must jointly with 'B' and 'C' perform the promise, and so on. And if all the three (i.e. 'A', 'B' and 'C') die before performance, then the legal representatives of all must jointly perform the promise.

8. Distinction between Succession and Assignment

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Succession	Assignment
In case of succession **both the burden and benefits attaching to the contract are succeeded** by process of law.	In case of assignment, the **benefit of the contract can only be assigned** but not the liabilities.
However, the successor's **liability is limited to the extend to the property inherited** by him.	Benefit is **coupled with a liability** OR when a **personal consideration is involved**, then **benefit cannot be assigned.**

9. Discharge of a Contract

Modes of Discharge of a Contract

- By Performance
- By Mutual Agreement
- By Impossibility of Performance
- By Lapse of Time
- By Operation of Law
- By Breach of Contract
- By waiver or remission of performance by promisee
- By neglect of promisee to afford the promisor reasonable facilities for performance
- By merger of rights

11.1 Discharge by performance

When the **parties to the contract fulfil their obligations arising under the contract within the time and in the manner prescribed**. Discharge by performance may be

- Actual performance; or
- Attempted performance.

Example : Actual performance – A contracts to sell his car to B on the agreed price. the contract comes to an end by performance as soon as the car is delivered to B and B pays the agreed price for it.

Example : Attempted performance – A contracted to supply certain quantity of timber to B. B made the supply of timber at appointed time and place, but A refused to accept the delivery. This is called as attempted performance.

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11.2 Discharge by mutual agreement

If the parties to a contract agree to **substitute a new contract for it, or to rescind or remit or alter it,** the original contract need not be performed [Section 62].

11.3 Discharge by impossibility of performance

- The impossibility may exist from the very start. In that case, it would be **impossibility ab initio.**
- Alternatively, impossibility may supervene. **Supervening impossibility** may take place owing to:
    - An **unforeseen change in law**, or
    - The **destruction of the subject-matter** essential to that performance, or
    - The **non-existence or non-occurrence of particular state of things**, which was naturally contemplated for performing the contract, **as a result of some personal incapacity** like dangerous malady, or
    - The declaration of a **war**.

11.4 Discharge by lapse of time

A **contract should be performed within a specified period** as prescribed by the Limitation Act, 1963. If it is **not performed** and if **no action is taken by the promisee within the specified period of limitation**, he is deprived of remedy at law.

Example : If a creditor does not file a suit against the buyer for recovery of the price within three years, the debt becomes time-barred and hence irrecoverable.

11.5 Discharge by operation of law

A contract may be discharged by operation of law which **includes by death of the promisor, by insolvency etc**.

11.6 Discharge by breach of contract

- If a **party to a contract fails to perform his obligation** according to the time and place specified, then he is said to have committed a breach of contract.
- Breach can be of **two types – actual breach or anticipatory breach**. In both cases, the breach discharges the contract.

> When a person **repudiates a contract before the stipulated time for its performance has arrived**, he is deemed to have committed **anticipatory breach.**

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Example : A contracted with B to supply 100 kgs of rice on 1st June. But A failed to deliver the same on said date. This is actual breach of contract. If time is not essential essence of contract B can give him another date for supply of goods and he will not be liable to claim for any damages if prior notice for the same is not given to A while giving another date.

11.7 Promisee may waive or remit performance of promise

Every promisee may **dispense with or remit, wholly or in part, the performance** of the promise made to him, **or may extend the time** for such performance **or may accept instead of it any satisfaction** which he thinks fit [Section 63].

11.8 Effects of neglect of promisee to afford promisor reasonable facilities for performance

If any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, **the promisor is excused by such neglect or refusal as to any non-performance caused thereby** [Section 67].

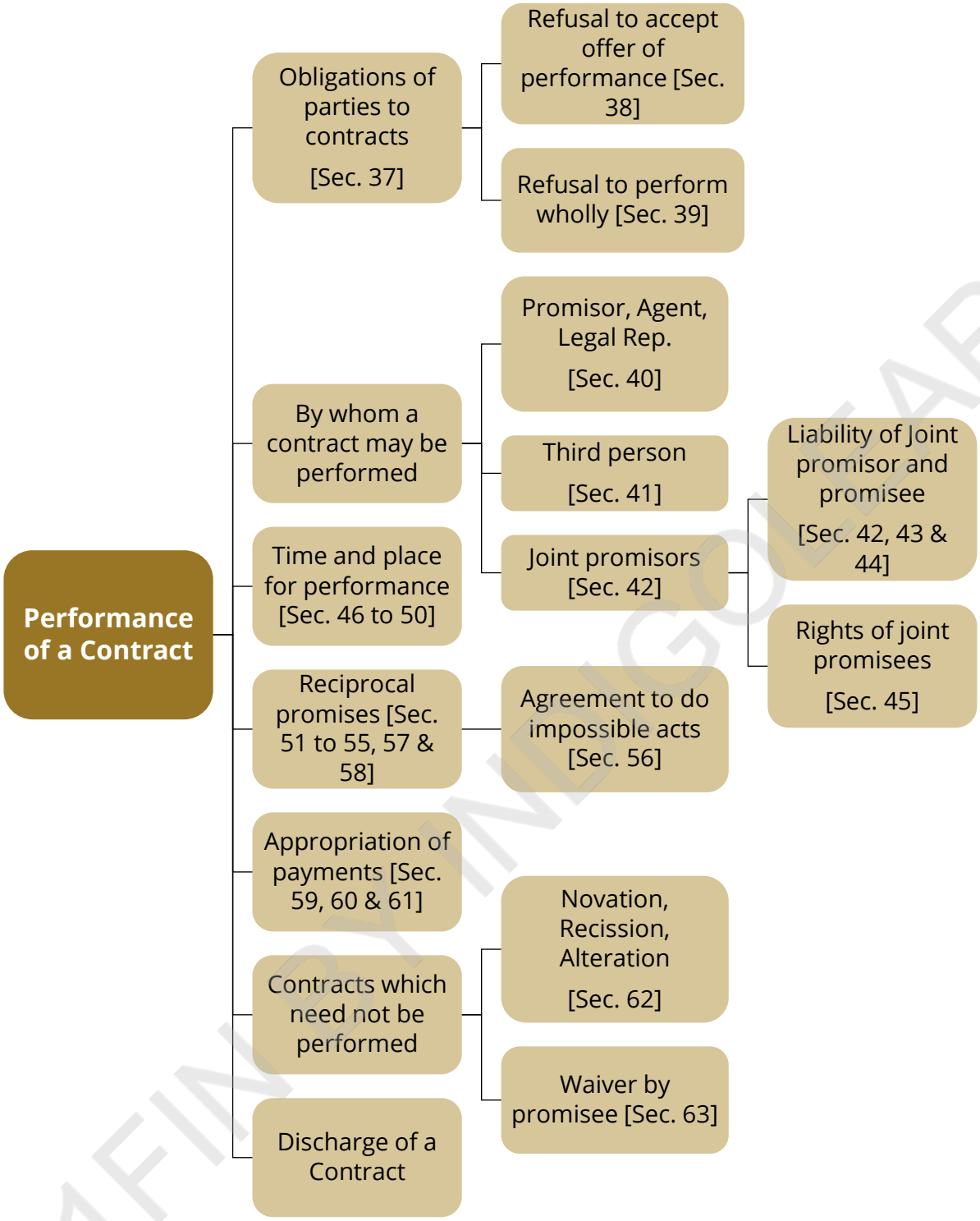
11.9 Merger of rights

In some situations, it is possible that **inferior and superior right coincides in the same person**. In such cases, **both the rights combine** leading to a **discharge of the contract governing the inferior rights**.

Example : A took a land on lease from B. Subsequently, A purchases that very land. Now, A becomes the owner of the land and the ownership rights being superior to rights of a lessee, the earlier contract of lease stands terminated.

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10. Overview



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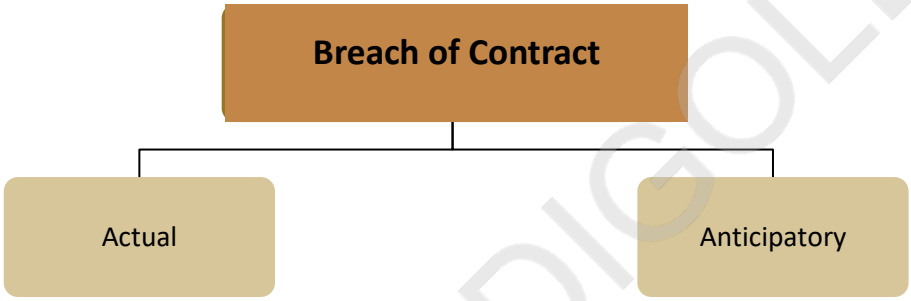
CH-1: UNIT 5 – BREACH OF CONTRACT AND ITS REMEDIES

Learning Outcomes –

- Concept of Breach of Contract
- Various modes of Breach of Contract
- Remedies for Breach of Contract
- Measurement of Damages

1. Introduction

Breach means **failure of a party to perform** his or her obligation under a contract.



2. Anticipatory Breach of Contract

- An anticipatory breach of contract is a breach of contract **occurring before the time fixed for performance has arrived**.
- Anticipatory breach of a contract may take either of the following **two ways:**
  a) **Expressly** by words spoken or written, and
  b) **Impliedly** by the conduct of one of the parties.

Examples :

1) Where A contracts with B on 15th July 2020 to supply 10 bales of cotton for a specified sum on 14th August 2020 and on 30th July informs B, that he will not be able to supply the said cotton on 14th August 2020, there is an **express rejection** of the contract.
2) Where A agrees to sell his white horse to B for ₹ 50,000/- on 10th of August 2020, but he sells this horse to C on 1st of August 2020, the anticipatory breach has **occurred by the conduct** of the promisor.

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2.1 Effect of anticipatory breach

As per **Section 39** of the Indian Contract Act, 1872 –

"When a **party to a contract has refused to perform or disable himself from performing, his promise** in its entirety, the **promisee may put an end to the contract**, unless he has signified, but words or conduct, his acquiescence in its continuance."

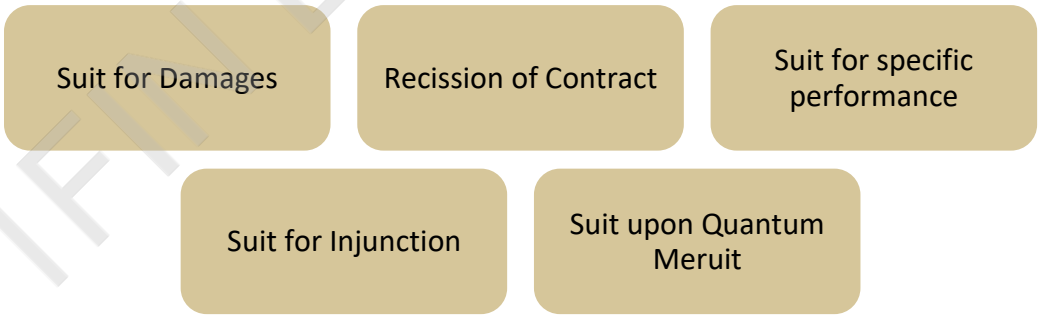
- The **promisee is excused from performance** or further performance of the contract.
- He **further has the following options**:
    i) He can **rescind the contract** and **sue the other party for damages immediately** without waiting till the due date of performance.
    ii) He may decide **not to rescind** the contract **and treat it as still operative** and **wait till the time of performance and then hold the other party responsible**.

3. Actual Breach of Contract

- While an anticipatory breach is before the time of performance, an actual breach of contract is **on the scheduled time of performance of the contract**.
- Actual breach of contract **may be committed** –
    - **At the time when the performance of the contract is due**, or
    - **During the performance** of the contract.

Example : A agrees to deliver 100 bags of sugar to B on 1 Feb 2020. On the said day, he failed to supply 100 bags of sugar to B. This is actual breach of contract. The breach has been committed by A at time when performance becomes due.

3.1 Remedies Available for Breach of Contract



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4. Suit for Damages

4.1 Compensation for loss or damage caused by breach of contract

As per **Section 73** of the Indian Contract Act, 1872 –

"When a contract has been broken, the **party who suffers by such a breach is entitled to receive**, from the party who has broken the contract, **compensation for any loss or damage** caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it".

- On the breach of the contract, **the party who suffers** from such a breach **is entitled to receive**, from the party who has broken the contract, **compensation for any loss or damage caused to him by breach.**
- Compensation can be claimed for :
    - any **loss or damage which naturally arises in the usual course** of events, or
    - any **loss or damage which the party knew when they entered into the contract**, as likely to result from the breach.

No compensation is payable for any remote or indirect loss.

- **Special damages**, if any, can be claimed only if the suffering party has **given notice about it earlier**. Also, the party suffering a loss is expected to take reasonable steps to minimize it.
- While estimating the loss incurred, all the means which existed to remedy the inconvenience caused by the non-performance of the contract should be considered.

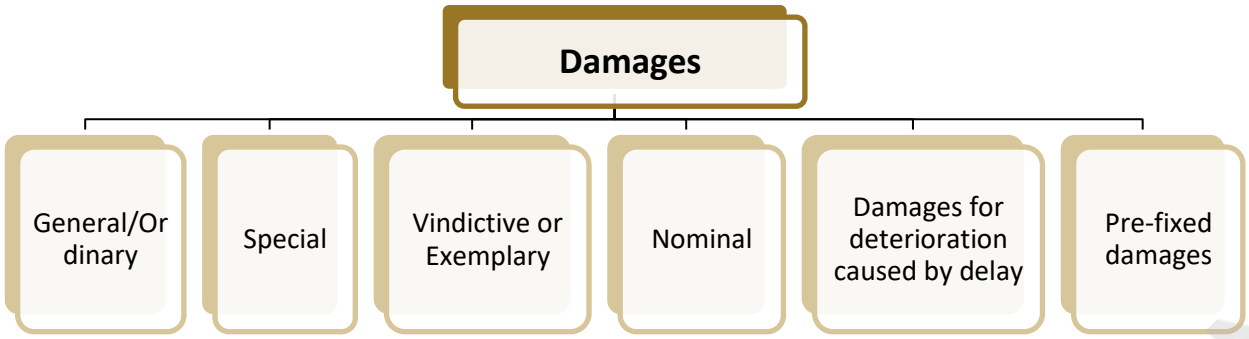
Example : Yash agrees to sell and deliver 50 kilograms of rice to Rohan for ₹ 5,000. The amount is to be paid on delivery. However, he fails to perform the promise. Rohan buys 50 kilograms of rice from a neighbourhood trader for ₹ 7,500. Rohan can claim compensation from Yash. The compensation amount is the additional amount that Rohan had to pay to procure the same quantity of rice of similar quality from the market. In this case, it is ₹2,500.

4.2 Compensation for failure to discharge obligation resembling those created by contract

When an obligation resembling those created by contract has been incurred and has not been discharged, any **person injured by the failure to discharge it is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it and had broken his contract.**

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4.3 Kind of Damages



4.3.1 Ordinary damages

The damages which **arise naturally** in the usual course of things from breach of contract.

Case Law: Hadley vs. Baxendale

Facts: The crankshaft of P's flour mill had broken. He gives it to D, a common carrier who promised to deliver it to the foundry in 2 days where the new shaft was to be made. The mill stopped working, D delayed the delivery of the crankshaft, so the mill remained idle for another 5 days. P received the repaired crankshaft 7 days later than he would have otherwise received. Consequently, P sued D for damages not only for the delay in the delivering the broken part but also for loss of profits suffered by the mill for not having been worked.

Judgement: The court held that P was entitled only to ordinary damages and D was not liable for the loss of profits because the only information given by P to D was that the article to be carried was the broken shaft of a mill and it was not made known to them that the delay would result in loss of profits.

4.3.2 Special damages

Where a **party to a contract receives a notice of special circumstances affecting the contract**, he will be liable not only for damages arising naturally and directly from the breach but also for special damages.

Example : 'A' delivered a machine to 'B', a common carrier, to be conveyed to 'A's mill without delay. 'A' also informed 'B' that his mill was stopped for want of the machine. 'B' unreasonably delayed the delivery of the machine, and in consequence 'A' lost a profitable contract with the Government.

- In this case, 'A' is entitled to receive from 'B', by way of compensation, the average amount of profit, which would have been made by running the mill during the period of delay.
- But, he cannot recover the loss sustained due to the loss of the Government contract, as 'A's contract with the Government was not brought to the notice of 'B'.

4.3.3 Vindictive or Exemplary damages

These damages may be **awarded only in two cases** –

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i) for **breach of promise to marry**, and

ii) for **wrongful dishonour by a banker of his customer's cheque** *(Gibbons v West Minister Bank).*

4.3.4 Nominal damages

- Nominal damages are awarded where the plaintiff has proved that **there has been a breach of contract, but he has not in fact suffered any real damage.**
- The amount may be a rupee or even 10 paise.

4.3.5 Damages for deterioration caused by delay

In the case of deterioration caused to goods by delay, **damages can be recovered from carrier even without notice.**

The word 'deterioration' not only implies physical damages to the goods, but it may also mean loss of special opportunity for sale.

4.3.6 Pre-fixed damages

Section 74 of the Act provides that if a **sum is named in a contract as the amount to be paid in case of a breach**, the aggrieved party is entitled to receive from the party at fault a reasonable compensation not exceeding the amount so named.

Example : If the penalty provided by the contract is ₹ 1,00,000 and the actual loss because of breach is ₹ 70,000, only ₹ 70,000 shall be available as damages, i.e., the amount of actual loss and not the amount stipulated. But if the loss is, say, ₹ 1,50,000, then only, ₹ 1,00,000 shall be recoverable.

5. Penalty and Liquidated Damages

- English Law makes distinction between liquidated damages and penalty, whereas **Indian Law does not make any distinction between the two.**
- If the sum fixed in the contract represents a **genuine pre-estimate by the parties of the loss**, which would be caused by a future breach of the contract it is **liquidated damages.**
- Where the sum fixed in the contract is **unreasonable and is used to force the other party to perform the contract,** it is **penalty**.
- **Section 74** of the Contract Act lays down if the parties have fixed what the damages will be, **the courts will never allow more.** Thus, a person complaining of breach of contract is **entitled to get reasonable compensation** and is not entitled to realise anything by way of penalty.
    - **Exception**: If a party enters into a **contract with the State or Central government for the performance of an act in the interest of the general public**, then a breach of such a contract makes the party liable to pay the entire amount mentioned in the contract.

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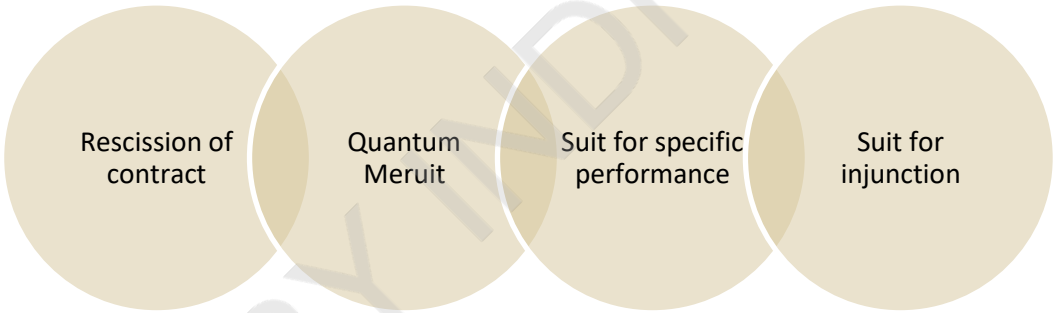
Examples :

- A borrows ₹ 10,000 from B and gives him a bond for ₹ 20,000 payable by five yearly instalments of ₹ 4,000 with a stipulation that in default of payment, the whole shall become due. This is a stipulation by way of penalty.
- A undertakes to repay B, a loan of ₹ 10,000 by five equal monthly instalments with a stipulation that in default of payment of any instalment, the whole shall become due. This stipulation is not by way of penalty and the contract may be enforced according to its terms.

5.1 Distinction between liquidated damages and penalty

- If the sum payable is far in excess of the probable damage on breach of the contract, then it is a penalty.
- If a contract mentions an amount payable at a certain date and an additional amount if a default happens, then the additional sum is a penalty.
- Even if the contract specifies a sum as 'penalty' or 'damages', the Court needs to discern this from the facts of the case
- In penalty, the payment intended to threaten (i.e., as a terrorem to) the offending party, whereas Liquidated damages is a genuine pre-estimate of the damage.
- The Indian Courts focus on awarding a reasonable compensation not exceeding the amount fixed in the contract and does not distinguish between the two.

5.2 Other remedies available for the breach of contract, besides claiming damages



5.2.1 Rescission of contract

When a contract is broken by one party, the other party may treat the contract as rescinded. In such a case he **is free from all his obligations under the contract and is entitled to compensation** for any damages that he might have suffered.

Example : A promises B to deliver 50 bags of cement on a certain day. B agrees to pay the amount on receipt of the goods. A failed to deliver the cement on the appointed day. B is discharged from his liability to pay the price.

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5.2.2 Quantum Meruit

> ***'Quantum Meruit'*** means as much as is earned/as much as the party doing the service has deserved.

- It covers a case where the party injured by the breach had at time of breach done part but not all of the work which he is bound to do under the contract and seeks to be **compensated for the value of the work done.**
- For the application of this doctrine, **two conditions** must be fulfilled:
    i) It is only available if the **original contract has been discharged**.
    ii) The **claim must be brought by a party not in default**.

Damages are compensatory in nature while **quantum merit is restitutory** (i.e., seeking to restore the person to the position which he was in earlier).

- The claim for quantum meruit arises in the following cases –
    - Agreement discovered to be void or when contract becomes **void**.
    - Something done **without intention of doing so gratuitously**.
    - Express or implied contract to render services but **no agreement as to remuneration.**
    - Party **refuses or abandons to perform** contract.
    - Divisible contract and **party not in default has enjoyed benefit of part performance.**
    - When an **indivisible contract** for a lump sum is **completely performed but badly** the person who has performed the contract can claim the lump sum, but the **other party can make a deduction for bad work.**

Example : A agrees to deliver 100 bales of cottons to B at a price of ₹1,000 per bale. The cotton bales were to be delivered in two instalments of 50 each. A delivered the first instalment but failed to supply the second. B must pay for 50 bags.

5.2.3 Suit for specific performance

Where damages are not an adequate remedy in the case of breach of contract, the court may in its discretion on a suit for specific performance direct party in breach, to carry out his promise according to the terms of the contract.

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5.2.4 Suit for injunction

Where a **party to a contract is negating the terms of a contract**, the court may by issuing an 'injunction orders', restrain him from doing what he promised not to do.

Example : N, a film star, agreed to act exclusively for a particular producer, for one year. During the year she contracted to act for some other producer. Held, she could be restrained by an injunction.

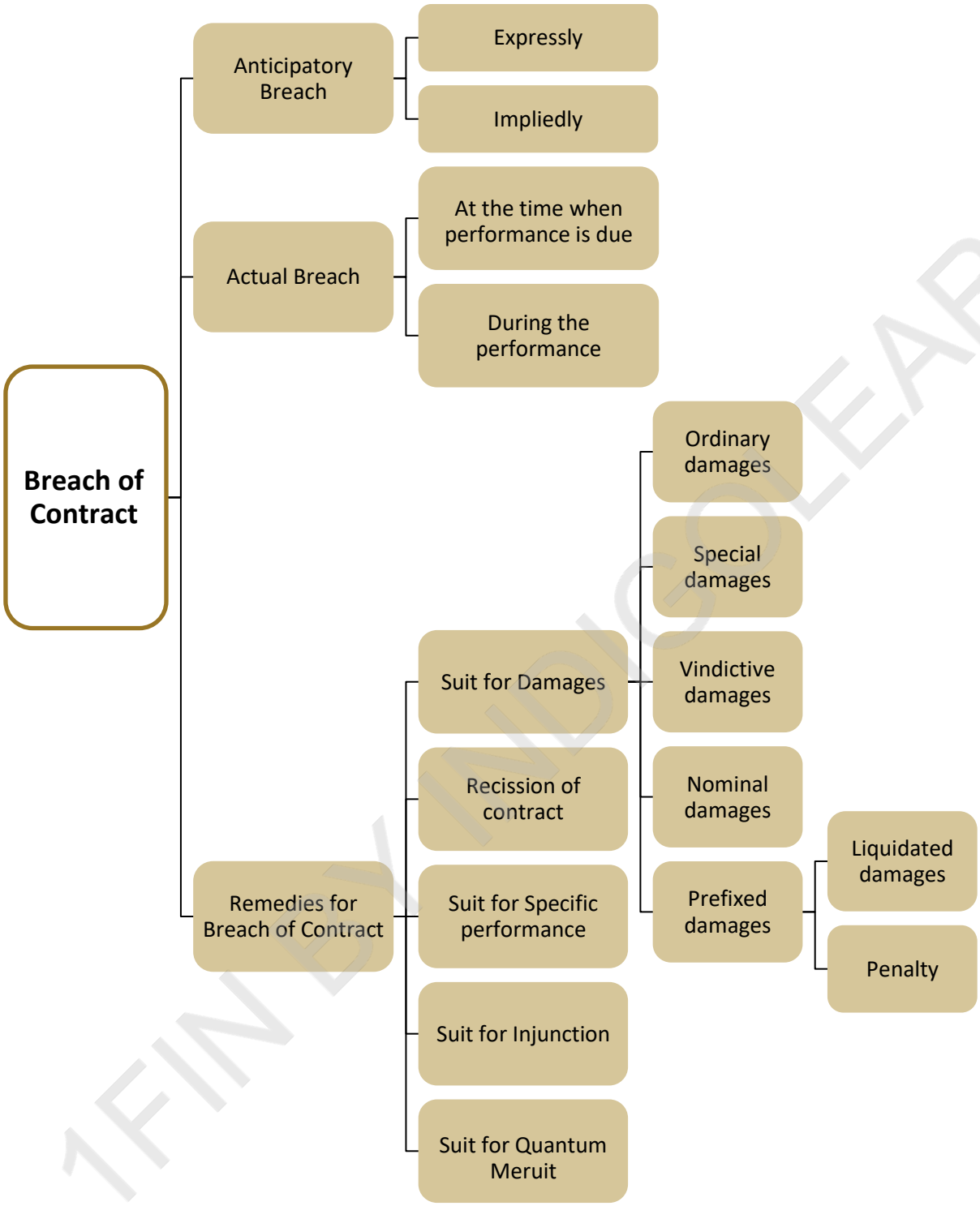
An injunction is basically like a decree for specific performance but for a negative contract. An injunction is a court order restraining a person from doing a particular act.

5.2.5 Party rightfully rescinding contract, entitled to compensation

A person who rightfully rescinds a contract is entitled to **compensation for any damage which he has sustained through non-fulfilment of the contract** [**Section 75**].

Example : A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her ₹ 100 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contract. B is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract.

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CH-1: UNIT 6 – CONTINGENT AND QUASI CONTRACTS

Learning Outcomes –

- Basic characteristics of Contingent contract and Quasi Contract.
- Enforcement of Contingent Contracts.
- Contingent Contract vs. Wagering Contract.
- Cases deemed as Quasi Contracts.

1. Contingent Contracts

A contract may be absolute or a contingent. An Absolute contract is one where the promisor undertakes to perform the contract in any event without any condition.

Section 31 of the Indian Contract Act, 1872 defines Contingent Contract as –

"**A contract to do or not to do something, if some event, collateral to such contract, does or does not happen**".

- In simple words, contingent contracts, are the ones where the promisor perform his obligation only when **certain conditions are met**.
- The **contracts of insurance, indemnity, and guarantee** are some examples of contingent contracts.

Collateral event – An event which is neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise [Pollock and Mulla].

Example : A contracts to pay B ₹100,000 if B's house is burnt. This is a contingent contract.

- Here the burning of the B's house is neither a performance promised as part of the contract nor it is the consideration obtained from B. Thus, the burning of the house is the collateral event.
- The liability of A arises only on the happening of the collateral event.

- **Essentials of a contingent contract –**

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i) The performance of a contingent contract would **depend upon the happening or non-happening of some event or condition**.

ii) **An event collateral to the contract -** The event is **not part of the contract**. The event should be neither performance promised nor a consideration for a promise.

Examples :

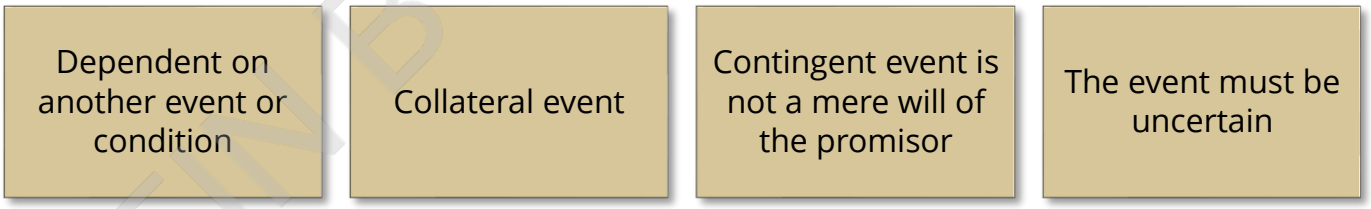
- A agrees to deliver 100 bags of wheat and B agrees to pay the price only afterwards. This is a conditional contract and not contingent because the event on which B's obligation is made to depend is part of the promise itself and not a collateral event.
- A promises to pay B ₹ 1,00,000 if he marries C. It is not a contingent contract.
- A agreed to construct a swimming pool for B for ₹ 200,000. And B agreed to make the payment only on the completion of the swimming pool. It is not a contingent contract as the event (i.e. construction of the swimming pool) is directly connected with the contract.

iii) **The contingent event should not be a mere 'will' of the promisor -** The event should be contingent in addition to being the will of the promisor.

Example : If A promises to pay B ₹100,000 if it rains on 1st April and A leave Delhi for Mumbai on a particular day, it is a contingent contract, because going to Mumbai is an event no doubt within A's will, but raining is not merely his will.

iv) **The event must be uncertain -** If the performance of the contract is dependent on an event, which is although a future event, but certain and sure to happen, then it will not be considered as a contingent contract.

Example : A agreed to sell his agricultural land to B after obtaining the necessary permission from the collector. As a matter of course, the permission was generally granted on the fulfilment of certain formalities. It was held that the contract was not a contingent contract as the grant of permission by the collector was almost a certainty.



2. Rules relating to Enforcement

2.1 Enforcement of contracts contingent on an event happening [Section 32]

- Where a contingent contract is made to do or not to do anything if an uncertain future event happens, **it cannot be enforced by law unless and until that event has happened**.
- If the **event becomes impossible**, such **contracts become void**.

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Example : A contracts to pay B a sum of money when B marries C. C dies without being married to B. The Contract becomes void.

2.2 Enforcement of contracts contingent on an event not happening [Section 33]

Where a contingent contract is made to do or not do anything if an uncertain future event does not happen, **it can be enforced only when the happening of that event becomes impossible and not before.**

Example : Where Rohit agrees to pay Mohan, ₹10,000 if a particular ship 'Titanic' does not return, the contract becomes enforceable only if the ship sinks so that it cannot return.

> Section 32 and 33 explains about enforceability of contracts contingent on happening or non-happening of event, where **no fixed time** is mentioned.

2.3 A contract which is contingent upon the conduct of a living person [Section 34]

If a contract is **contingent upon as to how a person will act at an unspecified time**, the event shall be considered to have **become impossible when such person does anything which renders it impossible** that he should so act within any definite time or otherwise than under further contingencies.

Example : 'A' agrees to pay 'B' a sum of money if 'B' marries 'C'. 'C' marries 'D'. This act of 'C' has rendered the event of 'B' marrying 'C' as impossible; it is though possible if there is divorce between 'C' and 'D'.

> ***Case Law: Frost V. Knight***
> **Facts:** The defendant promised to marry the plaintiff on the death of his father. While the father was still alive, he married another woman.
> **Judgement:** It had become impossible that he should marry the plaintiff and she was entitled to sue him for the breach of the contract.

2.4 Contingent on happening of specified event within the fixed time [Section 35]

Contingent contracts to do or not to do anything, if a specified uncertain event happens within a fixed time, **becomes void if,**

- **At the expiration of time fixed, such event has not happened**, **or**
- If, **before the time fixed**, such event **becomes impossible.**

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Example : Rohit promises to pay Mohan ₹10,000, if a certain ship 'Titanic' returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

2.5 Contingent on specified event not happening within fixed time [Section 35]

Contingent contracts to do or not to do anything, if a specified uncertain event does not happen within a fixed time, **may be enforced by law when**

- **The time fixed has expired, and such event has not happened or**
- **Before the time fixed has expired if it becomes certain that such event will not happen.**

Example : Rohit promises to pay Mohan ₹10,000, if a certain ship 'Titanic' does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

2.6 Contingent on an impossible event [Section 36]

Contingent agreements to do or not to do anything, if an impossible event happens are **void**, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

Example : 'A' agrees to pay 'B' ₹1,00,000/- if sun rises in the west next morning. This is an impossible event and hence void.

Section	Contingency	When Valid and Enforceable	When Void and not enforceable
Sec 32	Happening of an event	Event happens	Event becomes impossible
Sec 33	Non-Happening of an event	1. Event becomes impossible or 2. Does not happen	Event Happens
Sec 35	Happening of an event within specified time	Event happens within specified time	1. Time Lapses or 2. Event becomes Impossible
Sec 35	Non-Happening of an event within specified time	1. Time Lapses or 2. Event becomes Impossible	Event happens within specified time
Sec 36	Impossible Event	Never	Always

3. Contingent Contract Vs. Wagering Contract

Basis of difference	Contingent contract	Wagering contract
Meaning	Contract to do or not to do something with reference to a	A wagering agreement is a promise to give money or money's worth with reference

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	collateral event happening or not happening.	to an uncertain event happening or not happening.
Reciprocal promises	May not contain reciprocal promises.	Consists of reciprocal promises.
Uncertain event	Uncertain event is collateral.	Uncertain event is the core factor.
Nature of contract	Contingent contract may not be wagering in nature.	A wagering agreement is essentially contingent in nature.
Interest of contracting parties	Contracting parties have interest in the subject matter in contingent contract.	Contracting parties have no interest in the subject matter.
Doctrine of mutuality of lose and gain	Contingent contract is not based on doctrine of mutuality of lose and gain.	A wagering contract is a game, losing and gaining alone matters.
Effect of contract	Valid	Void

4. Quasi Contracts

- Even in the **absence of a contract**, certain **social relationships give rise to certain specific obligations to be performed** by certain persons. **These are known as quasi contracts** as they create same obligations as in the case of regular contract.
- Such cases are not contract in the strict sense, but the **Court recognises them as relations resembling those of contracts** and enforces them as if they were contracts. Hence the term **Quasi-contracts (i.e. resembling a contract).**
- Quasi contracts are **based on principles of equity, justice, and good conscience**.

  Example : A pays some money to B by mistake. It is really due to C. B must refund the money to A.

A quasi or constructive contract rest upon the maxims, "**No man must grow rich out of another person's loss**".

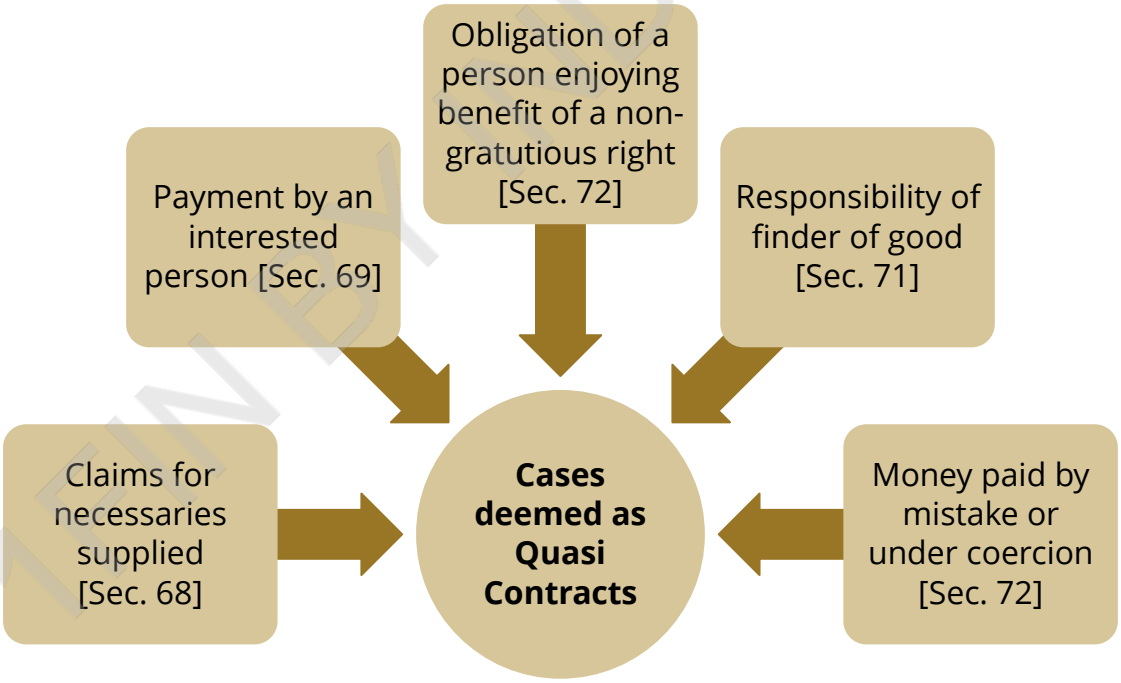
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✓ **Salient features of quasi contracts**

- It is usually a right to money and is generally (not always) to a liquated sum of money
- The right is not an outcome of an agreement but is imposed by law.
- The right is not available against everyone in the world but only against a specific person(s). Hence it resembles a contractual right.

4.1 Cases Deemed as Quasi – Contracts

Under the provisions of the Indian Contract Act, the relationship of quasi contract is deemed to have come to existence in five different circumstances. In none of these cases there comes into existence any contract between the parties in the real sense. Due to peculiar circumstances in which they are placed, the law imposes in each of these cases the contractual liability.



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4.1.1. Claim for necessaries supplied to persons incapable of contracting [Section 68]

If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, **the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person**.

Example : A supplies B, a lunatic, or a minor, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's property. To establish his claim, the supplier must prove that –

- ✓ The goods were supplied to the person who was minor or a lunatic and
- ✓ Also, that they were suitable to his actual requirements at the time of the sale and delivery.

4.1.2 Payment by an interested person [Section 69]

A person who is **interested in the payment of money which another is bound by law to pay**, and who therefore pays it, **is entitled to be reimbursed** by the other.

Example : B holds land in Bengal, on a lease granted by A, the zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the revenue law, the consequence of the sale will be the annulment of B's lease.

B, to prevent the sale and the consequent annulment of his own lease, pays to the government the sum due from A. A is bound to make good to B, the amount so paid.

4.1.3 Obligation of person enjoying benefits of non-gratuitous act [Section 70]

- Where **a person lawfully does anything for another person, or delivers anything to him not intending to do so gratuitously** and such **other person enjoys the benefit thereof**, the latter is bound to pay compensation to the former in respect of, or to restore, the thing so done or delivered.
- For a suit to succeed in this case, **the plaintiff must prove**:
    - That he had **done the act** or had delivered the thing **lawfully**,
    - That he **did not do so gratuitously**, and
    - That the **other person enjoyed the benefit.**

Example : A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. He is bound to pay A for them.

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Case Law: Shyam Lal vs. State of U.P.

Facts: 'K' a government servant was compulsorily retired by the government. He filed a writ petition and obtained an injunction against the order. He was reinstated and was paid salary but was given no work and in the meantime government went on appeal.

Judgement: Appeal was decided in favour of government and 'K' was directed to return the salary paid to him during period of reinstatement.

4.1.4 Responsibility of finder of goods [Section 71]

A person who finds goods belonging to another and takes them into his custody is subject to **same responsibility as if he were a bailee.** Thus, a finder of lost goods has:

i) to **take proper care of the property** as man of ordinary prudence would take,

ii) **no right to appropriate the goods,** and

iii) to **restore the goods if the owner is found**.

Example : 'P' a customer in 'D's shop puts down a brooch worn on her coat and forgets to pick it up and one of 'D's assistants finds it and puts it in a drawer over the weekend. On Monday, it was discovered to be missing. 'D' was held to be liable in the absence of ordinary care which a prudent man would have taken.

Case Law: Hollins vs. Howler L. R. & H. L.

Facts: 'H' picked up a diamond on the floor of 'F's shop and handed over the same to 'F' to keep till the owner was found. In spite of the best efforts, the true owner could not be traced. After the lapse of some weeks, 'H' tendered to 'F' the lawful expenses incurred by him and requested to return the diamond to him. 'F' refused to do so.

Judgement: 'F' must return the diamond to 'H' as he was entitled to retain the goods found against everybody except the true owner.

4.1.5 Money paid by mistake or under coercion [Section 72]

A person to whom money has been paid or anything delivered by mistake or under coercion, **must repay or return it.**

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Judgements made in few Cases

Shivprasad Vs Sirish Chandra - Every kind of payment of money or delivery of goods for every type of 'mistake' is recoverable.

Sales tax officer vs. Kanhaiyalal - A payment of municipal tax made under mistaken belief or because of mis-understanding of the terms of lease can be recovered from municipal authorities.

Seth Khanjelek vs National Bank of India - Any money paid by coercion is also recoverable. The word coercion is not necessarily governed by section 15 of the Act, rather, it is interpreted to mean and include oppression, extortion, or such other means.

Case Law: Trikamdas vs. Bombay Municipal Corporation

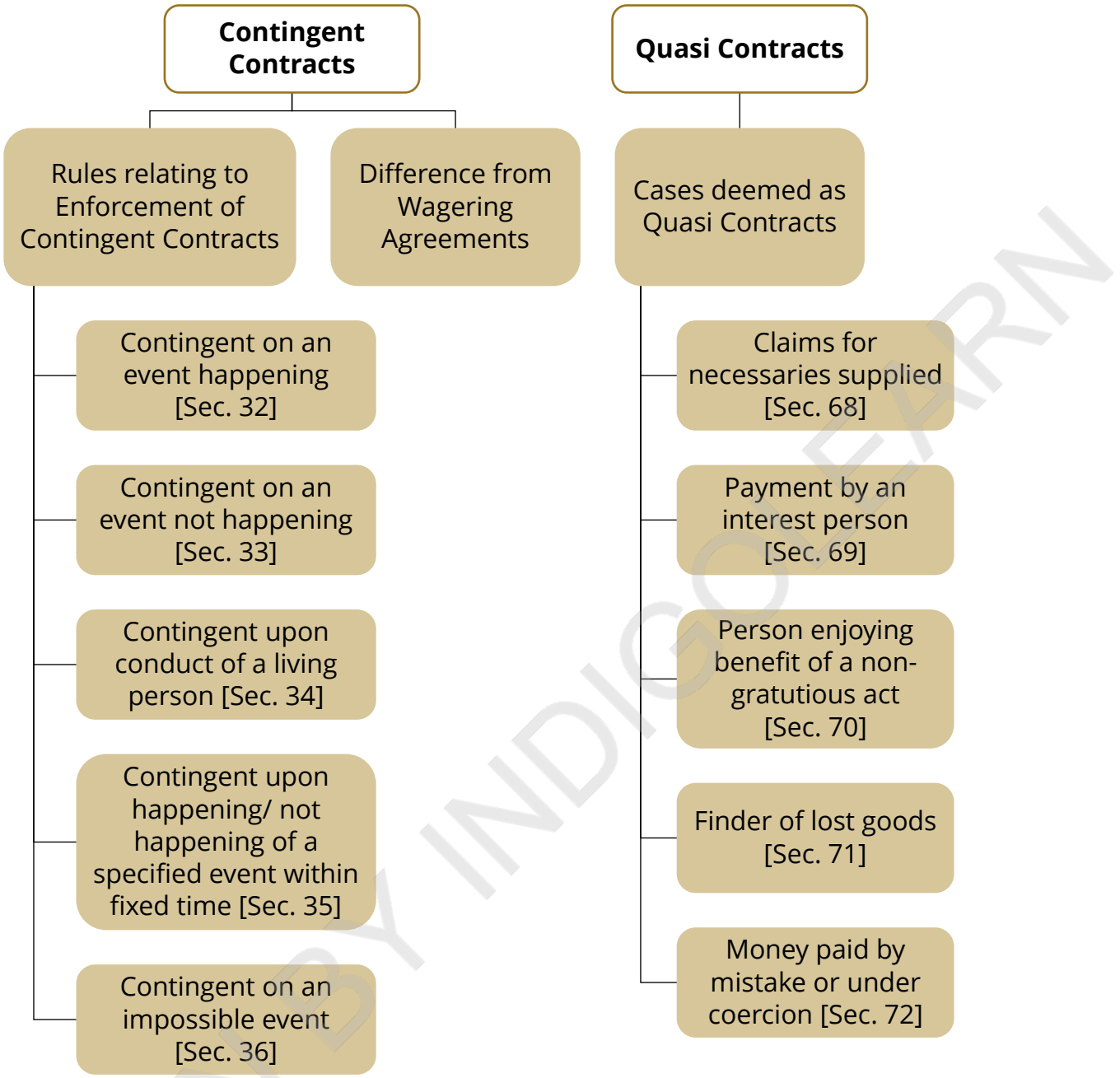
Facts: 'T' was traveling without ticket in a tram car and on checking he was asked to pay ₹5/- as penalty to compound transaction. T filed a suit against the corporation for recovery on the ground that it was extorted from him.
Judgement: The suit was decreed in T's favour.

4.2 Difference between quasi contracts and contracts

Basis of distinction	Quasi- Contract	Contract
Essential for formation of a valid contract	Absent	Present
Obligation	Imposed by law	Created by consent of the parties

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5. Overview



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CH 1 - UNIT 7: CONTRACT OF INDEMNITY AND GUARANTEE

Learning Outcomes –

- Identify special type of contracts i.e., Indemnity contracts and guarantee contracts and also the nature of obligations and rights of each of the parties to the contracts.
- Explain distinction between these contracts.

INTRODUCTION

Contract of Indemnity and Guarantee are the specific types of contacts provided under **Sections 124 to 147 of the Indian Contract Act, 1872**. In addition to the specific provisions, the general principles of contracts are also applicable to such contracts.

CONTRACT OF INDEMNITY

Section 124 and 125 of the Indian Contract Act, 1872 provides provisions relating to contract of indemnity.

2.1 Definition of "Contract of Indemnity"

The term **Contract of Indemnity** is **defined u/s 124 of the Indian Contract Act, 1872** as *"a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person."*

2.2 Parties in a Contract of Indemnity

Idemnifier	• Party who promises to indemnify/ save the other party from loss.
Idemnified/ Idemnity holder	• Party who is promised to be saved against the loss.

2.3 Basic conditions in a Contract of Indemnity

→ **"Existence of loss" is essential** – unless the promisee has suffered a loss, he cannot hold the promisor liable on the contract of indemnity.

→ Such loss is **caused by**:

- Conduct of the promisor himself, or
- Conduct of any other person

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Note: The loss occasioned by an accident not caused by any person, or an act of God/ natural event, is not covered.

case law:

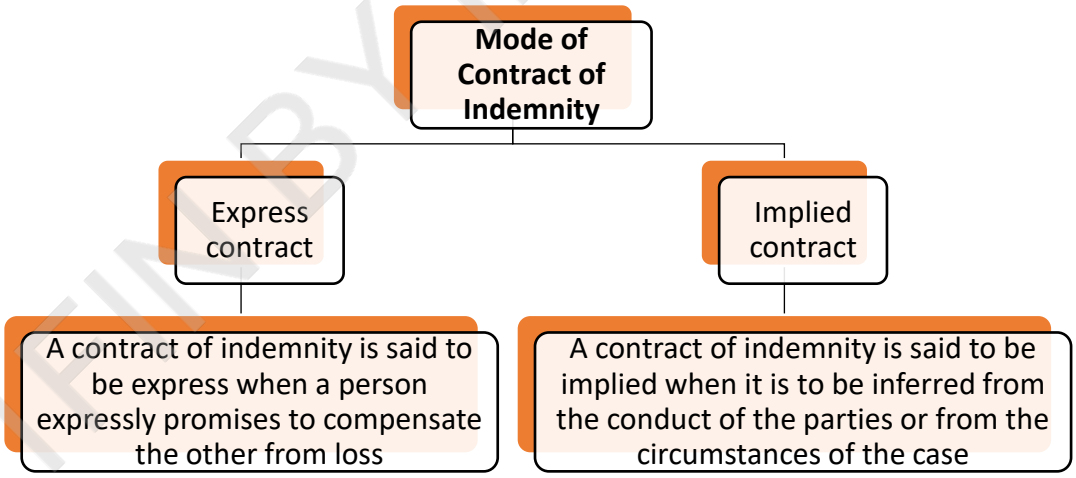
In case of **Gajanan Moreshwar v/s Moreshwar Madan (1942),** decision is taken on the basis of English Law. As per English Law, Indemnity means promise to save another harmless from the loss. Here it covers every loss whether due to negligence of promisee or by natural calamity or by accident.

→ Must fulfil all the **essentials of a valid of contract** which includes –

- Offer and acceptance
- Intention to create legal obligation
- Consideration
- Competency to contract
- Free consent
- Lawful object
- The agreement must not be expressly declared to be void. E.g. an agreement in restraint of trade/ marriage etc.
- The terms of the agreement must not be vague or uncertain
- The agreement must be capable of performance- An agreement to do an impossible act is void.
- Legal formalities complied

A contract of Fire Insurance or Marine Insurance is always a contract of Indemnity. But there is no contract of indemnity in case of a contract of Life Insurance.

2.4 Modes of Contract of Indemnity



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2.5 Rights of Indemnity holder when sued [Section 125]

In a contract of indemnity, the promisee i.e., the indemnity holder acting within the scope of his authority is **entitled to recover from the promisor, i.e., indemnifier the following rights –**

a) All **damages** which he may be compelled to pay in any suit,
b) All **costs** which he may have been compelled to pay in **bringing/ defending the suit**, and
c) All **sums** which he may have paid **under the terms of any compromise** of suit.

The Act is silent about the rights of the Indemnifier. But they are similar to the rights of a surety u/s 141 of the Indian Contract Act, 1872.

Note: These rights are not exhaustive. Indemnity holder may claim any other liability (absolute in nature) that he has incurred.

2.6 When does the liability of the indemnifier commence?

The liability of an indemnifier commences **as soon as the liability of the indemnity holder becomes absolute and certain**.

CONTRACT OF GUARANTEE

3.1 Definition of "Contract of Guarantee"

Section 126 of the Indian Contract Act, 1872 provides provisions relating to contract of guarantee.

A contract of guarantee is a **contract to perform the promise made or discharge the liability, of a third person in case of his default**.

3.2 Parties involved in a Contract of Guarantee

Surety - Person who gives the guarantee → **Principal debtor** - Person in respect of whose default the gurantee is given → **Creditor** - Person to whom the guarantee is given

Hence, the contract of guarantee is a **triplicate agreement** between principal debtor, creditor, and surety. There are, in effect 3 contracts –

1) A **principal contract** between the principal debtor and creditor.
2) A **secondary contract** between the creditor and the surety.

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3) An **implied contract** between the surety and the principal debtor whereby principal debtor is under an obligation to indemnify the surety.

3.3 Essential features of a Guarantee

Principal debt

- It is the essence of the guarantee that there should be someone liable as a principal debtor and surety undertakes to be liable on his default. If there is principal debt, there can be no valid guarantee.

Consideration

- A guarantee without consideration is void, but there is no need for direct a direct consideration between surety and the creditor.
- Consideration received by the principal debtor is sufficient consideration to the surety for giving the guarantee, but past consideration is no consideration for the contract of guarantee. [Sec. 127]

Existence of a liabilty

- There must be an existing liability or a promise whose performance is guaranteed.
- Such liability or promise must be enforceable by law and not time barred

No misrepresentation or concealment

- Any guarantee which has been obtained by the means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid [Sec. 142]
- Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid [Sec. 143]

Writing not necessary

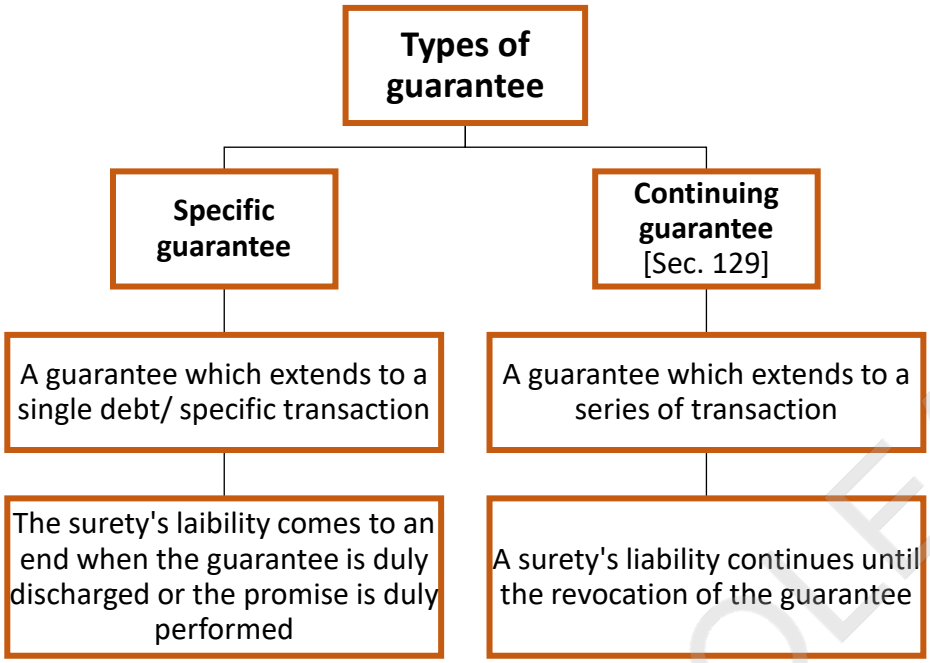
- Section 126 expressly provides that a guarantee may be either oral or written.

Joining of the other co-sureties

- The contract of guarantee is not valid if a condition is imposed by a surety that some other person must also join as a co-surety, but such other person does not join as a co-surety [Sec. 144].

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TYPES OF GUARANTEE



DISTINCTION BETWEEN A CONTRACT OF INDEMNITY AND A CONTRACT OF GUARANTEE

Point of distinction	Contract of indemnity	Contract of guarantee
Parties to the contract	Only 2 parties to the contract – indemnifier and indemnified.	There are 3 parties to the contract – creditor, principal debtor, and surety.
Nature and liability	The liability of the indemnifier is primary and unconditional.	The liability of the surety is secondary and conditional as the primary liability is that of the principal debtor.
Time of liability	Liability arises only on the happening of a contingency.	Liability arises only on the non-performance of an existing promise or non-payment of an existing debt.
Time to act	The indemnifier need not act at the request of indemnity holder.	The surety acts at the request of principal debtor.
Right to sue third party	Indemnifier cannot sue a third party for loss in his own name as there is no privity of contract.	Surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.
Purpose	Reimbursement of loss.	For the security of the creditor.

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Competency to contract	All parties must be competent to contract.	In case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.

NATURE AND EXTENT OF SURETY'S LIABILITY

Section 128 of the Indian Contract Act, 1872 provides provisions relating to the liability of the surety.

- ✓ The liability of the surety is **co-extensive with that of the principal debtor** unless it is otherwise provided by the contract. This means that the surety is liable for what the principal debtor is liable.
- ✓ The **liability of a surety arises only on default by the principal debtor**. If there is a condition precedent for surety's liability, the surety would be liable only when such condition is fulfilled.
- ✓ Where a **debtor cannot be held liable** on account of any defect in the document, **the liability of the surety also ceases**.
- ✓ Surety's liability continues if the principal debtor has not been sued or omitted from being sued i.e., the **creditor has a right to sue the surety directly without first proceeding against principal debtor**.

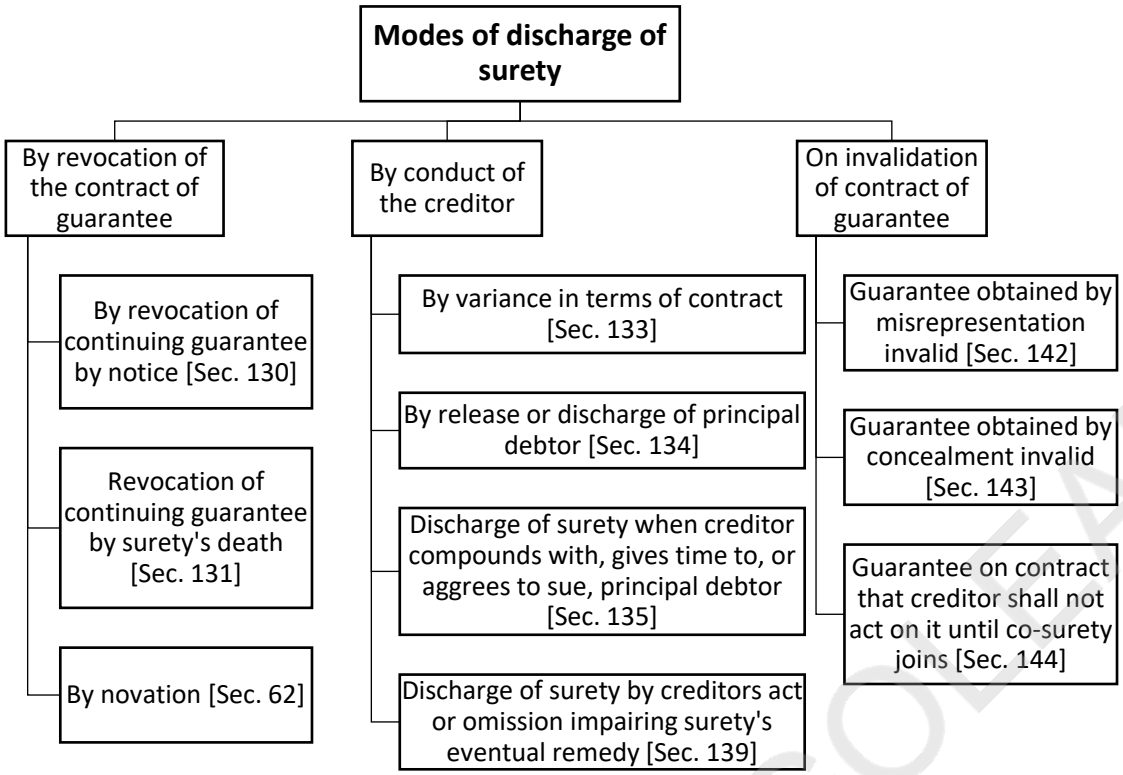
LIABILITY OF TWO PERSONS, PRIMARILY LIABLE, NOT EFFECTED BY ARRANGEMENT BETWEEN THEM THAT ONE SHALL BE SURETY ON OTHER'S DEFAULT

Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other (Guarantee), the **creditor cannot sue the guarantor, even if he is aware of such second contract because he is not party to such contract**. The two debtors shall hold the same liability as per primary contract.

Section 132 of the Indian Contract Act, 1872 states the liability of a guarantor in a case where creditor is not a party to a guarantee.

Example: A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

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8.1 By revocation of contract of guarantee

8.1.1 Revocation of continuing guarantee by notice [Sec. 130]

The continuing guarantee may be **revoked at any time by the surety as to future transactions by giving notice to the creditors**. After revocation the surety shall be liable for only those transactions that happened before the notice was given.

Revocation of specific guarantee: only if liability to principal debtor has not accrued.

8.1.2 Revocation of continuing guarantee by surety's

Example: A guarantees to B, to the extent of 100,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C Rs. 20000. C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee to pay Rs. 20000.

death [Sec. 131]

In the absence of any contract to the contrary, the death of surety operates as a **revocation of a continuing guarantee as to future transactions taking place after the death of the surety**. However, the **surety's estate remains liable for the past transactions** which have already y taken pace before ethe death of the surety.

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8.1.3 Revocation by novation [Sec. 62]

The surety under original contract is **discharged if a fresh contract is entered into either between the same parties or between the other parties**, the consideration being the mutual discharge of the old contract.

8.2 By conduct of the creditor

8.2.1 By variance in terms of contract [Sec. 133]

Where there is any variance in terms of contract between the principal debtor and creditor without surety's consent, it would **discharge the surety in respect of all transactions taking place subsequent to such variance**.

8.2.2 By release or discharge of principal debtor [Sec. 134]

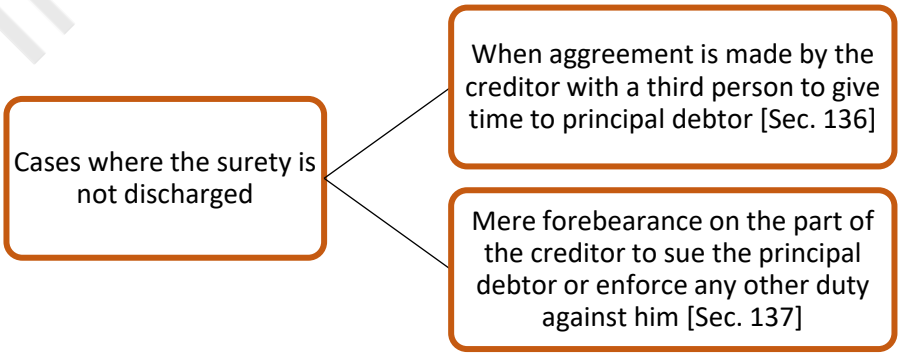
Note: Variation which is not substantial or material or which is beneficial to the surety will not discharge him of his liability *[M.S Anirudhan v Thomco's Bank Ltd.]*. This exception has however, got limited application in situations similar to facts of this case.

The surety is discharged if the **creditor –**

a) **Enters into a fresh/new contract** with principal debtor, by which the principal debtor is released, or
b) **Does any act or omission**, the legal consequence of which is the discharge of the principal debtor.

8.2.3 Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor [Sec. 135]

- **Composition**: If the creditor makes a composition with the principal debtor, without consulting the surety, the latter is discharged.
- **Promise to give time**: When the creditor allows the principal debtor more time for payment of debt, the surety is discharged.
- **Promise not to sue**: If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharged.



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8.2.4 Discharge of surety by creditor's act or omission impairing surety's eventual remedy [Sec. 139]

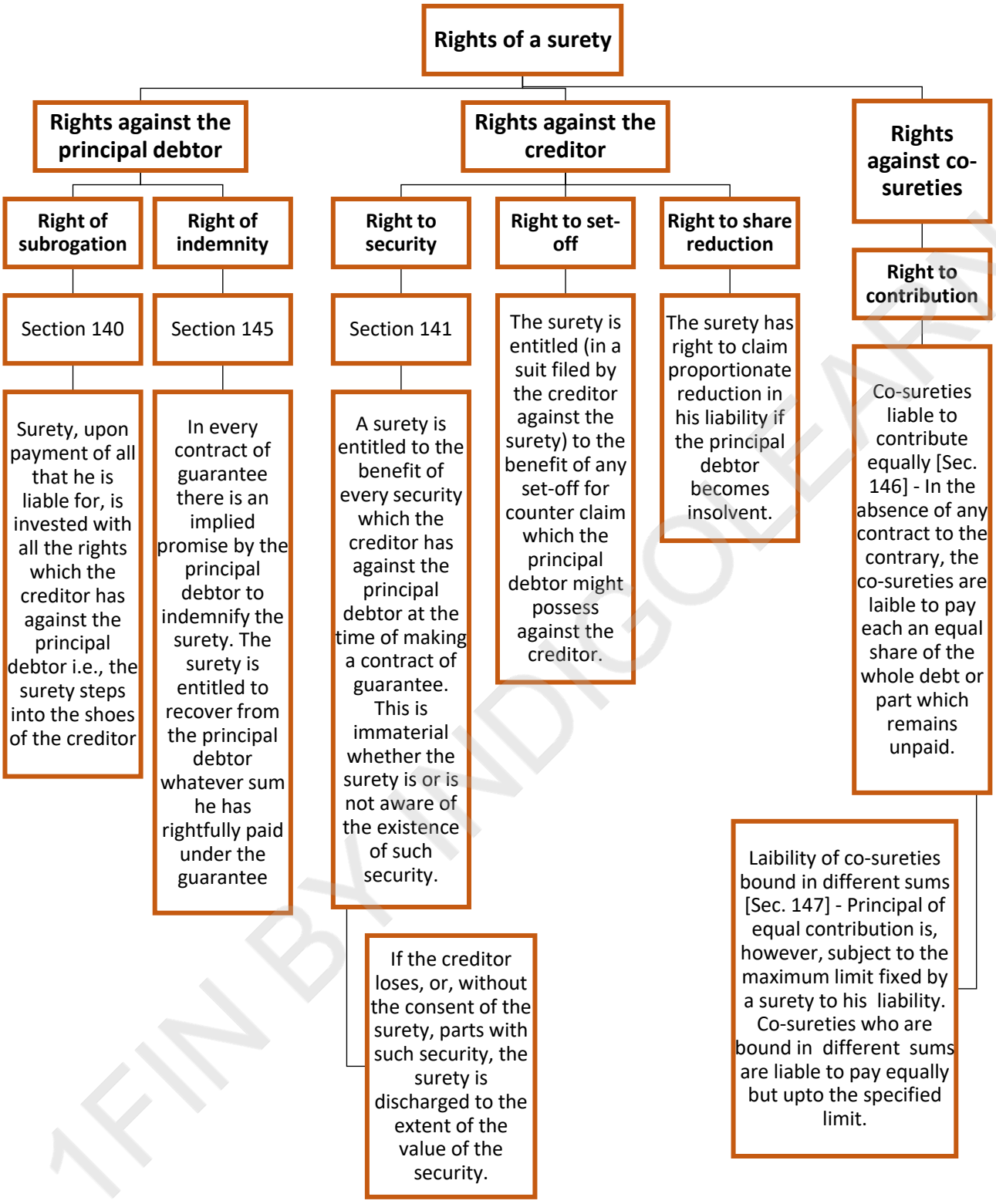
If the creditor does any act/omits to do an act, which is inconsistent with the rights of the surety, then the surety is discharged.

In a Supreme Court Case, it was decided that - A bank granted a loan on the security of the stock in the godown. The loan was also guaranteed by the surety. The goods were lost from the godown on account of the negligence of the bank officials. The surety was discharged to the extent of the value of the stock so lost.

8.3 By invalidation of contract of guarantee

- Guarantee obtained by misrepresentation made by the creditor, or with his knowledge or assent – Invalid [Sec 142]
- Guarantee obtained by concealment – Invalid [Sec 143]
- Guarantee on contract that creditor shall not act on it until so-surety joins – Invalid if that other person does not join [Sec 144]

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CH 1 - UNIT 8: BAILMENT AND PLEDGE

Learning Outcomes –

- Understand the general principles underlying contracts of bailment and pledge.
- Know duties and rights of the parties to the contracts.

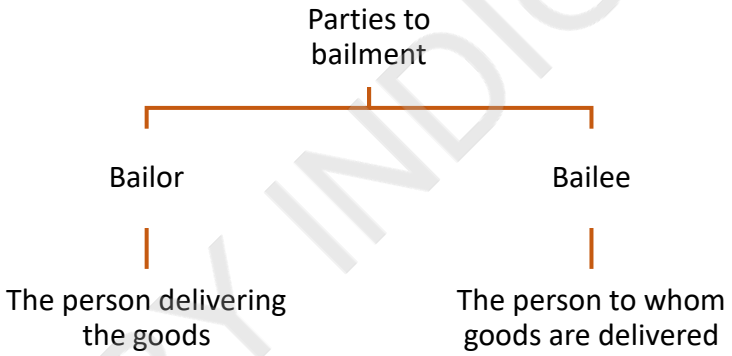
WHAT IS BAILMENT?

1.1 Definition of Bailment [Sec. 148]

As per **Section 148** of the Act, bailment is

→ the **delivery of goods** by one person to another for some purpose,
→ **upon a contract**, that the **goods shall, when the purpose is accomplished, be returned,** or otherwise disposed of according to the directions of the person delivering them.

1.2 Parties to Bailment



1.3 Essential elements of a contract of Bailment

1.3.1 Contract

- Bailment is based upon a contract.
- The contract may be **express or implied.**
- **No consideration is necessary** to create a valid contract of bailment.

1.3.2 Delivery of goods

- Bailment is only for **moveable goods**.
- The delivery of the possession of goods is of the following kinds:
    - **Actual delivery** – physically handing over goods
    - **Constructive delivery** – delivery is made by doing anything that has the effect of putting goods in the possession of the bailee or of any person authorized to hold them on his behalf.

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1.3.3 Purpose

- The goods are delivered for some purpose.
- The purpose may be **express or implied**.

1.3.4 Possession

- In bailment, **possession of goods changes**. Change of possession can happen by physical delivery or by any action that has the effect of placing the goods in the possession of bailee.
- The change of possession **does not lead to change of ownership**.

1.3.5 Return of goods

- Bailee is obliged to return the goods **physically to the bailor**.
- The goods **should be returned in the same form as given** or may be altered as per bailor's direction.
- The bailee **cannot deliver some other goods**, even those of higher value.

1.3.6 Types of Bailment

1. On the basis of benefit, bailment can be classified into three types:

a. For the exclusive benefit of bailor:

Example : The delivery of some valuables to a neighbour for safe custody, without charge.

b. For the exclusive benefit of bailee:

Example : The lending of a bicycle to a friend for his use, without charge.

c. For mutual benefit of bailor and bailee:

Example : Giving of a watch for repair.

2. On the basis of reward, bailment can be classified into two types:

a. Gratuitous Bailment:

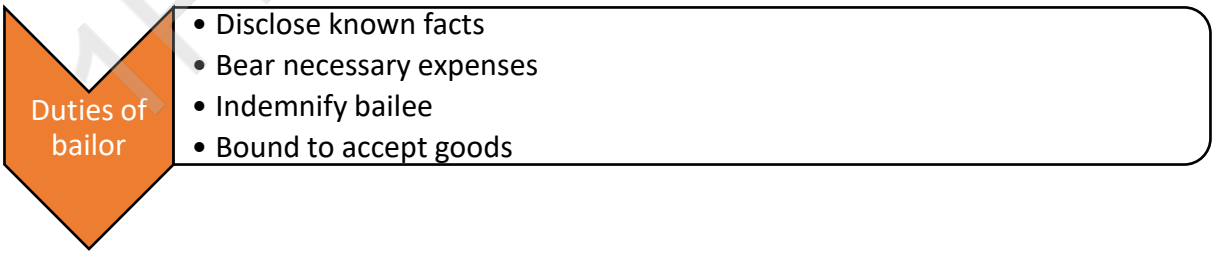
The word gratuitous means free of charge. So, a gratuitous bailment is one when the provider of service does it gratuitously i.e. free of charge. Such bailment would be either for the exclusive benefits of bailor or bailee.

b. Non-Gratuitous Bailment:

Non gratuitous bailment means where both the parties get some benefit i.e. bailment for the benefit of both bailor & bailee

RIGHTS AND DUTIES OF A BAILOR

2.1 Duties of bailor



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2.1.1 Disclose known facts [Section 150]

→ **In case of gratuitous bailment**: The bailor is bound to disclose to the bailee faults in the goods bailed of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extraordinary risks.
If he does not make such disclosure, he is responsible for damage arising to the bailee directly for such faults

→ **In case of non-gratuitous bailment**: If the goods are bailed for hire, the bailor is responsible for such damage, whether or not he was aware of the existence of such faults in goods bailed.

2.1.2 Bear necessary expenses [Section 158]

→ **In case of gratuitous bailment for the exclusive benefit of bailor**: The bailor shall repay the bailee the necessary expenses incurred by him for the purpose of the bailment

→ **In case of non-gratuitous bailment**: The bailor is liable to pay the extraordinary expenses incurred by the bailee.

2.1.3 Indemnify bailee

→ **Where the bailment was gratuitous and decides to terminate the bailment before the expiry of the period of bailment**: The bailor must compensate the bailee for the loss or damage suffered by the bailee that is in excess of the benefit received. **[Sec 159]**

→ Indemnify for any **loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment**, or to receive back the goods or give directions, respecting them. **[Sec 164]**

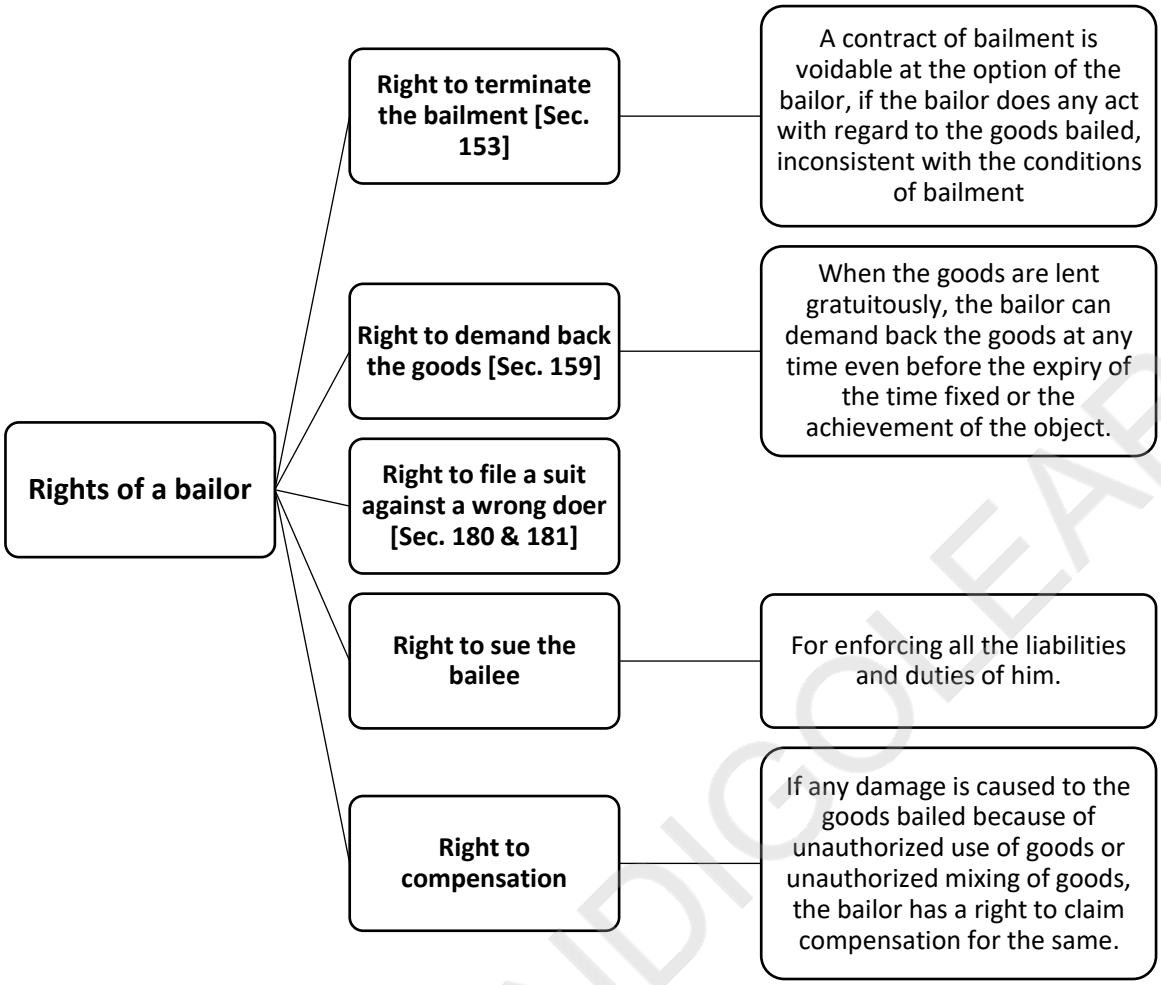
2.1.4 Bound to accept the goods [Sec. 164]

→ **When the bailee returns them after the time of bailment** has expired or the purpose of bailment has been accomplished.

- **If the bailor refuses**- bailee can claim compensation for all necessary expenses incurred for the safe custody.

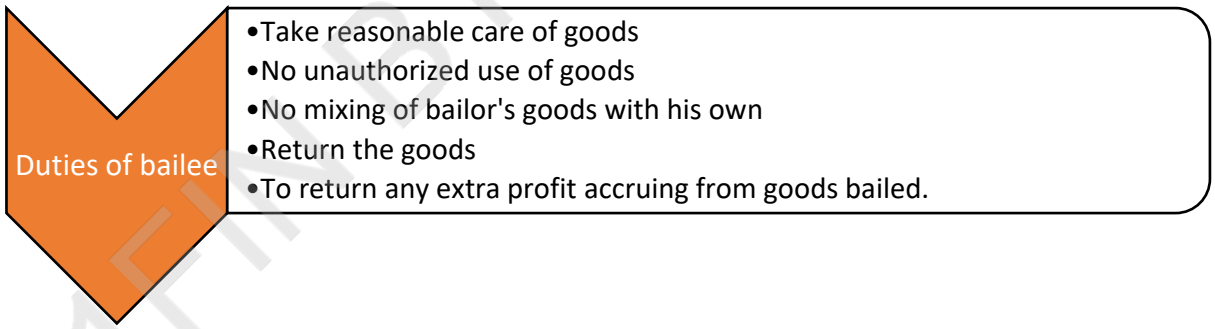
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2.2 Rights of bailor



RIGHTS AND DUTIES OF A BAILEE

3.1 Duties of a bailee



3.1.1 Take reasonable care of goods [Sec. 151 & 152]

→ Bailee shall take as much care of goods bailed to him **as a man of ordinary prudence would, under similar circumstances take care of his own goods** of the same bulk, quality, and value, as the goods bailed.

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→ **Exception**: In the absence of any special contract, the bailee is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken reasonable care as required u/s 151 [Sec. 152]

3.1.2 Not to make inconsistent use of goods [Sec. 153 & 154]

→ If the bailee makes use of any goods bailed, which is not according to the terms & conditions of the bailment, he is **liable to compensate the bailor for any loss or destruction of goods** [Sec. 153]

→ A contract of bailment is **voidable at the option of the bailor**, if the bailee uses the goods inconsistently [Sec. 154]

3.1.3 Not to mix the goods [Sec. 155, 156 & 157]

→ If the **bailee mixes the goods** bailed with his own goods, **with the consent of the bailor**: Both the parties shall have an interest in proportion to their respective shares in the mixture thus produced [Sec. 155].

→ If the **bailee mixes the goods bailed with his own goods without the consent of the bailor**,

- **Goods can be separated or divided**: The property of goods remains in the parties respectively.
  However, the bailee shall bear the expenses of separation or division and any damage arising from the mixture [Sec. 156].

- **It is impossible to separate the goods**: The bailor is entitled to be compensated by the bailee for any loss of the goods [Sec. 157].

3.1.4 Return the goods [Sec. 160 & 161]

→ The bailee shall return or deliver **according to the bailor's directions**, the goods bailed without demand, **as soon as**

- the **time** for which they were bailed, **has expired**, or
- the **purpose** for which they were bailed **has been accomplished** [Sec. 160].

→ If, by the default of the bailee, the **goods are not returned**, delivered, or tendered at the proper time, **he is responsible to the bailor for any loss, destruction, or deterioration of the goods from that time** [Sec. 161].

3.1.5 Return on accretion from the goods [Sec. 163]

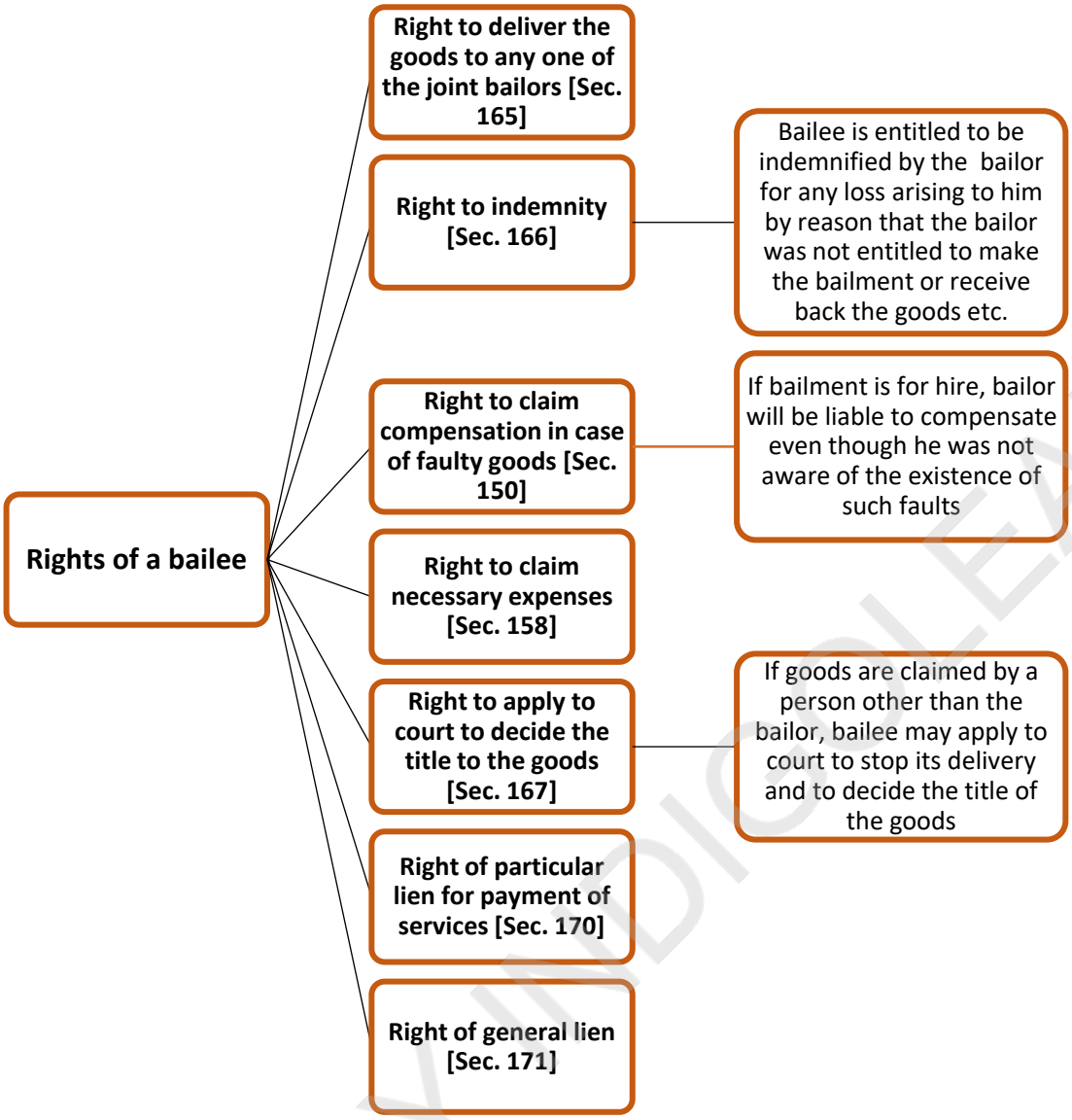
In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, **any increase or profit which may have accrued from the goods bailed.**

3.1.6 Not to set up adverse title

Bailee **must hold the goods on behalf of and for the bailor**. He cannot deny the title of the bailor.

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3.2 Rights of a bailee



Note: Duties of bailee corresponds with rights of bailor and duties of bailor relates to the rights of bailee.

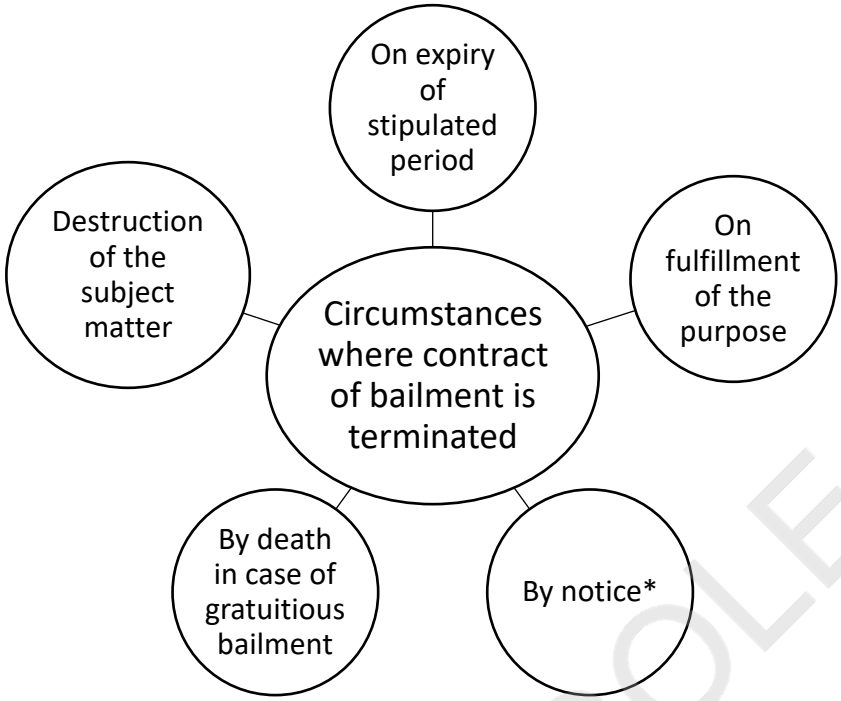
RIGHTS OF BAILER AND BAILEE AGAINST ANY WRONG DOER

If **a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury,** the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury [Sec. 180].

Whatever is obtained by way of **relief or compensation** in any such suit shall, as between the bailor and the bailee, be dealt with according to their respective interests [Sec. 181].

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TERMINATION OF BAILMENT



** where bailee acts in manner inconsistent with terms or where it is gratuitous bailment*

FINDER OF LOST GOODS

6.1 Right of finder of lost goods to sue for specific reward offered [Sec. 168]

- ✓ The finder of goods has **no right to sue the owner for compensation for trouble and expense voluntarily incurred by him** to preserve the goods and to find out the owner.
- ✓ but **he may retain the goods against the owner** until he receives such compensation.
- ✓ and, where the **owner has offered a specific reward for the return of goods lost,** the finder may sue for such reward, and may retain the goods until he receives it.

Right to collect reward is a primary and a superior right even more than the right to seek reimbursement of expenditure.

6.2 When finder of thing commonly on sale may sell it [Sec. 169]:

→ Owner:
- cannot with reasonable diligence be found, **or**
- if he refuses, upon demand, to pay lawful charges of the finder, **and**

→ when the **thing is in danger of perishing** or of losing the greater part of its value, **or**

lawful charges of the finder in respect of the thing found **amount to two-thirds of its value.**

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GENERAL AND PARTICULAR LIEN

RIGHT OF LIEN: Lien is the right of a person to retain the goods belonging to another until his claim is satisfied or some debt due to him is repaid.

Types of Lien: a. Particular Lien b. General Lien

General lien	Particular lien
Section 171 of the Indian Contract Act, 1872 confer on the bailee the right to general lien.	**Section 170** of the Indian Contract Act, 1872 confer on the bailee the right to particular lien.
Examples: • X becomes insolvent. Y is appointed as the official assignee to recover value from the assets of X. Here Y has general lien on all the assets of X. • A took a loan of Rs. 5 lacs from bank against a security worth Rs. 7 lacs. On defaulting to repay the loan, the bank sold the security and recovered only 4 lacs from market. The Bank can now recover remaining 1 lac from general lien on other assets of A.	Examples: • A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered. • A gives cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished, and to give a three months' credit for the price. B is not entitled to retain the coat until he is paid.
General lien relates to the right to keep possession of goods belonging to another **against general balance of account.**	Particular lien implies a right of the bailee to retain specific goods bailed **for non-payment of amount**.
Not automatic but recognised through an agreement.	It is **automatic**.
It can be exercised against goods even **without involvement of labour or skill**.	It comes into play in situations involving exercise of **labour or skill** in respect of goods bailed.
Only such persons as are specified u/s 171, e.g., **Bankers, factors, wharfingers, policy brokers etc. are entitled to general lien.**	**Bailee, finder of goods, pledgee, unpaid seller, agent, partner etc.** are entitled to particular lien.

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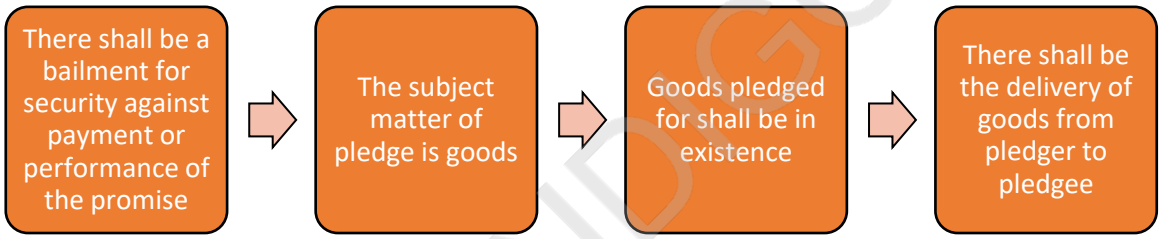
8.1 Definition of Pledge [Sec. 172]

The **bailment of goods as security for payment of a debt or performance of a promise** is called pledge.

8.2 Parties to Pledge [Sec. 172]



8.3 Essential of contract of Pledge



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9.1 Rights of Pawnee / Pledgee

Right to retain the pledged goods [Sec. 173]

- Pawnee may retain the goods pledged, not only for payment of debt or performance of the promise, but for the interest, of the debt, and all necessary expenses incurred by him in respect of the possession or preservation of the goods pledged

Right to retention of subsequent debts [Sec. 174]

- Pawnee has a right to retain the goods pledged towards subsequent advances as well, however subject to such right being specifically contemplated in the contract.

Pawnee's right to extraordinary expenses incurred [Sec. 175]

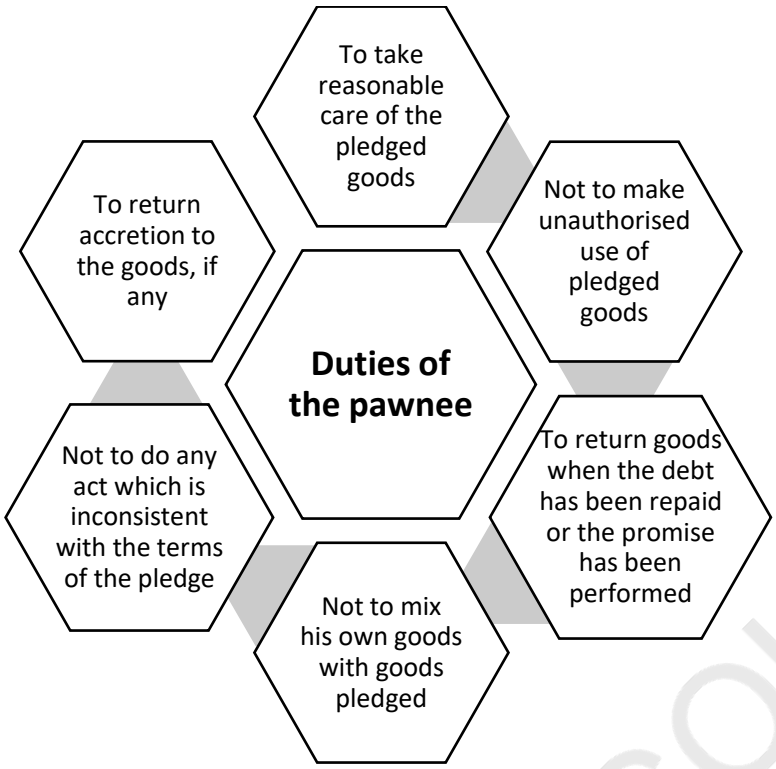
- Pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged.

Pawnee's right where pawnor makes default [Sec. 176]

- If pawnor makes default in payment of the debt, or performance, at the stipulated time of the promise, in respect of the goods pledged, pawnee may bring a suit against the pawnor, and retain the goods pledged as a collateral security; or he may sell the thing pledged on giving the pawn or reasonable notice of the sale.
- If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor.

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9.2 Duties of Pawnee



RIGHTS AND DUTIES OF PAWNOR

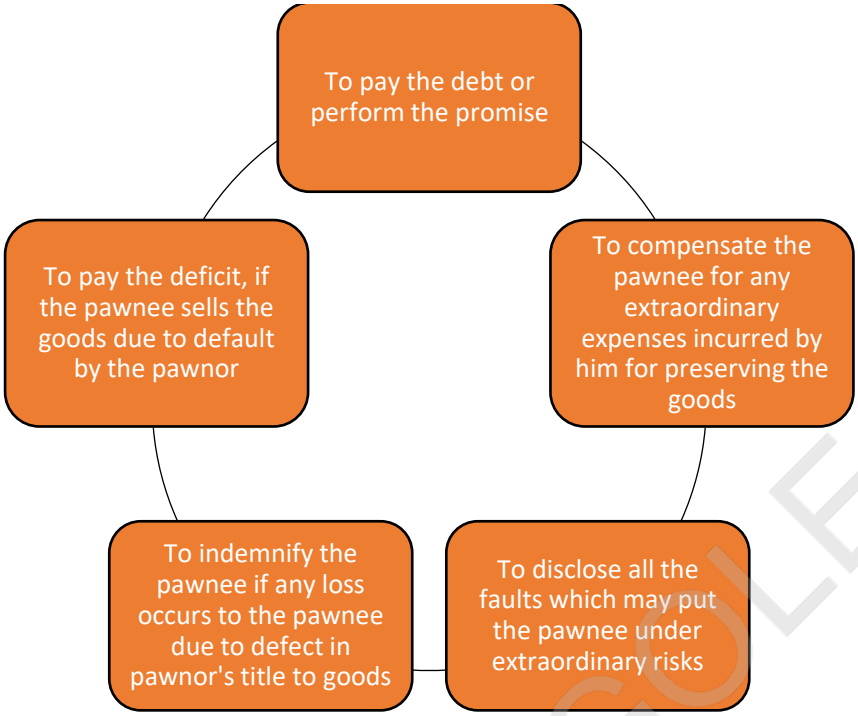
10.1 Rights of Pawnor

As a bailor of goods pawnor has **all the rights of the bailor**. Along with that he also has the right to redemption to the pledged goods which is enumerated u/s 177.

Right to redeem [Section 177] : If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the **pawnor makes default in payment of the debt or performance of the promise at the stipulated time**, he may redeem the goods pledged at any subsequent time before the actual sale of them; but he must, in that case, pay, in addition, any expenses which have arisen from his default.

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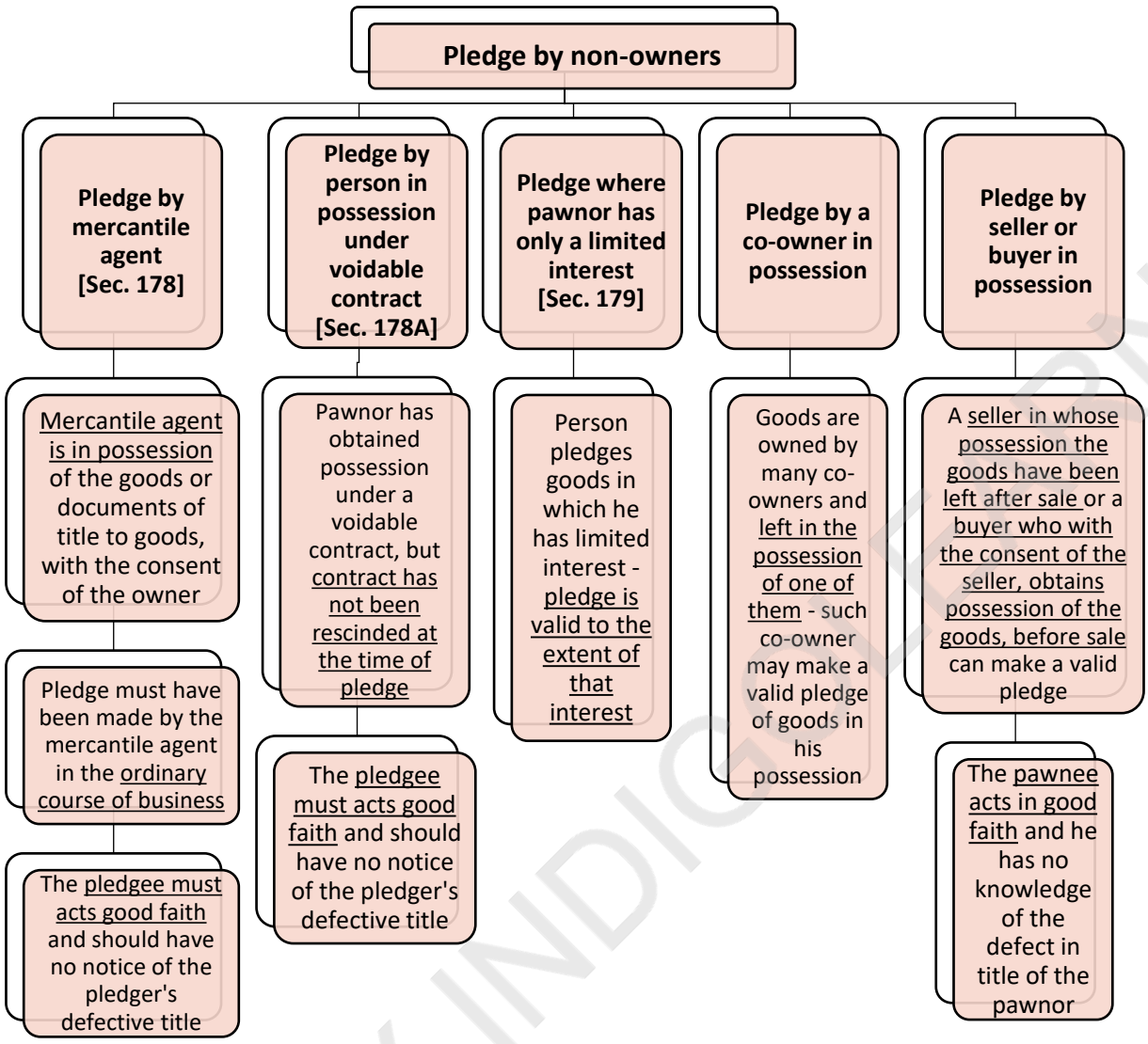
10.2 Duties of Pawnor



PLEDGE BY NON-OWNERS

Ordinarily it is the owner of goods, or any other person authorized by him in that behalf, who can pledge the goods. But in order to facilitate mercantile transactions, the law has recognised certain exceptions –

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DISTINCTION BETWEEN BAILMENT AND PLEDGE

Basis of distinction	Bailment	Pledge
Meaning	Transfer of goods by one person to another for some specific purpose.	Transfer of goods by one person to another as security for repayment of debt.
Parties involved	Bailor and bailee.	Pawnor and pawnee.
Purpose	For any purpose.	As security for payment of a debt or performance of a promise.

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Consideration	May be made for consideration or without consideration.	Always made for a consideration.
Right to sell the goods	Bailee has no right to sell the goods even if charges of bailment are not paid to him. Bailee's rights are restricted to suing the bailor or exercising lien.	Pawnee has the right to sell the goods if the pawnor fails to redeem the goods.
Right to use of goods	Bailee can use the goods only for specified purpose and not otherwise.	Pawnee cannot use the goods pledged.

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CH-1: UNIT 9 - AGENCY

- Learning Outcomes –
- Understand the relationship between agent and principal and the intention behind adoption of such course of agency.
- Understand rights and obligations of an agent as well as the circumstances under which the agent is personally liable for the acts done by him on behalf of the principal and the legal position of the agent, the principal and the third parties involved.
- Identify with the terms 'sub-agent' and 'substituted agent' and to distinguish between the two.

INTRODUCTION

A relationship of agency is established when one party (agent) is authorized by another party (principal) to act on his/ her behalf. Such relationships are initiated when one party desires to extend his/her activities beyond his/her present limits or capacity. **The law of agency is contained in sections 182 to 238 of the Indian Contract Act, 1872.**

WHAT IS AGENCY?

Section 182 of the Indian Contract Act, 1872 defines Agent and Principal.

Agent	Principal
A person employed to do any act for another or to represent another in dealing with the third persons.	A person for whom such act is done or who is so represented.

Test of agency:

a) Whether the person has the capacity to bind the principal and make him answerable to the third party.

b) Whether he can establish privity of contract between the principal and third parties.

If the answer to these questions is in affirmative, then there is a relationship of agency.

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Note: The rule of agency is based on the maxim ***Qui facit per alium, facit per se*** i.e., he who acts through an agent is himself acting.

APPOINTMENT AND AUTHORITY OF AGENTS

Who may employ an agent [Section 183]

- Person who has attained age of majority and
- who is of sound mind

Who may be an agent* [Section 184]

- Any person
- Minor, Person of unsound mind will not be responsible to Principal

Consideration not necessary [Section 185]

- no consideration is necessary to create an agency
- acceptance of the office of an agent is sufficient consideration

** According to Sec. 184, any person may become an agent i.e. a minor or a person of unsound mind may become an agent and the principal shall be bound by his acts. But in case of his misconduct or negligence, the principal shall not be able to proceed against him.*

CREATION OF AGENCY

Modes of creation of agency	
Express appointment [Sec. 186 & 187]	An authority is said to be express when it given by words, spoken, or written. **Example**: A is residing in Delhi and he has a house in Kolkata. A authorizes B under a power of attorney, as caretaker of his house. Agency is created by express agreement.
Implied appointment [Sec. 186 & 187]	Inferred from •the circumstances of the case, •things spoken or written, •or in the ordinary course of dealing. **Example**: If a person realises rent and gives it to the landlord, he impliedly acts for the landlord as an agent.
Agency by estoppel [Sec. 237]	When an agent has without authority done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations if he has by his words or conduct induced such third parties to believe that such acts and obligations were within the scope of the agent's authority.

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	Example: If Mr. P has for several months permitted Mr. A to buy goods from Mr. S and has paid for the goods bought by Mr. A, he cannot later refuse to pay Mr. S who has supplied goods on credit to Mr. A on the belief that he was Mr. P's agent and was buying goods on his behalf. Mr. P is estopped from asserting that Mr. A is not his agent.
Agency by necessity	Where an agent is authorised to do certain act, and while doing such an act, an emergency arises, he acquires an extra-ordinary or special authority to prevent his principal from loss. **Example**: Raja has a large farm on which Shyam is the caretaker. When Raja is in Canada, there is a huge fire on the farm. Shyam becomes an agent of necessity for Raja so as to save the property from being destroyed by fire. Raja (the principal) will be liable for any expenses, Shyam (his agent of necessity) incurred to put out the fire.
Agency by ratification [Sec. 196]	**Ratification** means approving a previous act or transaction. Where acts are done by one person on behalf of another, but without his knowledge or authority he may elect to ratify or disown it. Ratification will make the agency valid. Ratification may be express or implied by the conduct. **Essentials of a valid ratification:** • Ratification may be expressed or implied [Sec. 197]. • No valid ratification may be made by a person whose knowledge of the facts of the case is materially defective [Sec. 198]. • A person ratifying any unauthorised act done on his behalf ratifies the whole of the transaction of which such act formed a part [Sec. 199]. • An act done by one person on behalf of another, without such other person's authority, which, if done with authority, would have the effect of subjecting a third person to damages or of terminating its interest or rights, cannot, by ratification, be made to have such effect [Sec. 200]. • Ratification must be made within a reasonable period of time. • Ratification must be communicated to the other party. • An act to be ratified must be valid. **Example**: X who is Y's agent has on 10th January 2019 purchases goods from Z on credit without Y's permission. After the purchase, on 20th January 2019, Y tells X that he will accept responsibility to pay for the purchases although at the time of purchase the agent had no authority to buy on credit.

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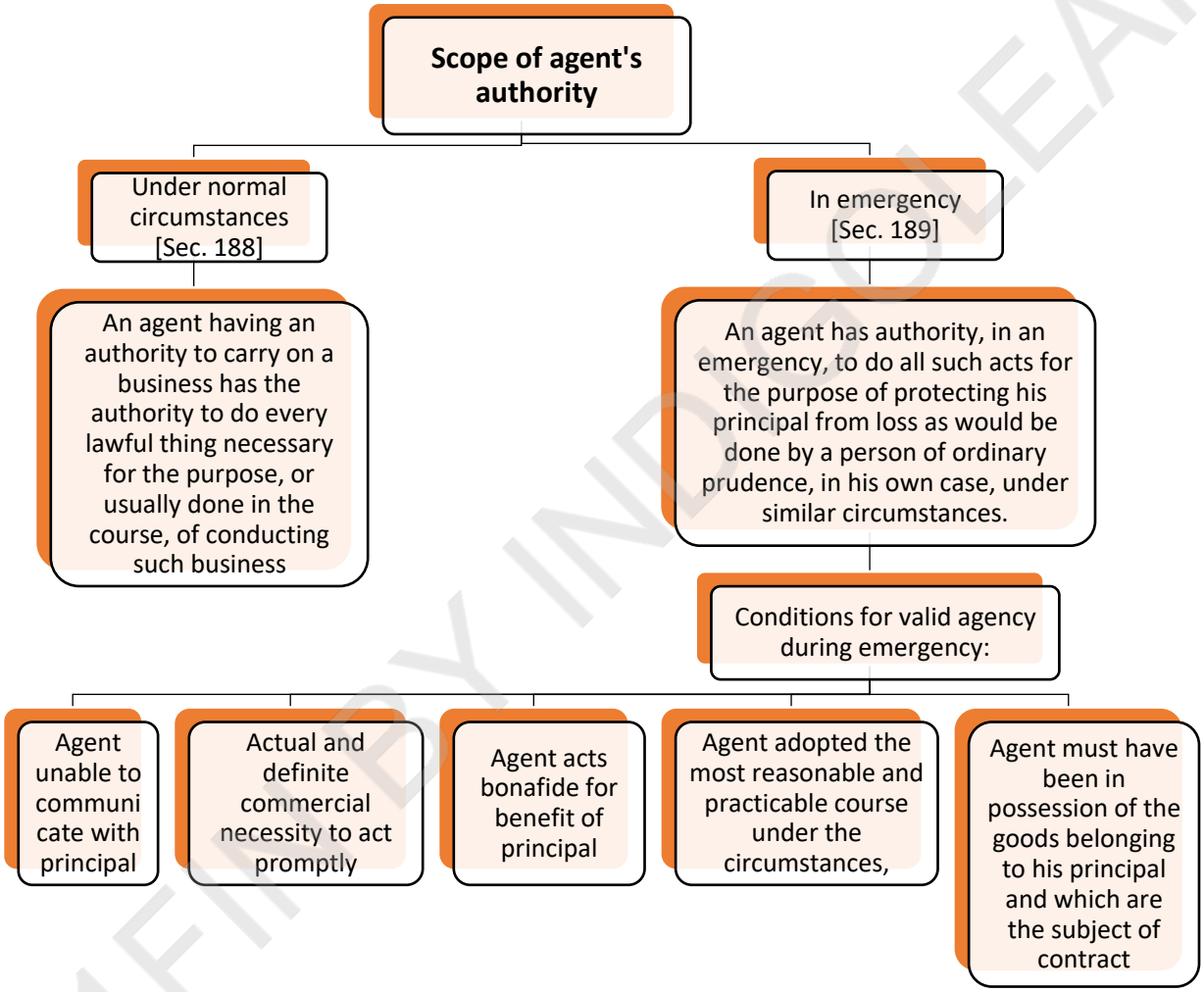
Agency by Operation of Law	When law treats one person as an agent of other. For example, a partner is the agent of the firm for the purposes of the business of the firm.

EXTENT OF AGENT'S AUTHORITY

✓ The authority of an agent means his capacity to bind the principal to third parties. The agent can bind the principal only if he acts within the scope of his authority.

✓ The agent's authority is governed by two principles –

- In normal circumstances and
- In emergency.



SUB-AGENTS

6.1 Definition of sub-agent [Sec. 191]

A sub-agent is a **person employed by, and acting under the control of, the original agent** in the business of agency.

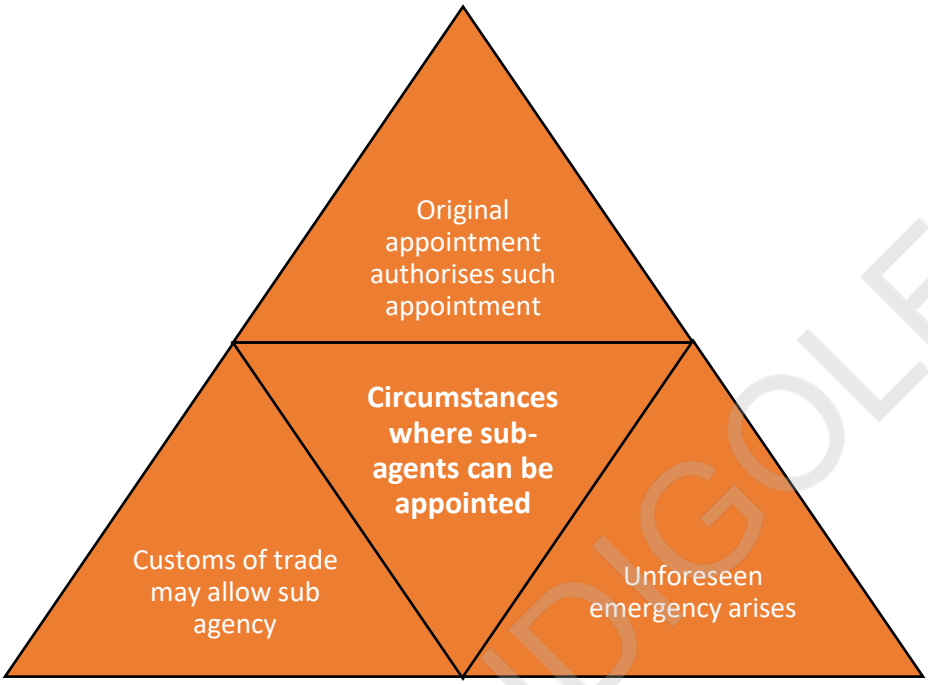
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6.2 When agent cannot delegate [Sec. 190]

An **agent cannot lawfully employ another person to perform acts which he has expressly or impliedly undertaken to perform personally**, unless by the ordinary custom of trade a sub-agent may, or from the nature of the agency, sub-agent must be employed.

This is based on the Latin principle "*delegatus non potest delegare*".

6.3 Exceptions where an agent can appoint sub-agent



6.4 Representation of principal by sub-agent properly appointed [Sec. 192]

- As regards to third persons, principal is bound by the acts of sub-agent.
- Agent is responsible to the principal for the acts of the sub-agent.
- Sub-agent is responsible for his acts to the agent, but not to the principal, except in case of fraud or willful wrong.

6.5 Agent's responsibility for sub-agent appointed without authority [Sec. 193]

Where an agent has appointed a person to act as sub-agent, without having authority to do so –

→ **Agent is responsible** for the acts of sub-agent to both principal and third parties.

→ **Principal is not bound by/responsible** for the acts of sub- agent.

Where sub-agent purportedly acts in name of the first principal, that first principal may

ratify the act of sub-agent.

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SUBSTITUTED AGENT

Substituted agent is a **person appointed by the agent to act for the principal,** in the business of agency, **with the knowledge and consent of the principal**. They are not sub-agents. They are agents of the principal.

7.1 Relation between principal and person duly appointed by agent to act in business of agency [Section 194]:

Where an agent, holding an express or implied authority to name another person to act for the principal in the business of the agency, has named another person accordingly, **such person is substitute agent** for the business entrusted. **Principal is bound by his actions.**

7.2 Agent's duty in naming such person [Section 195]:

Example: A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer, to conduct the sale. C is not a sub-agent but is A's agent for the conduct of the sale.

Example: A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not, but the surveyor is, responsible to A.

In selecting such agent for his principal, an **agent is bound to exercise the same amount of discretion as a man of ordinary prudence**. If done so, agent is not responsible to Principal in case of negligence of the substituted agent.

DIFFERENCE BETWEEN SUB-AGENT AND SUBSTITUTED AGENT

S.no	Sub Agent	Substituted Agent
1.	A sub-agent does his work under the control and directions of agent.	A substituted agent works under the instructions of the principal.
2.	The agent not only appoints a sub-agent but also delegates to him a part of his own duties.	The agent does not delegate any part of his task to a substituted agent.
3.	There is no privity of contract between the principal and the sub-agent.	Privity of contract is established between a principal and a substituted agent
4.	The sub-agent is responsible to the agent alone and is not generally responsible to the principal.	A substituted agent is responsible to the principal and not to the original agent who appointed him.

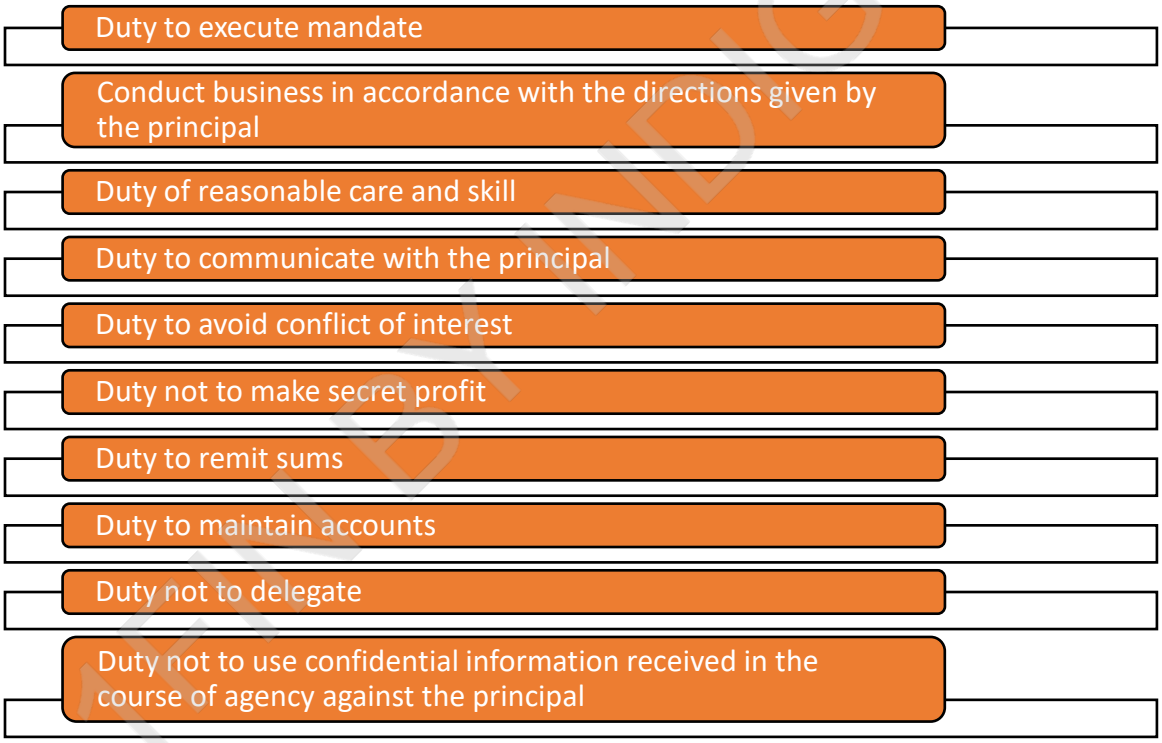
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5.	The agent is responsible to the principal for the acts of the sub-agent.	The agent is not responsible to the principal for the acts of the substituted agent.
6.	The sub-agent has no right of action against the principal for remuneration due to him.	The substituted agent can sue the principal for remuneration due to him.
7.	Sub-agents may be improperly appointed.	Substituted agents can never be improperly appointed.
8.	The agent remains liable for the acts of the sub-agent as long as the sub-agency continues.	The agent's duty ends once he has named the substituted agent.

Note: Both a sub-agent and a substituted agent are appointed by the agent.

DUTIES AND RIGHTS OF AN AGENT

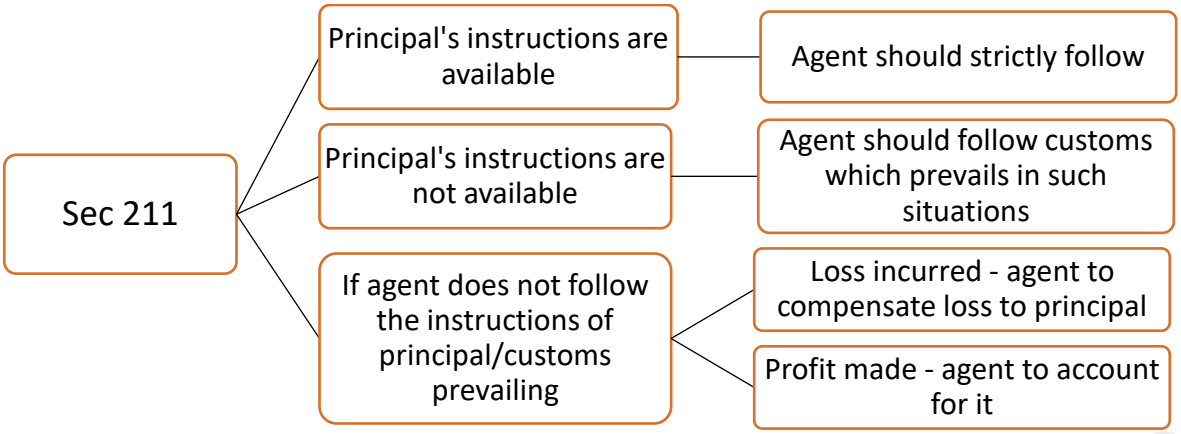
9.1 Duties of an agent



9.1.1 Duty to follow instructions or customs [Sec. 211]

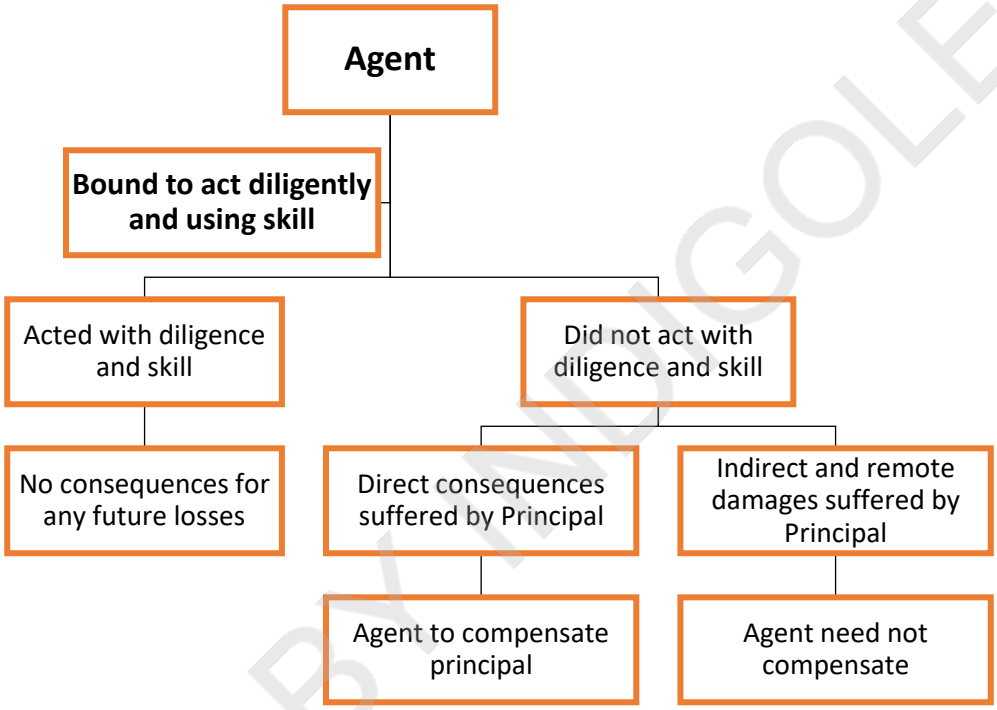
Agent must conduct business as per the instructions of the principal. In absence of instruction, he must follow general customs of business. Otherwise, loss sustained must be compensated back by agent to principal and if any profit accrues, he must account for it.

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9.1.2 Duty of reasonable care and skill [Sec. 212]

Reasonable skill and care to be used in exercising all his duties. Moreover, he is liable to compensate the principal for his negligence/misconduct.



9.1.3 Duty to communicate with principal [Sec. 214]

Agent has the duty to communicate with the principal and seek his instructions in case of any difficulty in execution of his duties.

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9.1.4 Duty to avoid conflict of interest

Right of principal when agent deals, on his own account, in business of agency without principal's consent [Section 215]

If an agent deals on his own account without first obtaining the consent of his principal and acquainting him with all material circumstances, the **principal may cancel the transaction, if**

i. material fact has been dishonestly concealed from him or

ii. Dealings have been disadvantageous to him.

Principal's right to benefit gained by agent dealing on his account in business of agency [Section 216]

If an agent deal on behalf of the principal without his knowledge, the **principal is entitled to claim any benefit** resulting from the transaction from the agent.

9.1.5 Duty not to make secret profits

It is the duty of an agent not to make any secret profit in the business of agency. His **relationship with the principal is of fiduciary nature** and this requires absolute good faith in the conduct of agency.

> **Note:** Secret profit means any advantage obtained by the agent over and above his agreed remuneration and which he would not have been able to make without his position as an agent.

9.1.6 Duty to render proper accounts [Sec. 213]

Accounts supported with vouchers must be submitted whenever demanded by principal.

9.1.7 Duty not to delegate [Sec. 190]

Agent shall not delegate any act which he is personally responsible to fulfil unless it's required in ordinary custom of trade or from the nature of agency.

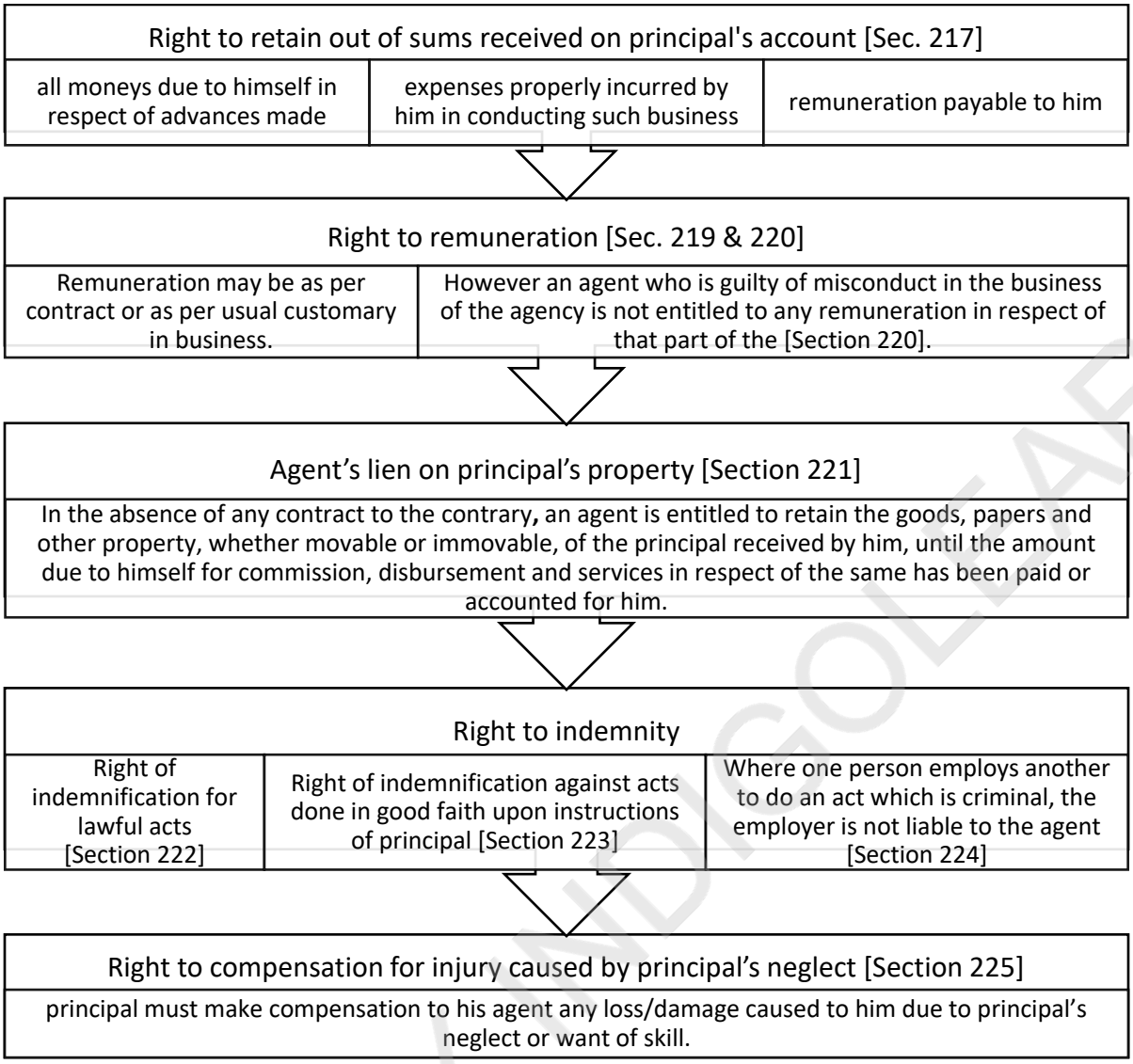
9.1.8 Duty to pay sums received to the principal [Sec. 218]

The agent shall pay all the sums received by him on account of the business of agency to the principal, subject to deduction of sums due to be paid to him.

9.1.9 Duty not to use confidential information received in the course of agency against the principal

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9.2 Rights of an agent



9.2.1 Conditions subject to which agent can exercise the right of lien on principal's property

a) Agent should be **lawfully entitled to receive remuneration**/commission from the principal.

b) Property **belongs to the principal**.

c) Property have been **received** by the agent **in his capacity as agent** and during the course of his ordinary duties as agent.

d) Agent has **only a particular/specific lien**.

Note: Agent's right to lien is lost when possession of property is lost, when agent waives his right or when agent's lien is subject to a contrary contract.

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PRINCIPAL'S LIABILITY TO THIRD PARTIES

10.1 Principal's liability for acts of the agent [Section 226]

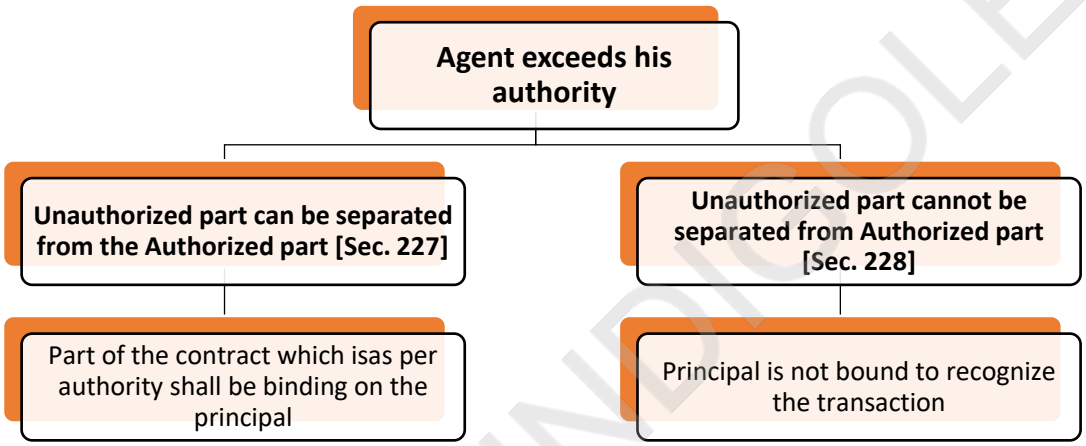
Principal is **liable for, or bound by, the acts of the agent** as per authority given in contract. Legal consequences and obligations born by principal as if he entered into contract himself.

10.2 Principal not bound, when agent exceeds authority [Section 227]

In such situation **part of the contract**, which is as per authority, shall be **binding on the principal**.

10.3 Principal is not bound when excess of agent's authority is not separable [Section 228].

Where an **agent does more than he is authorised** to do, and what he does is beyond the scope of his authority **cannot be separated** from what is within it, the **principal is not bound** to recognize the transaction.



Exception: Principal shall be liable to third parties for inducing belief that agent's unauthorized acts were authorized [Section 237].

10.4 Consequences of notice given to agent [Section 229]

Any notice given to or information obtained by agent during course of business, shall have the same legal consequence as if it had been **given to or obtained by the principal.**

10.5 Effect on agreement, of misrepresentation or fraud by agent [Sec238]

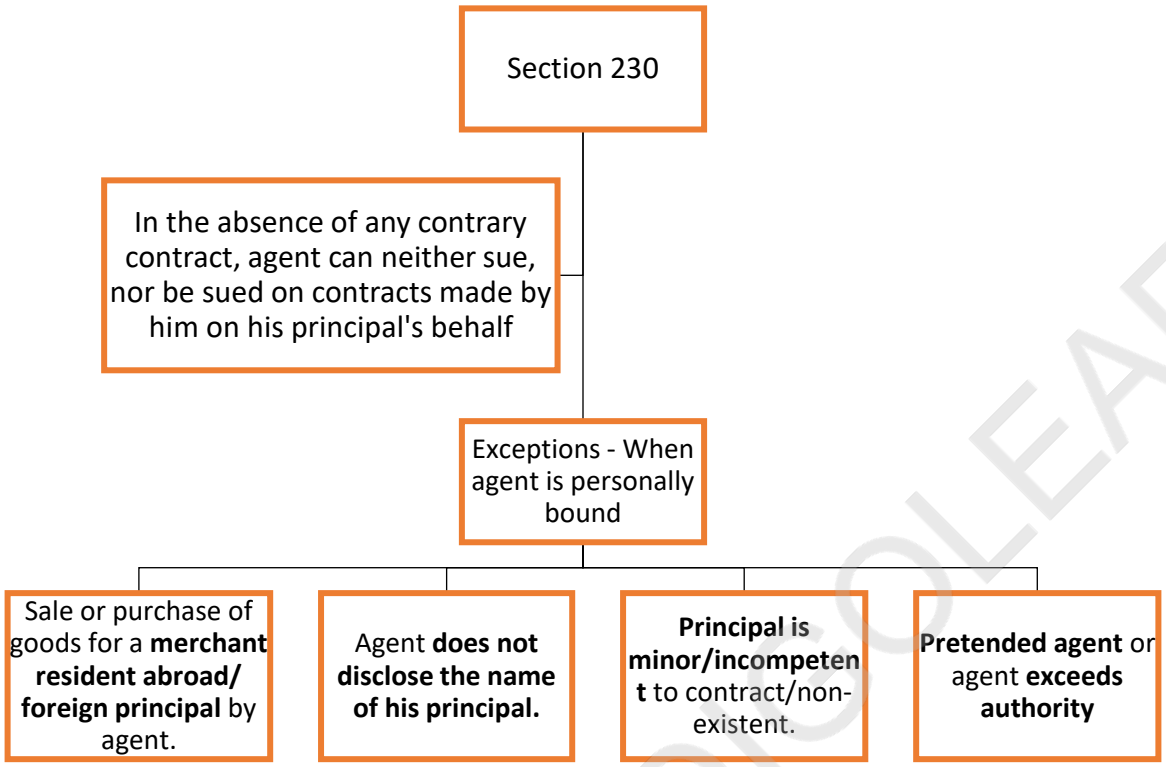
→ Misrepresentation by agents acting in the course of their business for their principals, have the **same effect as if such misrepresentations or frauds had been made, or committed, by the principals**.

→ **Misrepresentations** made, or frauds committed, by agents, **in matters which do not fall within their authority**, **do not affect their principals**.

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PERSONAL LIABILITY OF AGENT TO THIRD PARTIES

11.1 Agent cannot personally enforce, nor be bound by, contracts on behalf of principal [Section 230]



11.2 Rights of parties to a contract made by agent not disclosed [Section 231]

✓ If an agent makes a contract with a person who does not know/suspect that he is an agent, the **other contracting party has, as against the principal, the same right as he would have had as against the agent** if the agent had been the principal.

✓ If the **principal discloses himself before the contract is completed**, the other **contracting party may refuse to fulfil the contract**, if he can show that, if he had known who the principal in the contract was, he would not have entered into the contract.

11.3 Performance of contract with agent supposed to be principal [Section 232]

Where one man makes a contract with another, neither knowing nor having reasonable ground to suspect that the other is an agent, the **principal,** if he requires the performance of the contract, **can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract**.

11.4 Option of the third person to sue the agent or the principal

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a) Right of person dealing with agent personally liable [Section 233]: In cases where the agent holds himself personally liable, but is acting for the principal, a person dealing with him may hold either him or his principal, or both of them, liable.

b) Consequence of inducing agent or principal to act on belief that principal or agent will be held exclusively liable [Section 234]: When a person who has made a contract with an agent induces the agent to act upon the belief that the principal only will be held liable or induces the principal to act upon the belief that the agent only will be held liable, he cannot afterwards hold liable the agent or principal respectively.

11.5 Liability of pretended agent [Section 235]

A **person untruly representing himself to be the authorised agent of another**,

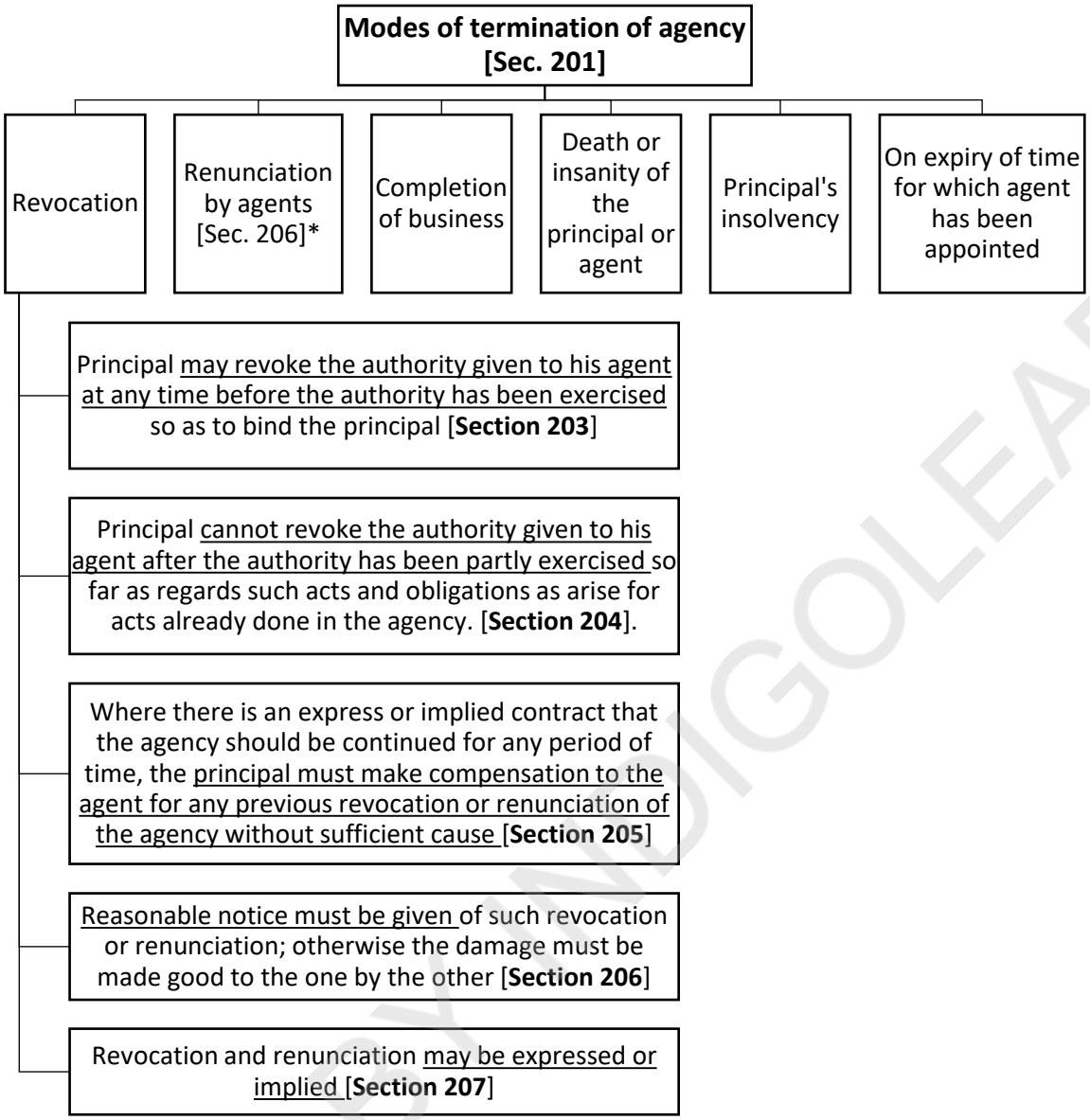
→ and thereby including a third person to deal with him as such agent,
→ is liable, **if his alleged employer does not ratify his acts**,
→ to **make compensation to another in respect of any loss or damage** which he has incurred by so dealing.

11.6 Person falsely contracting as agent, not entitled to performance [Section 236]

A person with whom a contract has been entered into in the character of agent, is **not entitled to require the performance of it** if he was acting, not as agent, but on his own account.

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12.1 Termination of agency



**An agent may renounce the business of agency in the same manner in which the principal has the right of revocation*

12.2 When agency is revocable [Sec. 202]

Example: A gives authority to B to sell A's land, and to pay himself, out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

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Where the **agent has himself an interest in the property which forms the subject matter of the agency**, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

12.3 Effects of Termination [Section 208]

The termination of the authority of an agent **does not**, so far as regards the agent, **take effect before it becomes known** to him, or so far as regards third persons, before it becomes known to them.

12.4 Agent's duty on termination of agency by principal's death or insanity [Section 209]

When an agency is terminated by the principal dying or becoming of unsound mind, the **agent is bound to take** on behalf of the representatives of his late principal, **all reasonable steps for the protection and preservation of the interests entrusted to him.**

12.5 Termination of sub-agent's authority [Section 210]

The **termination of the authority of an agent causes the termination** (subject to the rules herein contained regarding the termination of an agent's authority) **of the authority of all sub-agents appointed by him**.

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CH-2: UNIT 1 – FORMATION OF THE CONTRACT OF SALE

Learning Outcomes –

- Scope of the Sale of Goods Act, 1930.
- Definition of certain terms.
- Sale and Agreement to Sell.
- Distinguishing Sale from other similar Contracts.
- How a Contract of Sale is made.
- Subject Matter of a Contract of Sale.
- Ascertainment of Price.

1. Introduction

- **Sale of Goods Act, 1930 is an Act to define and amend the law relating to the sale of goods.**
- It extends to the **whole of India**. Since 2019, it also applicable to Jammu & Kashmir
- It came into force on **1st July, 1930**.

2. Scope of the Act

- The provisions of the Act are **applicable to the contracts related to the sale of goods**.

  The Act is **not applicable for the sale of immovable properties** like land, shop, or house etc. Sale of immovable properties comes under Transfer of Property Act, 1882.

Contract of Sale of Goods is a contract whereby the **seller transfers** or agrees to transfer the **property in goods** to the **buyer** for a **price** (consideration).

The general provisions of the Indian Contract Act, 1872 apply to a Contract of Sale of Goods in so far as they are not inconsistent with the express provisions of the Sale of Goods Act.

3. Sale and Agreement to Sell [Section 4]

- **Contract of Sale of Goods** - A contract of sale of goods is **a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price [Section 4(1)].**

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- A contract of sale may be **absolute or conditional [Section 4(2)].**
- **Sale Vs. Agreement to sell –**
    - Where under a contract of sale, the **property in the goods is transferred** from the seller to the buyer, the contract is called a **sale**,
    - But where the **transfer** of the property in the goods is **to take place at a future time or subject to some condition** thereafter to be fulfilled, it is called an **agreement to sell**. **[Section 4(3)]**
- An **agreement to sell becomes a sale** when the **time elapses or the conditions are fulfilled** subject to which the property in the goods is to be transferred. **[Section 4(4)]**

Example : X agrees to sell his car to Y for ₹ 2,00,000 after one month. Y agrees to buy the car and make the payment after one month. This is an agreement to sell and it will become a sale after one month when X makes the payment and gets the ownership of the car .

3.1 Elements of a Contract of Sale

The **following elements must co-exist** so as to constitute a contract of sale of goods under the Sale of Goods Act, 1930 –

Two parties	The seller and the buyer are the two must be parties and should be different persons.
Subject Matter	Goods, covering only moveable property can be the subject matter of contract. May be existing goods or future goods.
Price	Consideration for the contract of sale should be in money (and not in kind). But it can be partly money and partly in kind. But money is essential.
Transfer of Property	From seller to buyer must take place. General property is transferred.
Absolute or Conditional	A contract of sale may be absolute or conditional.
Valid contract	All other essential elements of a valid contract must be present. Eg: agreement, free consent, parties are competent, lawful consideration, etc.

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3.2 Distinction between Sale and an Agreement to Sell

Basis of difference	Sale	Agreement to sell
Transfer of property	The property in the goods passes to the buyer immediately.	Property in the goods passes to the buyer on future date or on fulfilment of some condition.
Nature of contract	It is an executed contract.	It is an executory contract.
Remedies for breach	The seller can sue the buyer for the price of the goods because of the passing of the property therein to the buyer.	The aggrieved party can sue for damages only and not for the price unless the price was payable at a stated date.
Subsequent loss or destruction of goods	Liability of the buyer.	Liability of the seller.
Burden of risk	Risk of loss is that of the buyer since risk follows ownership.	Risk of loss is that of the seller.
Nature of rights	Creates Jus in rem i.e. right against a thing.	Creates Jus in personam i.e. right against a person.
Right of resale	The seller cannot resell the goods.	The seller may sell the goods since ownership is with the seller.
In case of insolvency of seller	The official assignee will not be able to take over the goods but will recover the price from the buyer.	The official assignee will acquire control over the goods, but the price will not be recoverable.
In case of insolvency of buyer	The official assignee will have control over the goods.	The official assignee will not have any control over the goods.

4. Definitions

4.1 Buyer [Section 2(1)]

'Buyer' means **a person who buys or agrees to buy goods.**

4.2 Seller [Section 2(13)]

'Seller' means **a person who sells or agrees to sell goods.**

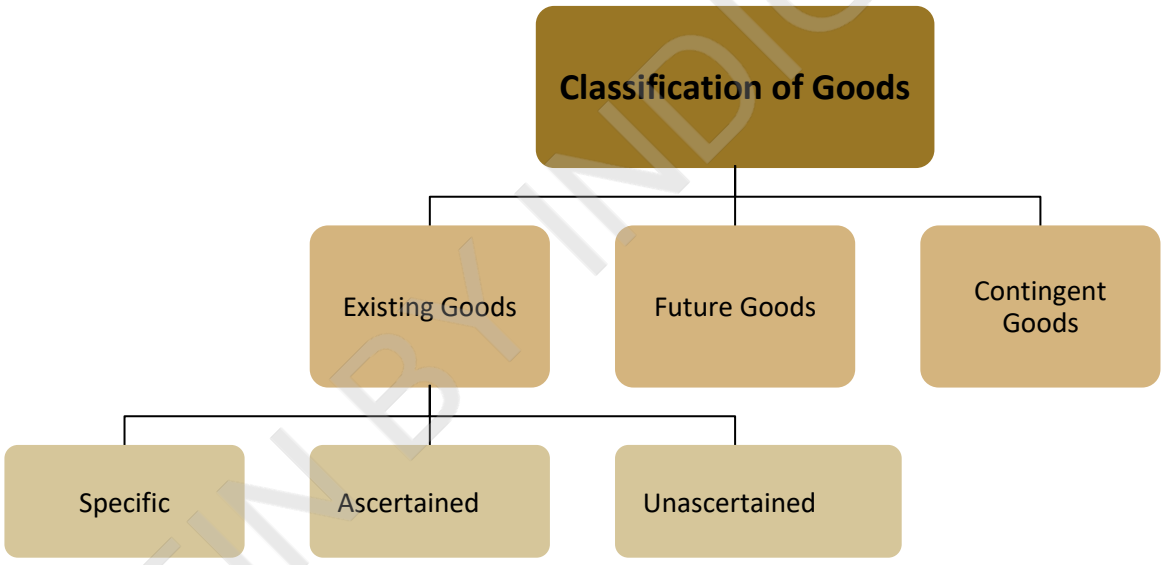
4.3 Goods [Section 2(7)]

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- "Goods" means every kind of **movable property**
  - ✓ **other than actionable claims and money**; and
  - ✓ **includes stock** (bundle of shares) **and shares, growing crops, grass, and things attached to or forming part of the land**, which are agreed to be severed before sale or under the contract of sale.
  - ✓ **Eg:** Cars, food, mobiles, clothes, crops, trees that can be severed from earth, timber, etc

Fixed Deposit Receipts (FDR) are considered as goods under Section 176 of the Indian Contract Act read with Section 2(7) of the Sale of Goods Act.

- '**Actionable claims'** are claims, which can be **enforced only by an action or suit [E.g.,** Debt i.e debts on which some action can be claimed**].** Actionable claims can be transferred but cannot be sold.
- **Money in circulation cannot be goods** but currency notes and coins not in circulation and collected by numismatists shall be considered as goods.
- "Goods" include both **tangible goods and intangible goods** like goodwill, copyrights, patents, trademarks etc.
- **Stock and shares, gas, steam, water, electricity, and decree of the court** are also considered to be goods.



4.3.1 Existing Goods

- Existing Goods are such goods which are **in existence at the time of the contract of sale**, i.e., **those owned or possessed or acquired by the seller at the time of contract of sale** [Section 6].
- The existing goods may be of **following kinds:**

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a) **Specific goods [Section 2(14)] –**

Goods **identified and agreed upon at the time a contract of sale** is made.

Example : 'A' had five cars of different models. He agreed to sell his 'Santro' car to 'B' and 'B' agreed to purchase the same car. In this case, the sale is for specific goods as the car has been identified and agreed at the time of the contract of sale.

Any specified and finally decided goods like a Samsung Galaxy S7 Edge, Whirlpool washing machine of 7 kg etc, are specific goods.

b) **Ascertained Goods –**

Those goods which are **identified in accordance with the agreement after the contract of sale is made.** When **from a lot or out of large quantity of unascertained goods, the number or quantity contracted for is identified,** such identified goods are called ascertained goods.

Example : Raj has 500 apples. Out of these 500 apples, Raj decides to sell 200 apples. To sell these 200 apples, Raj will need to separate them from the 500 (larger set). Thus, Raj selects 200 apples from a larger group of unspecified apples. These 200 apples are now the ascertained goods.

c) **Unascertained goods –**

Goods which are **not specifically identified or ascertained** at the time of making of the contract. They are **indicated or defined only by description or sample**.

Example : Say, from Raj's 500 apples, he decides to sell 200 apples but doesn't specify which ones he wants to sell. A seller will have the liberty to choose any 200 apples from the lot. These are thus the unascertained goods.

4.3.2 Future Goods [Section 2 (6)]

Future Goods means **goods to be manufactured or produced or acquired by the seller after making the contract of sale.**

A contract for the sale of future goods is always an agreement to sell. It is never actual sale because a person cannot transfer what is not in existence.

Example : P agrees to sell to Q all the milk that his cow may yield during the coming year. This is a contract for the sale of future goods.

Example : Amit is a manufacturer of chairs. Shyam ordered Amit to manufacture 200 units of chairs of specific design and they made an agreement for the same. This is the sale with respect to future goods.

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4.3.3. Contingent Goods [Section 6(2)]

- The **acquisition** of which by the seller **depends upon an uncertain contingency** (uncertain event) are called contingent goods.
- Like the future goods, in the case of contingent goods also, **the property does not pass to the buyer at the time of making the contract.**

Example : A agrees to sell to B a Picasso painting provided he is able to purchase it from its present owner. This is a contract for the sale of contingent goods.

Example : P contracts to sell 50 pieces of particular article provided the ship which is bringing them reaches the port safely. This is an agreement for the sale of contingent goods.

4.4 Delivery [Section 2(2)]

- Delivery means **voluntary transfer of possession** from one person to another.
- The **transfer of possession is the end result of the whole delivery process**. The delivery **could occur even when the goods are transferred to a person other than the buyer** but who is authorized to hold goods on behalf of the buyer.

4.4.1 Forms of Delivery

Actual Delivery	Goods are physically delivered to the buyer or to a third person who is authorised to hold goods on behalf of the buyer.
Constructive Delivery	No change in custody or actual possession of the thing. Takes place when a person in possession of the goods belonging to the seller acknowledges to the buyer that he holds the goods on the buyer's behalf.
Symbolic Delivery	Delivery of a thing in token of a transfer of something else.

Example : Where a warehouseman holding the goods of A agrees to hold them on behalf of B, at A's request, it is Constructive Delivery.

Example : Delivery of goods in the course of transit may be made by handing over documents of title to goods, like bill of lading or railway receipt or delivery orders or the key to a warehouse containing the goods is handed over to the buyer . Such handing over of documents of title or a key etc., are Symbolic deliveries.

4.5 Deliverable state [Section 2(3)]

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Goods are said to be in a deliverable state when they are in such a **condition that the buyer would, under the contract, be bound to take delivery of them**.

Example : When 'A' contracts to sell timber and make bundles thereof, the goods will be in a deliverable state after A has put the goods in such a condition.

4.6 Document of title to goods [Section 2(4)]

Document of title to goods includes

- bill of lading,
- dock-warrant,
- warehouse keeper's certificate,
- wharfingers' certificate,
- railway receipt,
- multimodal transport document,
- warrant or order for the delivery of goods and
- any other **document used in the ordinary course of business as**
    - **proof of the possession or control of goods** or,
    - **authorizing or purporting to authorize**, either by endorsement or by delivery, **the possessor of the document to transfer or receive goods thereby represented**.

A document amounts to a **document of title** only where it **shows an unconditional undertaking to deliver the goods to the holder of the document.**

'Document Showing Title' Vs 'Document of Title'.

There is difference between 'Document showing title' and 'Document of Title'. **A document showing title merely shows that the person named in the document is its owner.** It does not allow that person to transfer the ownership by mere endorsement of the document. For example, a share certificate is a 'document' showing title but not a document of title.

4.7 Mercantile Agent [Section 2(9)]

An agent who **in the customary course of business** has, as such agent, **authority either to sell goods or to consign goods** for the purpose of sale or **to buy goods** or **to raise money on the security of the goods**.

Example : Auctioneers or brokers, etc

4.8 Property [Section 2(11)]

'Property' here means '**ownership' or general property**.

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The property in the goods **means the general property i.e., all ownership rights of the goods, and not just a special property.**

Example : If A who owns certain goods pledges them to B, A has general property in the goods, whereas B has special property or interest in the goods to the extent of the amount of advance he has made.

4.9 Insolvent [Section 2(8)]

A person is said to be insolvent when he **ceases to pay his debts in the ordinary course of business, or cannot pay his debts as they become due**, whether he has committed an act of insolvency or not.

4.10 Price [Section 2(10)]

Price means the **money consideration for a sale of goods**.

4.11 Quality of goods [Section 2(12)]

Quality of goods **includes their state or condition**.

5. Sale distinguished from Other Similar Contracts

5.1 Sale and Hire Purchase

- Contract of sale resembles with contracts of hire purchase very closely, and indeed the **real object of a contract of hire purchase is the sale of the goods ultimately.**
- Hire purchase agreements are governed by the **Hire-purchase Act, 1972.**
- **Hire-Purchase agreement** – means an agreement under which **goods are let on hire and under which the hirer has an option to purchase them** in accordance with the terms of the agreement **and includes an agreement under which** –
    - **Possession of goods is delivered** by the owner thereof to a person **on condition that such person pays the agreed amount in periodical instalments**, and
    - The **property in the goods is to pass to such person on the payment of the last of such instalments**, and

Time of passing property	Property in the goods is transferred to the buyer **immediately** at the time of contract.	The property in goods passes to the hirer **upon payment of the last instalment**.

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Position of the party	The **position of the buyer** is that of the **owner** of the goods.	The **position of the hirer** is that of a **bailee** till he pays the last instalment.
Termination of contract	**Buyer cannot terminate** the contract and is bound to pay the price of the goods.	The **hirer may terminate** the contract by returning the goods to its owner without any liability to pay the remaining instalments.
Burden of Risk of insolvency of the buyer	The **seller takes the risk** of any loss resulting from the insolvency of the buyer.	The **owner takes no such risk**, for if the hirer fails to pay an instalment, the owner has the right to take back the goods.
Transfer of title	The **buyer can pass a good title** to a bona fide purchaser from him	The **hirer cannot pass any title** even to a bona fide purchaser.
Resale	The **buyer in sale can resell** the goods.	The **hire purchaser cannot resell** unless he has paid all the instalments.

- Such person has a **right to terminate the agreement at any time before the property so passes**.

5.2 Sale and Bailment

A 'bailment' is the **delivery of goods for some specific purpose** under a contract on the **condition that the same goods are to be returned** when the purpose is accomplished to the bailor **or are to be disposed of** according to the directions of the bailor.



Provisions related to bailment are regulated by the Indian Contract Act, 1872.

Transfer of property	The property in goods is transferred from the seller to the buyer. So it is **transfer of general property.**	There is only transfer of possession of goods from the bailor to the bailee for any of the reasons like safe custody, carriage etc. So, it is **transfer of special property.**

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Return of goods	The return of goods in contract of sale is **not possible.**	The **bailee must return the goods to the bailor** on the accomplishment of the purpose for which the bailment was made.
Consideration	The consideration is the **price in terms of money.**	The consideration **may be gratuitous or non-gratuitous**.

5.3 Sale and contract for Work and Labour

A contract of sale of goods is one in which some goods are sold or are to be sold for a price. But where **no goods are sold, and there is only the doing or rendering of some work of labour, then the contract is only of work and labour** and not of sale of goods.

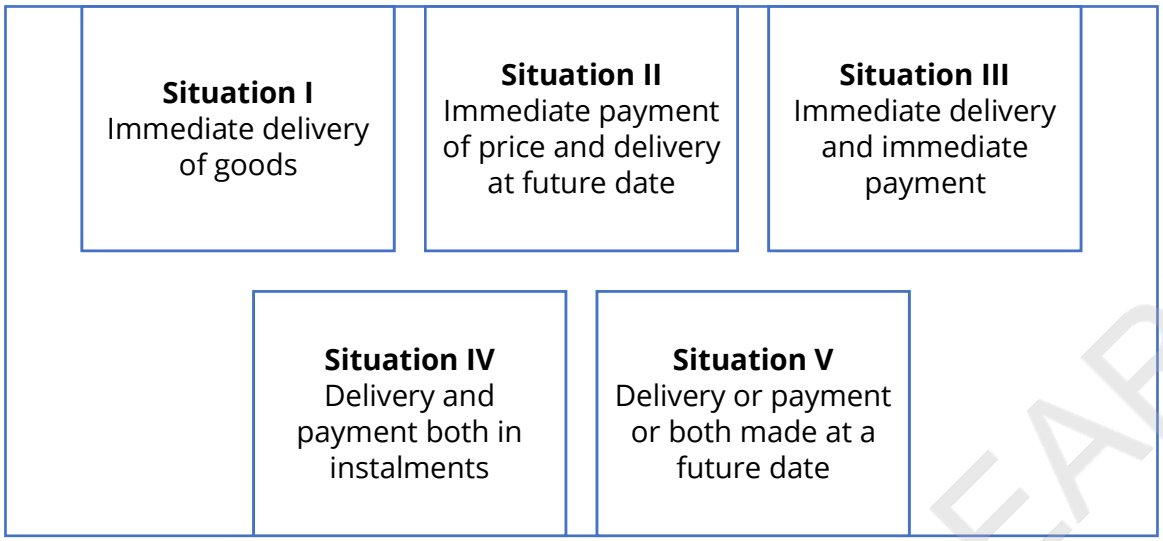
Example : Where gold is supplied to a goldsmith for preparing an ornament or when an artist is asked to paint a picture.

6. How a Contract of Sale is made [Section 5]

- A contract of sale is **made by an offer to buy or sell goods for a price and the acceptance of such offer [Section 5(1)].**
- A contract of sale **may be made** –
  - In **writing** or
  - By **word of mouth**, or
  - **Partly** in writing and partly by word of mouth or
  - May be **implied** from the conduct of the parties.
- A contract of sale can be absolute or conditional.
- **Ex:** Ram agrees to deliver his old bike valued at Rs.50,000 to Sam in exchange for a new model of Triumph and agrees to pay the difference in cash, it is a Contract of Sale – as there are two parties, subject matter is goods, sold for price (part money and part kind), it's a valid contract and goods are agreed to be delivered.

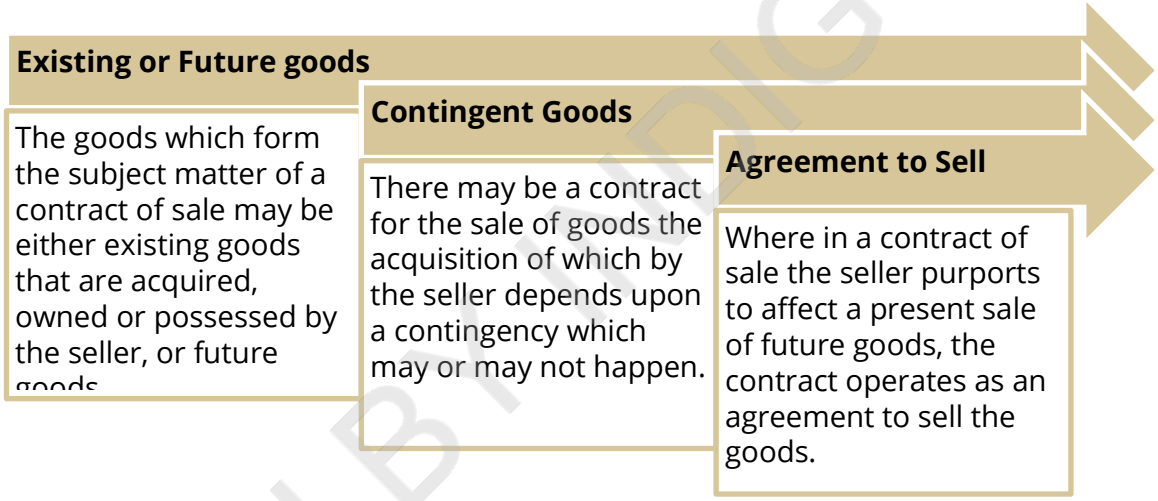
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- **Modes of Delivery & Payment in Contract of Sale –**



7. Subject Matter of a Contract of Sale

7.1 Existing or Future Goods [Section 6]



7.2 Goods perishing before making of contract [Section 7]

Where there is a **contract for the sale of specific goods**, if the goods **without the knowledge of the seller** have, at the time when the contract was made, perished or become so damaged as no longer to answer to their description contract - **the contract is void.**

Example : A agrees to sell B 50 bags of wheat stored in the A's godown. Due to water logging, all the goods stored in the godown were destroyed. At the time of agreement, neither parties were aware of the fact. The agreement is void.

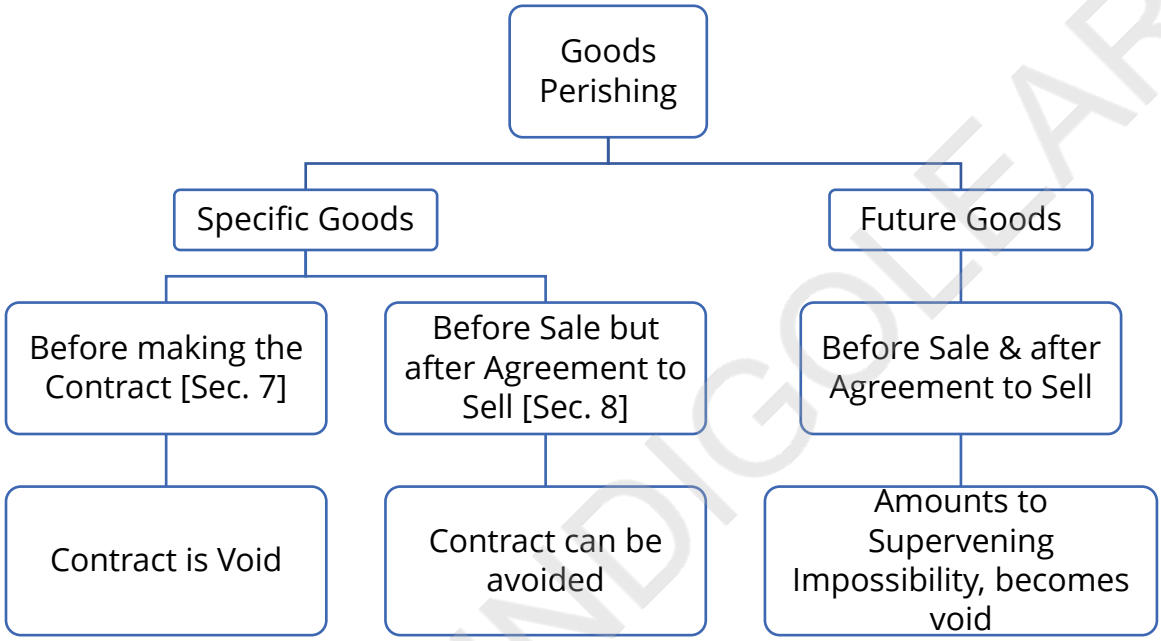
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7.3 Goods perishing before sale but after agreement to sell [Section 8]

Where there is an **agreement to sell specific goods**, and **subsequently** the goods without any fault on the part of the seller or buyer perish or become so damaged as no longer to answer to their description in the agreement **before the risk passes to the buyer** - **agreement is thereby avoided or becomes void**.

7.4 Perishing of future goods

If the future goods are **specific**, the destruction of such goods will amount to **supervening impossibility** and the contract shall become **void**.



8. Ascertainment of Price

8.1 Ascertainment of price [Section 9]

- The price in the contract of sale may be-
  - **Fixed** by the contract, or
  - **Agreed to be fixed in a manner provided by the contract**
  - **Determined by the course of dealings** between the parties.
- **Where the price is not determined** in accordance with the foregoing provisions, the **buyer shall pay the seller a reasonable price**.

8.2 Agreement to sell at valuation [Section 10]

Price is mutually agreed by the parties to the contract. But in some cases price is determined by third person like experts and valuers.

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Where there is an **agreement to sell goods on the terms that the price is to be fixed by the valuation of third party** and –

i) **Such third party cannot or does not make such valuation** –

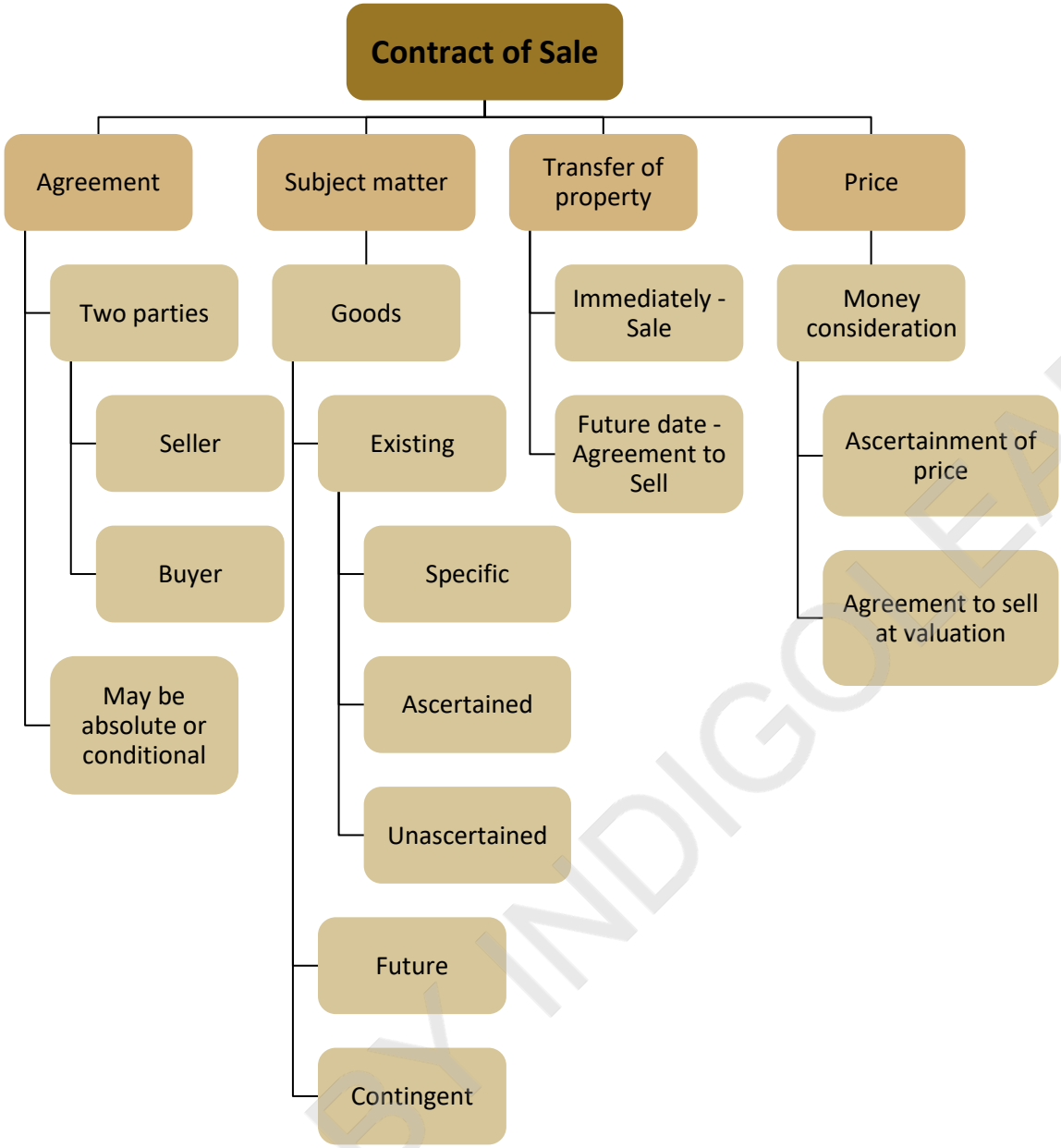
- **Agreement is avoided.**
- If the **goods or any part thereof have been delivered** to, and appropriated by, the buyer, he shall **pay a reasonable price therefore**.

ii) In case the **third party is prevented by the default of either party** from fixing the price - the **party not in fault may maintain a suit for damages** against the party in default.

Example : P is having two bikes. He agrees to sell both of the bikes to S at a price to be fixed by the Q. He gives delivery of one bike immediately. Q refuses to fix the price. As such P asks S to return the bike already delivered while S claims for the delivery of the second bike too. In the given instance, buyer S shall pay reasonable price to P for the bike already taken. As regards the second bike, the contract can be avoided.

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9. Overview



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CH-2: UNIT 2 – CONDITIONS AND WARRANTIES

Learning Outcomes –

- Stipulation as to Time.
- Conditions and Warranties.
- Express and Implied - Conditions and Warranties.
- Doctrine of 'Caveat Emptor'.

1. Introduction

At the time of selling the goods, a seller usually makes certain statements or representations with a view to induce and influence the intending buyer to purchase the goods.

Such representations are generally about the nature and quality of goods, and about their eligibility to suit buyer's purpose or requirement.

When these statements or representations do not form a part of the contract of sale, they are not relevant and have no legal effects on the contract.

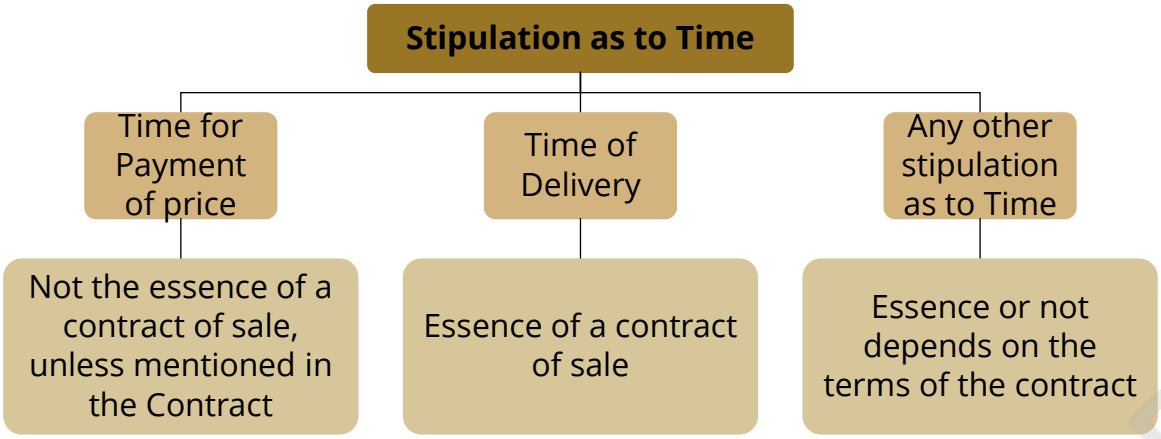
But, when these form part of the contract of sale and the buyer relies upon them, they are relevant and have legal effects on the contract of sale.

Stipulation - A representation which forms a part of the contract of sale and affects the contract.

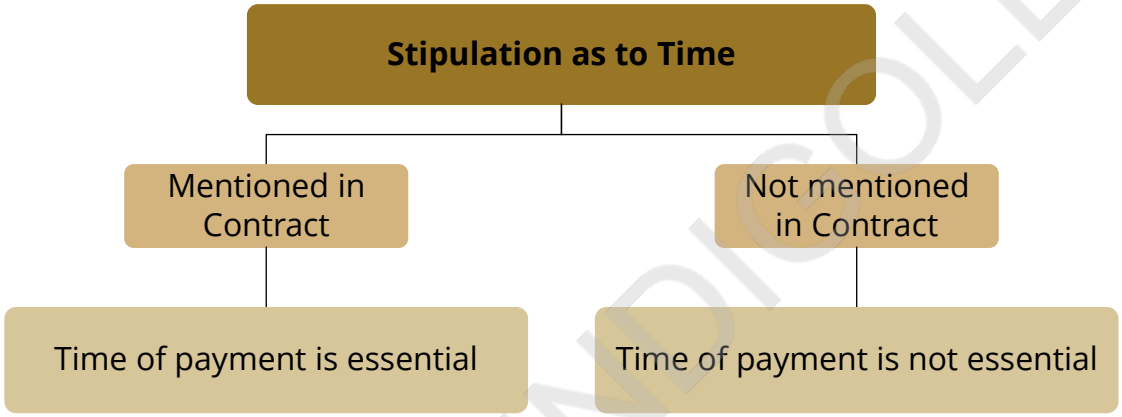
2. Stipulation as to Time [Section 11]

- As regard to **time for the payment of price**, *unless a different intention appears from the terms of contract*, **stipulation as regard this, is not deemed to be of the essence** of a contract of sale.
- **Stipulation as to time of delivery** are usually **the essence of the contract**.

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All conditions given in the contract have to be abided by both, buyer and seller.



3. Conditions and Warranties [Section 12]

According to **Section 12** of the Sale of Goods Act, 1930 –

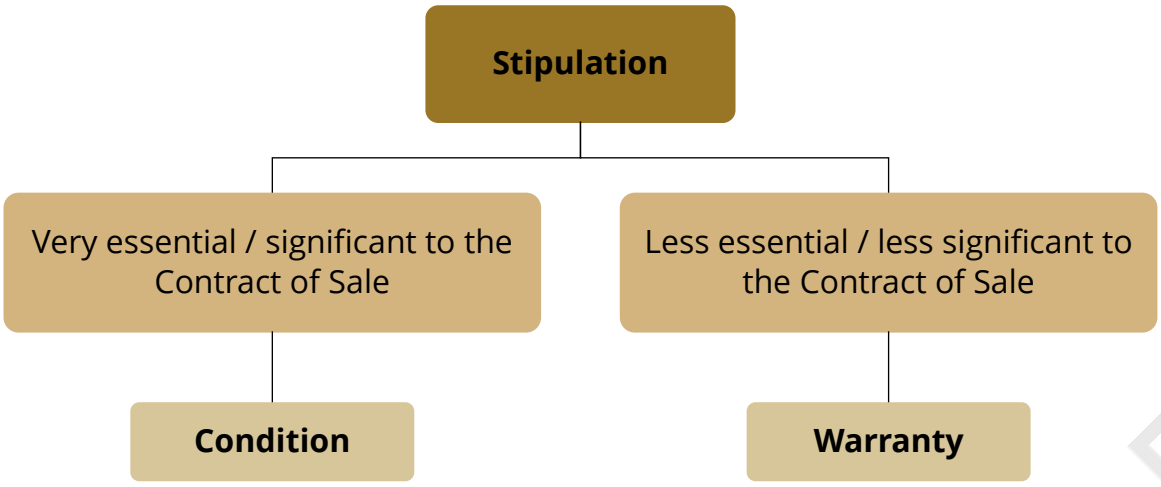
(1) A stipulation in a contract of sale with reference to goods which are the subject thereof may be a **Condition or a Warranty**.

(2) A **Condition** is a stipulation **essential to the main purpose** of the contract, the breach of which gives rise to a right to treat the contract as repudiate.

(3) A **Warranty** is a stipulation **collateral to the main purpose** of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.

(4) **Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract**. A stipulation may be a condition, though called a

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Example : Breach of Condition – Prakash wants to purchase a baking oven from Qadir, which should have a capacity of 5 trays with 4 cakes per tray. Qadir, shows the drawing of the oven and says, "There are 5 trays which can bake 4 cakes per tray." Later Prakash buys the oven but finds out later on that the oven had only 2 trays.

This amounts to a breach of condition because the seller made a stipulation which forms the essence of the contract. In this case, the 5-tray capacity was a stipulation that was essential to the main purpose of the contract and hence its breach is a breach of condition. Prakash is therefore entitled to reject the oven and have a refund of the price.

Example : Breach of Warranty – Ram buys a new Maruti car from the showroom and the car is guaranteed against any manufacturing defect under normal usage for a period of one year from the date of original purchase and in the event of any manufacturing defect there will be replacement of defective part if it cannot be properly repaired. After six months, Ram finds that the horn of the car is not working.

Here, in this case Ram cannot terminate the contract. The manufacturer can either get it repaired or replace it with a new horn. Ram gets a right to claim for damages, if any, suffered by him but not the right of repudiation.

Condition Vs. Warranty

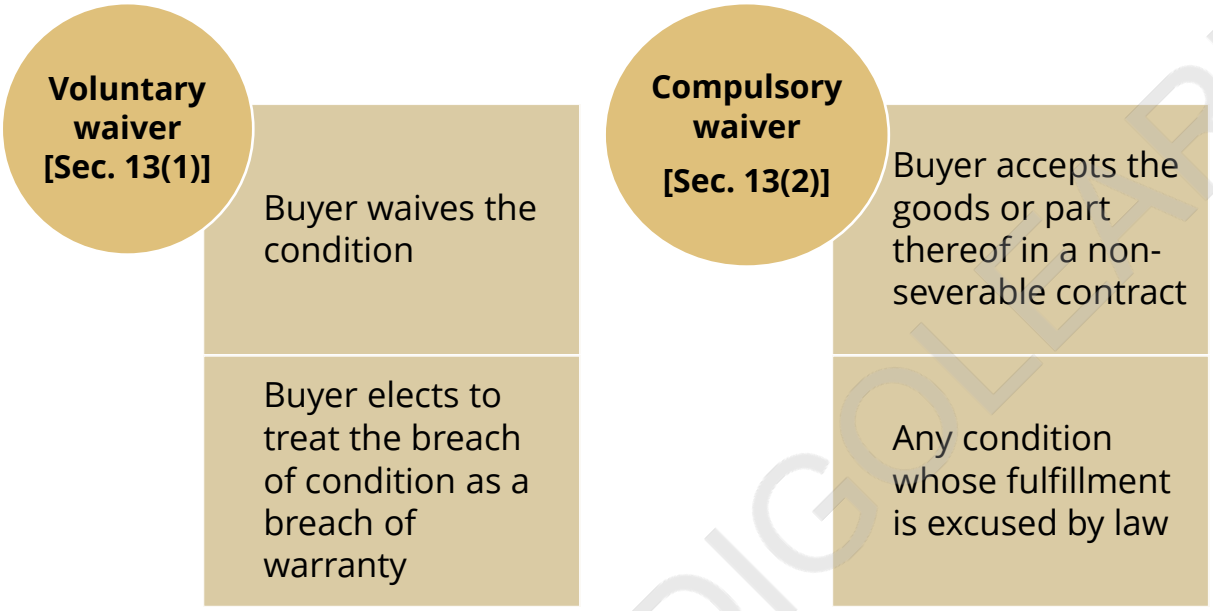
Basis of differences	Condition	Warranty
Meaning	A condition is an **essential stipulation** to the main purpose of the contract. [Sec 12(2)]	A warranty is a **collateral stipulation,** which is additional to the main purpose of the contract. [Sec12(3)]
Right in case of breach	The aggrieved party can repudiate (cancel) the contract or claim damages or both.	The aggrieved party can claim only damages.

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Conversion of stipulations	A breach of condition may be treated as a breach of warranty as per Sec 13.	A breach of warranty cannot be treated as a breach of condition.

4. When Condition is to be treated as Warranty [Section 13]

In the following cases, a contract is not avoided even on account of a breach of a condition –



Example : A agrees to supply B 10 bags of first quality sugar @ ₹ 625 per bag but supplies only second quality sugar, the price of which is ₹ 600 per bag. There is a breach of condition and the buyer can reject the goods. But if the buyer so elects, he may treat it as a breach of warranty, accept the second quality sugar and claim damages @ ₹ 25 per bag. – Voluntary waiver.

Example : Mrs. Kumar agrees to buy one six seater dining table from Banta Furnitures looking at brochure. Banta furniture delivers 6 chairs and six seater table as the chairs are attached to the table and part of the model chosen. There is a breach of condition but the chairs are non-severable. If Mrs. Kumar accepts it, the condition would be treated as warranty. – Compulsory waiver.

5. Express and Implied Conditions and Warranties [Sections 14 -17]

'Conditions' and 'Warranties' may be either **express or implied**.

5.1 Express Conditions

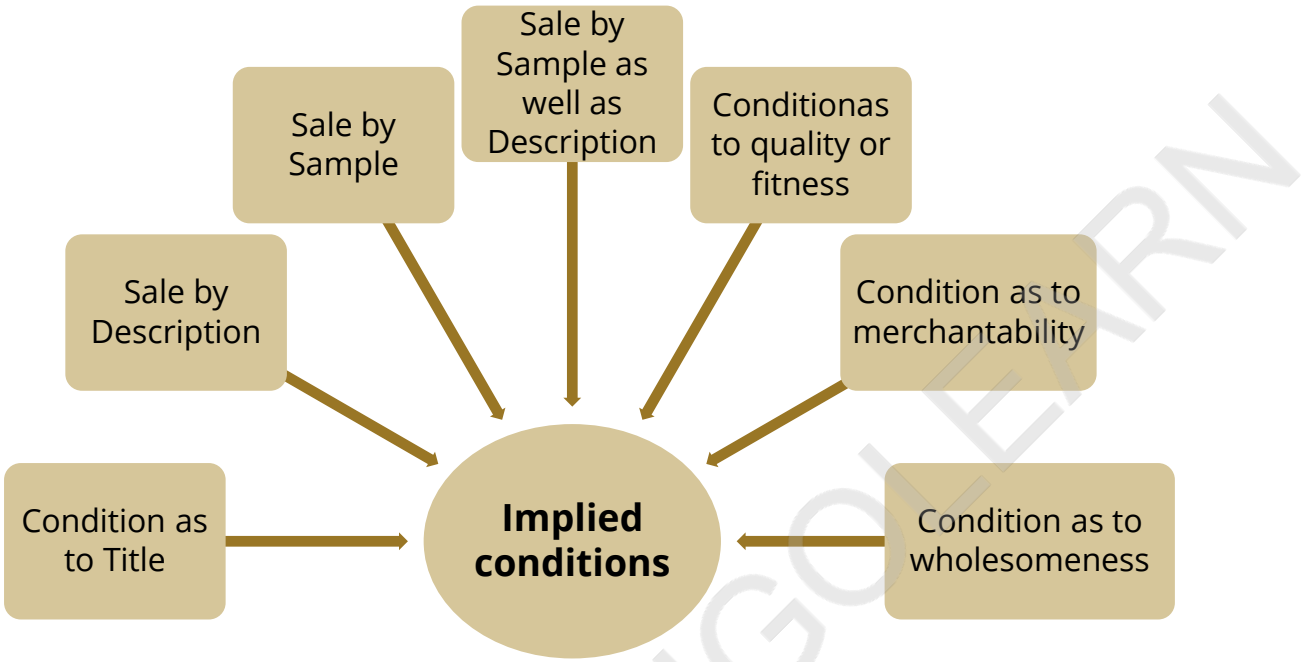
Agreed upon between the parties **at the time of contract** and are **expressly provided** in the contract.

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5.2 Implied Conditions

Those which are **presumed by law to be present** in the contract. Implied conditions are **incorporated by law** in the contract of sale.

Following are the implied conditions in a contract of sale unless otherwise agreed in the contract –



5.2.1 Condition as to title [Section 14(a)]

- In every contract of sale, the condition implied is that the **seller has the right to sell the goods at the time when the property is to pass**. i.e.,
  - **In case of a sale**, he has a **right to sell the goods**, and
  - **In the case of an agreement to sell**, he will have the **right to sell the goods at the time when the property is to pass**.
- **If Seller's title is defective** – Then, buyer must return the goods to the true owner and recover the price from the seller.

Example : If A sells to B tins of condensed milk labelled 'C.D.F. brand', and this is proved to be an infringement of N Company's trademark, it will be a breach of implied condition that A had the right to sell.

B in such a case will be entitled to reject the goods or take off the labels, and claim damages for the reduced value. If the seller has no title and the buyer has to hand over the goods to the true owner, he will be entitled to a refund of the price.

5.2.2 Sale by description [Section 15]

- If there is a contract of sale of goods by description, a default implied condition is that these **goods must correspond with this description**.

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- Description usually means the specifications / representations of product.
- The buyer is not bound to accept and pay for the goods which are not in accordance with the description of goods. The **buyer is entitled to reject the goods whether the buyer is able to inspect them or not**.

Example : A ship was given as "copper-fastened vessel" in description but actually it was only partly copper-fastened. It was held that goods did not match with the description and hence could be returned or if the buyer took the goods, he could claim damages for breach.

- **The Act does not define 'description'. It could be** –

  i) **Where the class or kind to which the goods belong has been specified**, e.g., 'Egyptian cotton', "java sugar", etc., and

  ii) **Where the goods have been described by certain characteristics essential to their identification**, e.g., jute bales of specified shipment, steel of specific dimension, etc.

  In these cases, description assumes the form of a **statement or representation regarding the identity of particular goods** by reference to the place of origin or mode of packing, etc.

Whether or not such a statement or representation is essential depends, in each case, on the construction of the contract.

5.2.3 Sale by sample [Section 17]

When the goods are to be supplied on the basis of a sample the following conditions are implied:

i) The bulk supplied shall **match with the sample in quality**.

ii) The **buyer shall have a reasonable opportunity of comparing the bulk with the sample I,e. inspect the final goods.**

iii) The **goods shall be free from any latent defect i.e. a hidden defect.**

Example : In a case of sale by sample of two parcels of wheat, the seller allowed the buyer an inspection of the smaller parcel but not of the larger parcel. In this case, it was held that the buyer was entitled to refuse to take the parcels of wheat.

Example : A company sold certain shoes made of special sole by sample for the French Army. The shoes were found to contain paper not discoverable by ordinary inspection. Held, the buyer was entitled to the refund of the price plus damages.

In case of latent defects, the buyer has the remedy of

- reject the goods,
- recover the price;
- claim damages

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5.2.4 Sale by sample as well as by description [Section 15]

Where the goods are sold by sample as well as by description the implied condition is that the **bulk of the goods supplied shall correspond both with the sample and the description.**

Example : A agreed with B to sell certain oil described as refined sunflower oil, warranted only equal to sample. The goods tendered were equal to sample, but contained a mixture of hemp oil. B can reject the goods.

Basis	Situation 1	Situation 2	Situation 3	Situation 4
Description	✓	✓	✗	✗
Sample	✓	✗	✓	✗
Contract status	Valid – Buyer cannot repudiate	Buyer can repudiate	Buyer can repudiate	Buyer can repudiate

5.2.5 Condition as to quality or fitness [Section 16(1)]

- Ordinarily, there is no implied condition as to the quality or fitness of the goods sold for any particular purpose.
- However, there is implied condition on the part of the seller that the **goods supplied shall be reasonably fit for the purpose for which the buyer wants** them, **provided the following terms are fulfilled**:
    a) The buyer should have **made known to the seller the particular purpose** for which goods are required.
    b) The buyer should **rely on the skill and judgement of the seller**.
    c) The **goods must be of a description dealt in by the seller**, whether he be a manufacturer or not.
- Where the goods can be used for only one purpose, the buyer need not tell the seller the purpose for which he requires the goods.

Example : 'A' bought a set of false teeth from 'B', a dentist. But the set was not fit for 'A's mouth. 'A' rejected the set of teeth and claimed the refund of price. It was held that 'A' was entitled to do so as the only purpose for which he wanted the set of teeth was not fulfilled.

Example : 'A' went to 'B's shop and asked for a 'Merrit' sewing machine. 'B' gave 'A' the same and 'A' paid the price. 'A' relied on the trade name of the machine rather than on the skill and judgement of the seller 'B'. In this case, there is no implied condition as to fitness of the machine for the buyer's particular purpose.

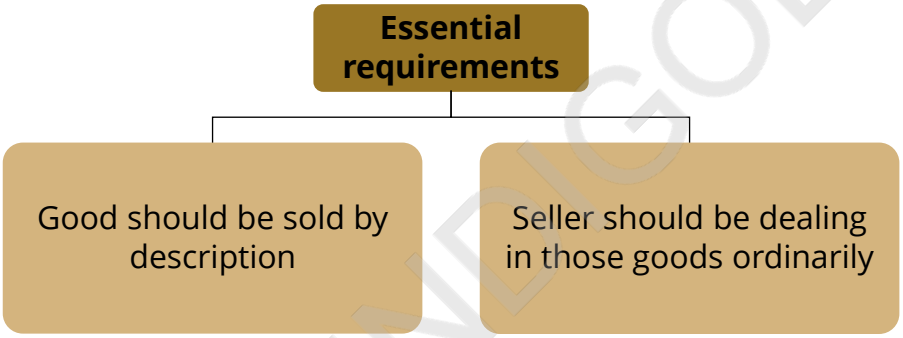
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As a **general rule**, it is the **duty of the buyer to examine the goods thoroughly before he buys them** in order to satisfy himself that the goods will be suitable for his purpose for which he is buying them. This is known as ***Rule of Caveat Emptor*** which means **"*Let the buyer beware*".** [discussed in detail later on in the Unit]

5.2.6 Condition as to Merchantability [Section 16(2)]

Where **goods are bought by description** from a **seller who deals in goods of that description** (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality.

"Merchantable Quality" – goods of such a quality and in such a condition a man of ordinary prudence would accept them as goods of that description.



To be merchantable, a good for sale must be usable for the purpose it is made for. Goods should be in such condition that an ordinary man would purchase and use

It must be of average worth (not necessarily special) in the marketplace and must not be broken, unworkable, damaged, contaminated or flawed.

Example: A bought a black velvet cloth from C and found it to be damaged by white ants. Held, the condition as to merchantability was broken.

5.2.7 Condition as to wholesomeness

In the case of eatables and provisions, there is another implied condition that the goods shall be wholesome, in addition to the implied condition as to merchantability.

Example : A supplied F with milk. The milk contained typhoid germs. F's wife consumed the milk and was infected and died. Held, there was a breach of condition as to fitness and A was liable to pay damages.

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5.3 Implied Warranties

It is the stipulation which has **not been included in the contract of sale in express words**, but the **law presumes** that the parties have incorporated it into their contract. Implied warranties are read into every contract of sale unless they are expressly excluded by the express agreement of the parties.

Implied warranties may also be excluded by the course of dealings between the parties or by usage of trade [Section 62].

The Act discloses the following **Implied Warranties** –



If express agreement negates the implied warranties, express agreement will prevail.

5.3.1 Warranty as to undisturbed possession [Section 14(b)]

- There is an implied warranty that the **buyer shall have and enjoy quiet possession of the goods.**
- This means that, **after receiving the title** of ownership from the true owner **the buyer should not be disturbed either by the seller or any other person claiming superior title of the goods**. In such a case, the buyer is entitled to claim compensation and damages from the seller as a breach of implied warranty.

Example : X buys a laptop from Y. After the purchase, X spends some money on its repair and uses it for some time. Unknown to the parties, it turns out that the laptop was stolen and was taken from X and delivered to its rightful owner.

Y shall be held responsible for a breach and X is entitled to damages of not only the price but also the cost of repairs.

5.3.2 Warranty as to non-existence of encumbrances [Section 14(c)]

An implied warranty that

- **the goods shall be free from any charge or encumbrance**
- **in favour of any third party**

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- **not declared or known to the buyer**

before or at the time the contract is entered into.

Encumbrance is a mortgage or other claim on property or assets.

Example : A pledges his car with C for a loan of ₹15,000 and promises him to give its possession the next day. A, then sells the car immediately to B, who purchased it on good faith, without knowing the fact.

B may either ask A to clear the loan or himself may pay the money and then file a suit against A for recovery of the money with interest.

5.3.3 Warranty as to quality or fitness by usage of trade [Section 16(3)]

An **implied warranty as to quality or fitness for a particular purpose** may be annexed or attached by the usage of trade.

5.3.4 Disclosure of dangerous nature of goods

In case the **goods are inherently dangerous, or they are likely to be dangerous** to the buyer **and the buyer is ignorant** or unaware of the danger, an implied warranty on the part of the seller emerges. The seller must warn the buyer duly about the dangerous nature of the goods if any. **In case of a breach of this warranty, the seller will be liable in damages.**

Example : X purchases a bottle of disinfectant from a person Y. Y knows that the cap of the bottle is defective or cheap and if opened by a novice without care, it may spill and result in partial burning or other damages of the person. When X opens the bottle, he is injured.

In this case, X is liable in damages to Y as Y should have been duly warned of the probable danger.

Implied Conditions	Implied Warranties
• Condition as to Title • Sale by Description • Sale by Sample • Sale by sample and description • Condition as to quality and fitness • Condition as to Merchantability • Condition as to Wholesomeness	• Undisturbed possession • Non-existence of Encumbrance • Quality and fitness by usage of trade • Disclosure of dangerous nature of goods

6. Caveat Emptor

In case of sale of goods, the doctrine **'Caveat Emptor' means 'let the buyer beware'**.

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Section 16 of the Sale of Goods Act, 1930 lays down the rule of 'Caveat Emptor' which states that –

"Subject to the provisions of this Act or of any other law for the time being in force, **there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale**".

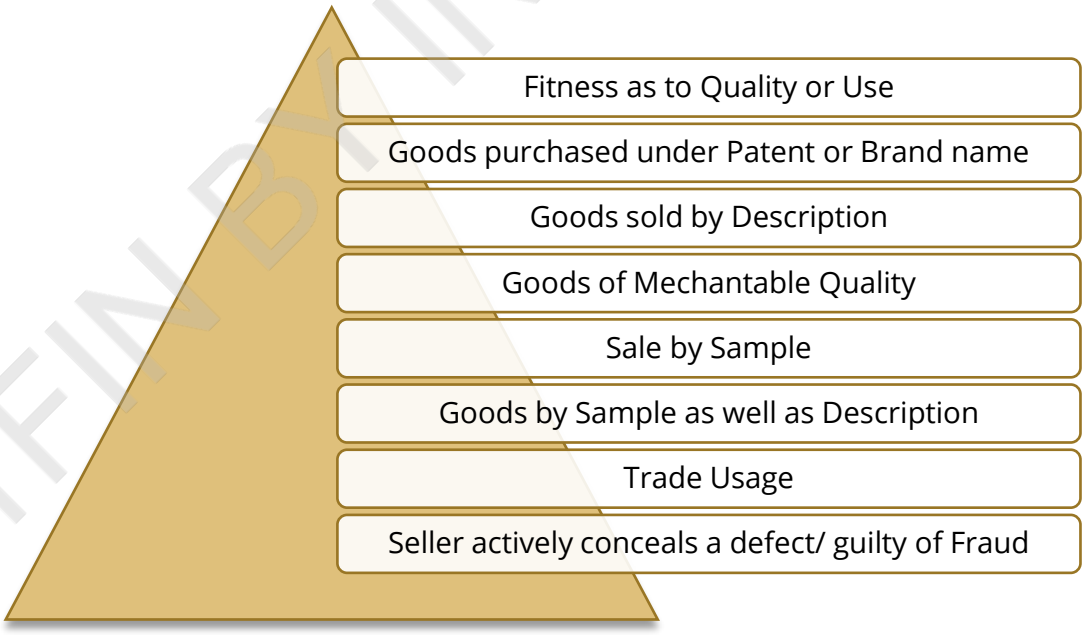
- It is the **duty of the buyer to satisfy himself before buying the goods** that the goods will serve the purpose for which they are being bought.
- If the goods turn out to be defective or do not serve his purpose or if he depends on his own skill or judgment, the **buyer cannot hold the seller responsible.**

  Example : A sold pigs to B. These pigs being infected, caused typhoid to other healthy pigs of the buyer. It was held that the seller was not bound to disclose that the pigs were unhealthy. The rule of the law being "Caveat Emptor".

  Example : A purchases a horse from B. A needed the horse for riding but he did not mention this fact to B. The horse is not suitable for riding but is suitable only for being driven in the carriage. Caveat emptor rule applies here and so A can neither reject the horse nor can claim compensation from B.

Exceptions to Caveat Emptor

- The doctrine of Caveat Emptor is, however, subject to the following **exceptions** –



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6.1 Fitness as to quality or use [Section 16(1)]

There is an implied condition that goods shall be reasonably fit for a particular purpose, if –

- The **buyer had made known to the seller the purpose** of his purchase, and
- The buyer **relied on the seller's skill and judgement**, and
- **Goods** are of a description **which is in the course of Seller's business** to supply.

Example : An order was placed for some trucks to be used for heavy traffic in a hilly country. The trucks supplied by the seller were unfit for this purpose and broke down. There is a breach of condition as to fitness.

Case Law: Priest vs. Last

Facts: P, a draper, purchased a hot water bottle from a retail chemist, P asked the chemist if it would stand boiling water. The Chemist told him that the bottle was meant to hold hot water. The bottle burst when hot water was poured into it and injured his wife.
Judgement: It was held that the chemist shall be liable to pay damages to P, as he knew that the bottle was purchased for the purpose of being used as a hot water bottle.

Goods which can be used for multiple purposes – Where the article can be used for only one particular purpose, the buyer need not tell the seller the purpose for which he required the goods. But where the article can be used for a number of purposes, the **buyer should tell the seller the purpose for which he requires the goods, if he wants to make the seller responsible**.

Case Law: Bombay Burma Trading Corporation Ltd. vs. Aga Muhammad

Facts: Timber was purchased for the **express purpose** of using it as railways sleepers and it was found to be unfit for the purpose.
Judgement: The Court held that the contract could be avoided.

6.2 Goods purchased under patent or brand name [Proviso to Section 16(1)]

In case where the goods are purchased under its patent name or brand name, there is **no implied condition that the goods shall be fit for any particular purpose.**

6.3 Goods sold by description [Section 15]

Where the goods are sold by description there is an **implied condition that the goods shall correspond with the description**. If it is not so then the seller is responsible.

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6.4 Goods of Merchantable Quality [Section 16(2)]

- Where the **goods are bought by description from a seller who deals in goods of that description** there is an implied condition that the goods shall be of merchantable quality. **The rule of Caveat Emptor is not applicable**.
- But, where the **buyer has examined the goods** this **rule shall apply** if the **defects were such which ought to have not been revealed by ordinary examination.**

6.5 Sale by sample [Section 17]

Where the goods are bought by sample, this **rule of Caveat Emptor does not apply if the bulk does not correspond with the sample**.

6.6 Goods by sample as well as description [Section 15]

Where the goods are bought by sample as well as description, **the rule of Caveat Emptor is not applicable in case the goods do not correspond with both the sample and description or either of the conditions.**

6.7 Trade Usage [Section 16(3)]

An **implied warranty or condition** as to quality or fitness for a particular purpose may be **annexed by the usage of trade** and if the seller deviates from that, this rule of Caveat Emptor is not applicable.

Example : In readymade garment business, there is an implied condition by usage of trade that the garments shall be reasonably fit on the buyer.

6.8 Seller actively conceals a defect or is guilty of fraud

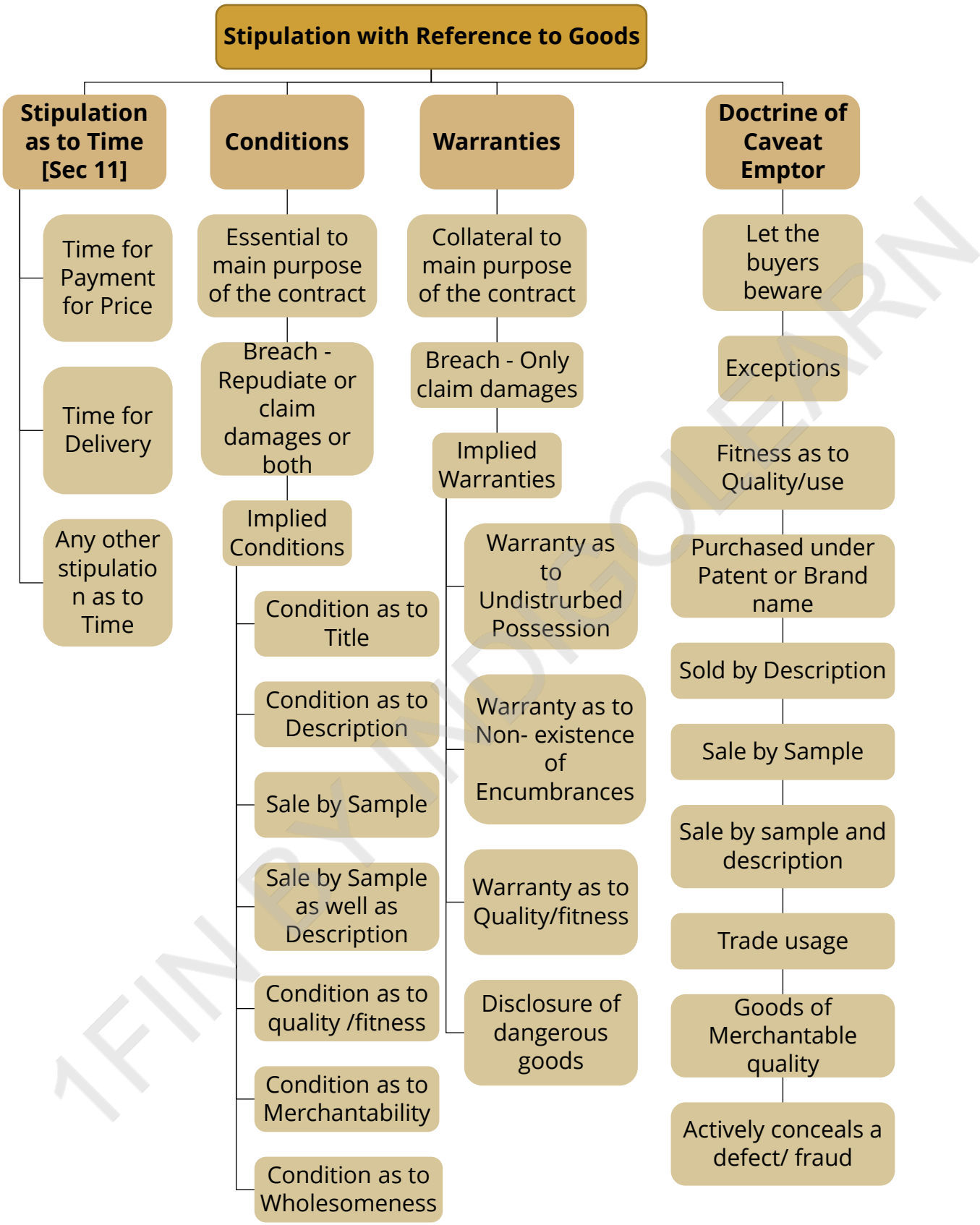
The rule of Caveat Emptor will not apply –

- Where the **seller sells the goods by making some misrepresentation or fraud** and the **buyer relies on it**, or
- When the **seller actively conceals some defect** in the goods so that the **same could not be discovered by the buyer on a reasonable examination**.

In such a case the buyer has a right to avoid the contract and claim damages.

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7. Overview



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CH-2: UNIT 3 – TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS

Learning Outcomes –

- Passing of property from seller to buyer.
- Appropriation of goods.
- Passing of property Vs. Passing of title.
- Rule '*Nemo dat quod non habet*' and its exceptions.
- Rules relating to delivery and acceptance of goods.

1. Introduction

- Sale of goods involves **transfer of ownership of property** from seller to buyer.
- A contract of sale of goods involves transfer of ownership in **three stages** –



Delivery is voluntary transfer of possession.

- **The general rule is that risk prima facie passes with the property.**
- If the goods are lost or damaged, the **burden of loss** is borne by the person who is the **owner** at the time when the goods are lost or damaged.
- Where the goods are damaged by the act of the third party, it is the **owner who can take action.** Suit for price by the seller can be filed only when the property has passed to the buyer.

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2. Passing of Property

- **Passing of property implies passing of ownership.**

  Ownership and possession are two different aspects. Ownership gives right in goods whereas possession gives right only to use goods in the manner allowed by the owner.

- **Once the property has passed** to the buyer, the risk in the goods sold is that of the buyer and not of the seller, though the goods may still be in the seller's possession.

- The **rules regarding transfer of property in goods** from the seller to the byer depend on two basic factors:

  - **Identification of Goods [Section 18] –** Where there is a contract for sale of unascertained goods, the **property in goods cannot pass to the buyer unless and until the goods are ascertained**.
  - **Intentions of parties [Section 19]** - The **property in goods is transferred** to the buyer **at such time as the parties to the contract intend** it to be transferred. This can be ascertained based on terms of contract, conduct of parties and circumstances.

Passing or transfer of property is the most important element to decide legal rights and liabilities of sellers and buyers.

Primary rules determining the passing of property from seller to buyer can be understood w.r.t. following type of goods :-

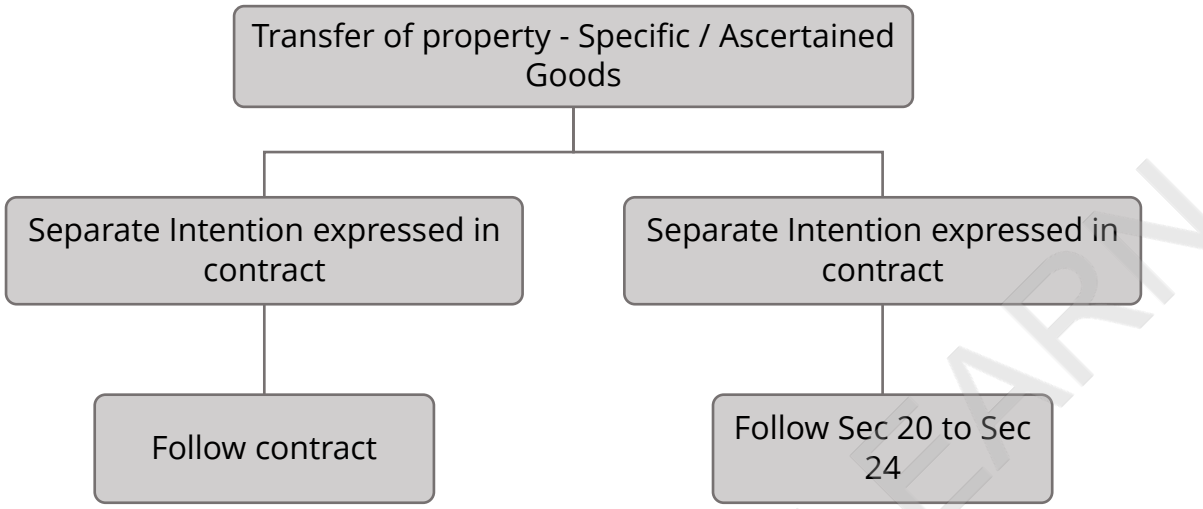
- Specific or Ascertained Goods
- Passing of Unascertained Goods
- Goods sent on Approval or 'On Sale or Return' basis
- Transfer of Property in case of Reservation of Right of Disposal

2.1 Property (Specific or ascertained goods) passes when intended to pass [Section 19]

- **Transfer of Property in case of a contract for sale of Specific or Ascertained Goods** – The property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred [Section 19(1)].
- **Ascertaining the Intention of Parties** – The intention of the parties shall be ascertained with due regard to –
  - The **terms** of the contract,
  - The **conduct** of the parties, and
  - The **circumstances** of the case [**Section 19(2)**].

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- Unless a different intention appears, the **rules contained in sections 20 to 24** are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer [**Section 19(3)**].



- **The stages of goods while passing of property are as follows:**



2.1.1 Specific goods in a deliverable state [Section 20]

➔ Where there is an unconditional contract for the sale of specific goods in deliverable state,

➔ **the property in goods passes to the buyer when the contract is made.**

This rule holds true even if the time of payment of price, or the time for delivery of the goods, or both, is postponed.

Example : X goes into a shop and buys a television and asks the shopkeeper for its home delivery. The shopkeeper agrees to do it. The television immediately becomes the property of X.

2.1.2 Specific goods to be put into a deliverable state [Section 21]

➔ Where there is a contract for the sale of specific goods, and

➔ the seller is bound **to do something** to put the goods in deliverable state,

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➔ the **property does not pass until such thing is done and** buyer has **notice** thereof**.**

Example : Peter buys a laptop from an electronics store and asks for a home delivery. The shopkeeper agrees to it. However, the laptop does not have a Windows operating system installed. The shopkeeper promises to install it and call Peter before making the delivery. In this case, the property transfers to Peter only after the shopkeeper has installed the OS making the laptop ready for delivery, and intimated the buyer about it.

2.1.3 Specific goods in a deliverable state, when the seller has to do anything thereto in order to ascertain price [Section 22]

➔ Where there is a contract for the sale of specific goods in a deliverable state,

➔ but the **seller is bound to weigh, measure, test or do some other act or thing with reference to the goods** for the purpose of ascertaining the price,

➔ the **property does not pass until such act or thing is done and** the buyer has **notice** thereof.

Example : Vikas purchases wallpaper from Sneh, however the price of the same will be determined only after Sneh takes the measurement of the wall in order to ascertain the quantity of wallpaper required to cover the wall. In this case, property will pass to Vikas only when Sneh takes the measurements, ascertains the price and informs Vikas about the same.

2.2 Goods must be ascertained

- Where there is a **contract for the sale of unascertained goods**, property in the goods is **not transferred to the buyer unless and until the goods are ascertained** [Section 18].
- The rules in respect of passing of property of unascertained goods are as follows –

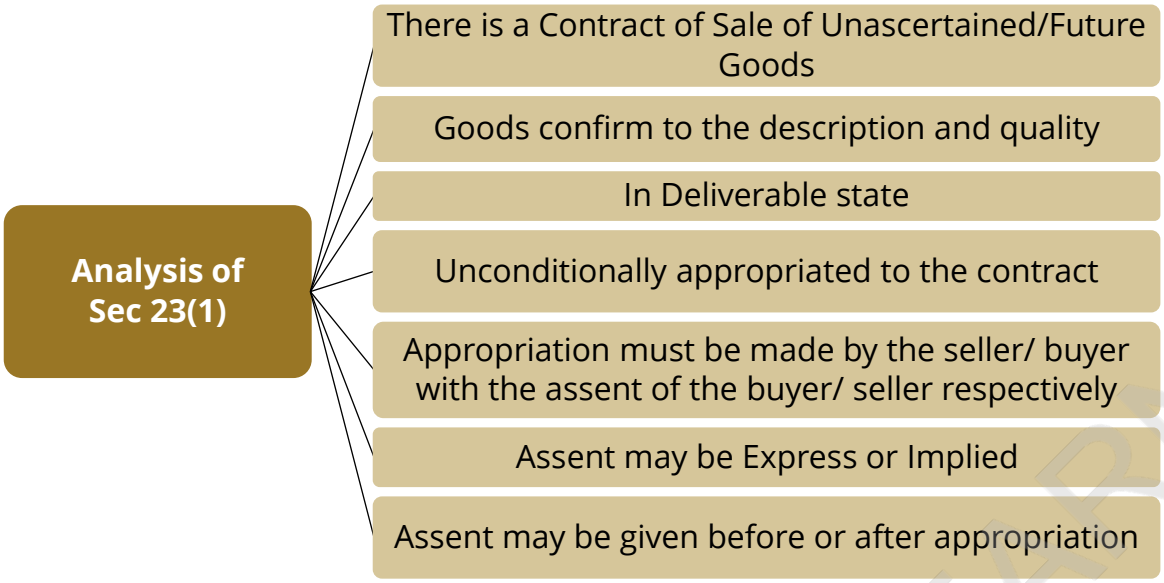
1. **Sale of unascertained goods by description [Section 23(1)]**

   In case of contract of sale of unascertained/ future goods by description and such **goods are unconditionally appropriated** [i.e., set aside] **to the contract**, either by seller with the assent of the buyer or vice versa, **the property in goods thereupon passes to the buyer**.

   Assent may be express or implied and may be given before or after the appropriation is made.

Appropriation of goods involves selection of goods with the intention of using them in performance of the contract and with the mutual consent of the seller and the buyer.

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2. **Delivery to the carrier [Section 23(2)]**

When, in pursuance of the contract, the **seller delivers the goods to the buyer or to a carrier or other bailee** (whether named by the buyer or not) for the purpose of transmission to the buyer, **and does not reserve the right of disposal**, he is **deemed to have unconditionally appropriated the goods to the contract**.

Example : A bill of lading of a railway parcel is made out in the name of the buyer and is sent to him, the ownership in the goods passes from the seller to the buyer. In case the goods are subjected to accidental loss or by theft, the seller will not be liable.

Example : M places an order for a book with a book seller in Mumbai. He asks him to send the book by courier. Payment of the book was to be made by cheque. The seller sends the book by courier. The book is lost in the way. The seller wants the buyer to bear the loss. According to Section 23 (2), it is an unconditional appropriation of goods because of which buyer M has become the owner of the goods. Therefore, he will bear the risk of loss of the book in the way.

2.3 Goods sent on approval or 'On sale or return' [Section 24]

A sale on approval, as applicable to the Sale of Goods Act, is a conditional sale of goods that is made on a trial basis. A buyer who enters into a sale of approval agreement receives the goods and has to deciding whether to buy within a given time period.

When **goods are sent on 'Sale or Approval' basis** property in them passes to the buyer when –

i) **Buyer signifies his approval** to the seller, or

Example : P brought a musical instrument from a musical shop on a condition that he will purchase it if he likes that instrument. After a week he has informed the shop owner that he has agreed to purchase the musical instrument. The ownership is transferred when he has decided to purchase the instrument as his own.

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ii) Buyer does not signify his approval but **retains the goods without giving a notice of rejection** and

- If a time had been fixed for rejection – Such time has expired, or
- If no time had been fixed for rejection – A reasonable time has expired, or

Example : 'A' sends to 'B' a water motor on approval or return in March 2020. 'B' returns it after trial in August 2020. The water motor has not been returned within a reasonable time, and therefore, 'A' is not bound to accept it and 'B' must pay the price.

iii) Buyer **does something to the good which is equivalent to accepting the goods** or does any act adopting the transaction.

Example : 'A' delivered some jewellery to 'B' on sale or return basis. 'B' pledged the jewellery with 'C'. It was held that the ownership of the jewellery had been transferred to 'B' as he had adopted the transaction by pledging the jewellery with 'C'. In this case, 'A' has no right against 'C'. He can only recover the price of the jewellery from 'B'.

2.3.1 Sale for cash only or Return

When goods are delivered by a person on 'Sale or return' on the condition that the goods will remain the property of the seller till they are paid –

- **Property in such goods does not pass to the buyer until** the condition is complied with, i.e., **cash is paid for**.

Example : 'A' delivered his jewellery to 'B' on sale for cash only or return basis. It was expressly provided in the contract that the jewellery shall remain 'A's property until the price is paid. Before the payment of the price, 'B' pledged the jewellery with 'C'. It was held that at the time of pledge, the ownership was not transferred to 'B'. Thus, the pledge was not valid, and 'A' could recover the jewellery from 'C'.

2.4 Reservation of right of disposal [Section 25]

- In certain cases, the seller may reserve the right of disposal of goods until certain conditions are fulfilled, **in such a case irrespective of delivery of goods** to a buyer the **property in goods does not pass to the buyer until conditions imposed by seller are fulfilled**.

  Example : X sends furniture to a company by a truck and instructs the driver not to deliver the furniture to the company until the payment is made by the company to him. The property passes only when the payment is made.

- **Circumstances under which the right to disposal may be reserved –**

  i) If the **goods are shipped or delivered to a railway administration for carriage** and by the bill of lading or railway receipt, the **goods are deliverable to the order of the seller or his agent**, then the seller is prima facie deemed to reserve the right of disposal.

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ii) Where the **seller draws a bill on the buyer for the price and sends to him the bill of exchange together with the bill of lading or the railway receipt,** to secure acceptance or payment thereof, the **buyer must return the bill of lading, if he does not accept or pay the bill.** If he wrongfully retains the bill of lading or the railway receipt, the property in the goods does not pass to him.

Section 25 deals with **'Conditional Appropriation'** as distinguished from 'unconditional appropriation' dealt with under Section 23 (2).

3. Risk *Prima Facie* Passes with Property [Section 26]

According to Section 26 of the Sale of Goods Act, 1930 –

"Unless otherwise agreed, the **goods remain at the seller's risk until the property therein is transferred to the buyer**,

but when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not".

- Thus, **in ordinary circumstances, risk is borne by the buyer only when the property in the goods passes over to him**. However, the parties may, agree to the contrary.

  For instance, the parties may agree that risk will pass sometime after or before the property has passed from the seller to the buyer.

  Example : 'A' bids for an antique painting at a sale by auction. After the bid, when the auctioneer struck his hammer to signify acceptance of the bid, he hit the antique which gets damaged. The loss will have to be borne by the seller, because the ownership of goods has not yet passed from the seller to the buyer.

- **Exception** to the rule that **'Risk follows Ownership'** –

  i) **Where delivery of the goods has been delayed through the fault of either buyer or seller**, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault [First Proviso to Section 26].

  ii) The **duties and liabilities of the seller or the buyer as bailee of goods for the other party** remain unaffected even when the risk has passed generally.

  Example : 'A' contracted to sell 100 bales of cotton to 'B' to be delivered in February. 'B' took the delivery of the part of the cotton but made a default in accepting the remaining bales. Consequently the cotton becomes unfit for use. The loss will have to be borne by the buyer 'B'.

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4. Transfer of Title by Non-Owners

4.1 Sale by person not the owner [Section 27]

According to Section 27 of the Sale of Goods Act, 1930 –

"Subject to the provisions of this Act and of any other law for the time being in force, where **goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner**, **the buyer acquires no better title to the goods than the seller had**, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell".

- The general rule regarding the transfer of title is that **the seller cannot transfer to the buyer of goods a better title than he himself has.** If the seller is not the owner of goods, then the buyer also will not become the owner i.e. the title of the buyer shall be the same as that of the seller.
- This rule is expressed in the Latin maxim '***Nemo dat quod non habet***' which means **'No one can give what he has not got'.**

  Example : If A sells some stolen goods to B, who buys them in good faith, B will get no title to that and the true owner has a right to get back his goods from B.

  Example : P, the hirer of vehicle under a hire purchase agreement, sells them to Q. Q, though a bona fide purchaser, does not acquire the ownership in the vehicle. At the most he acquires the same right as that of the hirer.

4.2 Exceptions to the rule that Non-owner cannot convey a better Title to the Buyer

If this rule is strictly followed, then the innocent buyers may be put to loss in many cases. Therefore, to protect the interests of innocent buyers, a number of exceptions have been provided to this rule as follows –

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Cases where a Non-Owner can convey a better title to bonafide purchaser of goods for value :

- Sale by a Mercantile Agent
- Sale by one of the Joint Owners
- Sale by a person in possession under a voidable contract
- Sale by one who has already sold but continues to be in possession
- Sale by buyer obtaining possesion before property has been vested in him
- Effect of Estoppel
- Sale by an Unpaid seller
- Sale under the Provisions of other Acts

4.2.1 Sale by a Mercantile Agent [Proviso to Section 27]

The sale by a mercantile agent of the goods for document of title to goods would pass a **good title** if –

- He was in **possession** of the goods/documents with **consent of the owner**,
- He was acting in the **ordinary course** of business, and
- The **buyer has acted in good faith** and has no notice, at the time of the contract of sale, of the fact that the seller had no authority to sell.



Definition of Mercantile Agent has been discussed in Unit 1 of Chapter 2.

4.2.2 Sale by one of the Joint Owners [Section 28]

Where **any one of several joint owners has the possession** of the goods **with the permission of the other co-owners,** the property in goods is transferred to the buyer if –

- The person **buys** these goods in **good faith**, and
- Has **no notice**, at the time of the contract of sale, **of the fact that the seller has no authority to sell**.

Example : A, B, and C are three brothers and joint owners of a TV and VCR and with the consent of B and C, the VCR was kept in possession of A. A sells the TV and VCR to P who buys it in good faith and without notice that A had no authority to sell. P gets a good title to VCR and TV.

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4.2.3 Sale by a person in possession under voidable contract [Section 29]

When a seller who has obtained goods under a voidable contract sells the goods; the **buyer will get a good title** to the goods he has bought **provided that the contract has not been rescinded until the time of sale**.

Example : X fraudulently obtains a diamond ring from Y. This contract is voidable at the option of Y. But before the contract could be terminated, X sells the ring to Z, an innocent purchaser. Z gets the good title and Y cannot recover the ring from Z even if the contract is subsequently set aside.

4.2.4 Sale by one who has already sold the goods but continues in possession thereof [Section 30(1)]

When even after selling the goods the seller continues to be in possession of the goods/ documents of title to them, he may sell them to a **third person**, and if such person **obtains the delivery in good faith and without notice of previous sale, he will get a good title to the goods**.

A pledge or other disposition of the goods or documents of title by the seller in possession are equally valid.

Example : During IPL matches, P buys a TV set from R. R agrees to deliver the same to P after some days. Meanwhile R sells the same to S at a higher price, who buys in good faith and without knowledge about the previous sale. S gets a good title.

4.2.5 Sale by buyer obtaining possession before the property in the goods has vested in him [Section 30(2)]

Where the buyer obtains possession of the goods before property in them has passed to him, he may sell, pledge, or dispose the goods to a **third person**, and if such person **obtains delivery in good faith and without notice of the lien or other right of the original seller**, **he will get a good title to the goods**.

A person in possession of goods under a **'hire-purchase' agreement** which gives him only an option to buy is **not covered** within this section unless it amounts to a sale.

Example : A took a car from B on this condition that A would pay a monthly instalment of ₹5,000 as hire charges with an option to purchase it by payment of ₹1,00,000 in 24 instalments. After the payment of a few instalments, A sold the car to C. B can recover the car from C since A had neither bought the car, nor had agreed to buy the car. He had only an option to buy the car.

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4.2.6 Effect of Estoppel

Where the **owner is estopped by the conduct from denying the seller's authority to sell**, the **transferee will get a good title** as against the true owner.

Example : 'A' said to 'B', a buyer, in the presence of 'C' that he (A) is the owner of the horse. But 'C' remained silent though the horse belonged to him. 'B' bought the horse from 'A'. Here the buyer (B) will get a valid title to the horse even though the seller (A) had not title to the horse. In this case, 'C', by his own conduct, is prevented from denying 'A's authority to sell the horse. Here, 'C's silence has induced 'B' to believe that 'A' is the owner of the horse.

4.2.7 Sale by an unpaid seller [Section 54(3)]

Where an **unpaid seller, who had exercised his right of lien or stoppage in transit resells the goods**, the **buyer acquires a good title** to the goods as against the original buyer.

4.2.8 Sale under the provisions of other Acts

- **Sale by an Official Receiver or Liquidator of the Company** will give the purchaser a valid title.
- **Purchase of goods from a finder of goods** will get a valid title under circumstances [Section 169 of the Indian Contract Act, 1872]
- **A sale by pawnee** can convey a good title to the buyer [Section 176 of the Indian Contract Act, 1872]

5. Performance of the Contract of Sale

The performance of a contract of sale implies

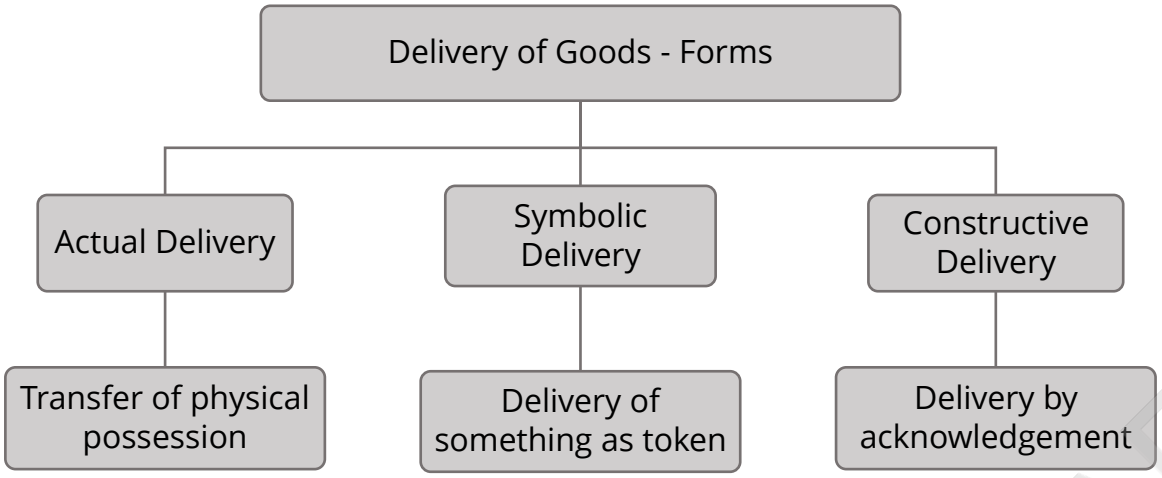
➔ delivery of goods by the seller and
➔ acceptance of the delivery of goods and payment of price for them by the buyer

in accordance with the terms of the contract.

5.1 Delivery

- Delivery means **voluntary transfer of possession** from one person to another [Section 2(2)]
- For delivery, **physical possession is not important**.
- If the **possession is taken through unfair means**, there is **no delivery** of the goods.
- Delivery of goods is of **three types:**
    - **Actual** Delivery
    - **Symbolic** delivery
    - **Constructive** Delivery

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5.2 Duties of seller and buyer [Section 31]

- Duty of Seller – To deliver the goods
- Duty of the Buyer – To accept the goods and pay for them.
- Delivery, acceptance, and payment should be in accordance with the terms of the Contract of Sale.

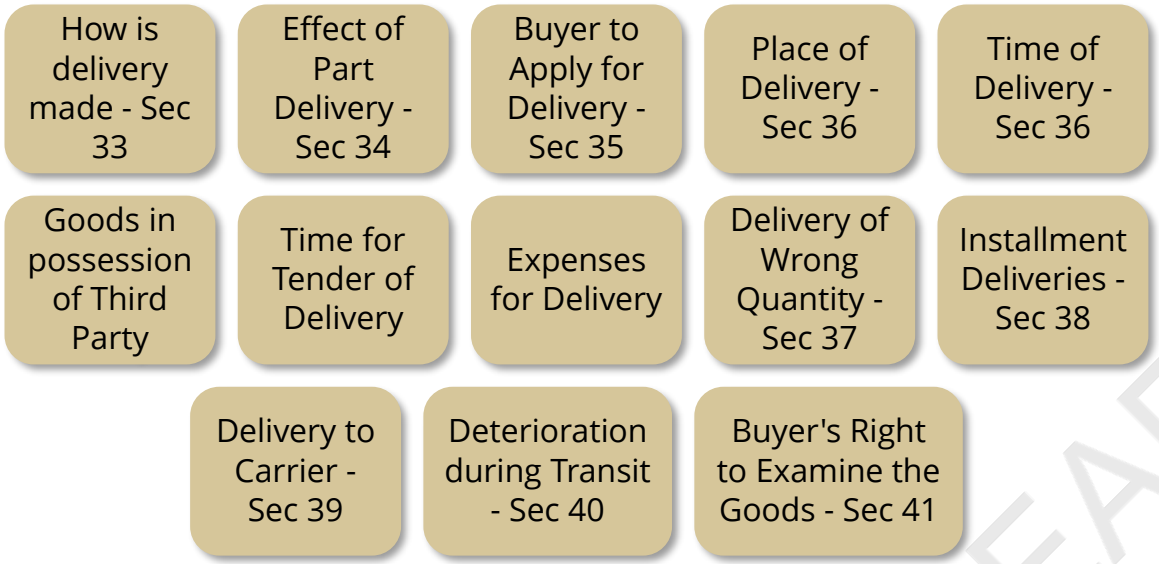
5.3 Payment and delivery are Concurrent Conditions [Section 32]

- **Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions**.
- This means that,
    - The **seller shall be ready and willing to give possession** of the goods to the buyer in exchange for the price, **and**

      The **buyer shall be ready and willing to pay the price** in exchange for possession of the goods.

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5.4 Rules Regarding Delivery of goods



5.4.1 Delivery [Section 33]

Delivery of goods sold may be made **by doing anything** –

- **Which the parties agree** shall be treated as delivery **or**
- **Which has the effect of putting the goods in the possession of the buyer** or of any person authorised to hold them on his behalf.

5.4.2 Effect of part delivery [Section 34]

- If a **part-delivery of the goods is made in progress of the delivery of the whole**, then it has the **same effect** for the purpose of passing the property in such goods **as the delivery of the whole**.
- However, a **part-delivery with an intention of severing it from the whole does not operate as a delivery of the remainder**.

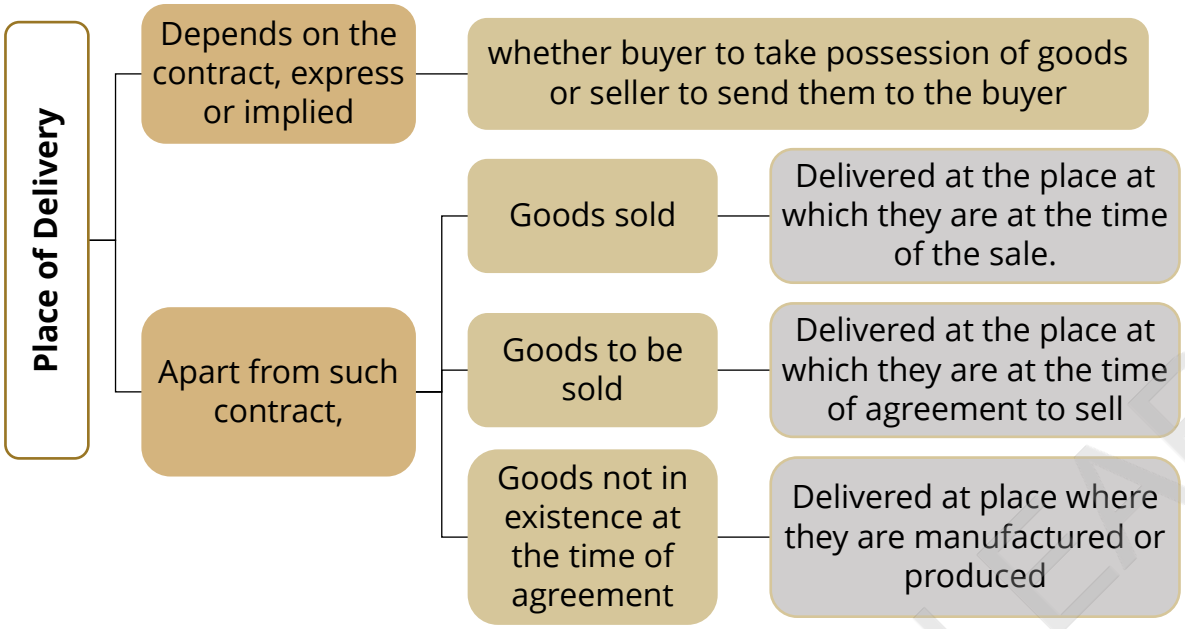
Example : Certain goods lying at godown were sold in a lot. The seller instructed the godown keeper to deliver them to the buyer who had paid for them and the buyer, thereafter, accepted them and took away part. Held, there was delivery of the whole.

5.4.3 Buyer to apply for delivery [Section 35]

Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery.

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5.4.4 Place of delivery [Section 36(1)]



5.4.5 Time of delivery [Section 36(2)]

Where under the contract of sale, the seller is bound to send the goods to the buyer, but **no time for sending them is fixed**, the **seller is bound to send them within a reasonable time.**

5.4.6 Goods in possession of a third party [Section 36(3)]

Where the goods at the time of sale are in possession of a third person, **there is no delivery unless and until such third person acknowledges to the buyer that he holds the goods on his behalf**. However, this shall not affect the operation of the issue or transfer of any document of title to goods.

5.4.7 Time for tender of delivery [Section 36(4)]

The demand or tender of delivery is to be made at a **reasonable hour**. If not, then it is rendered ineffectual.

What is 'reasonable hour' is a question of fact.

5.4.8 Expenses for delivery [Section 36(5)]

The **seller shall bear all expenses** pertaining to putting the goods into a deliverable state unless the parties agree to some other terms in the contract.

5.4.9 Delivery of wrong quantity [Section 37]

- **Delivering lesser quantity** – Where the seller delivers to the buyer a quantity of goods less than he contracted to sell,

  ➔ the **buyer may reject them**.

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However, if the buyer accepts the goods so delivered, he shall pay for them at the contract rate.

- **Delivering larger quantity** – Where the seller delivers to the buyer a quantity of goods larger than he contracted to sell,

  ➔ the **buyer may accept the goods included in the contract and reject the rest, or**
  ➔ **he may reject the whole**.

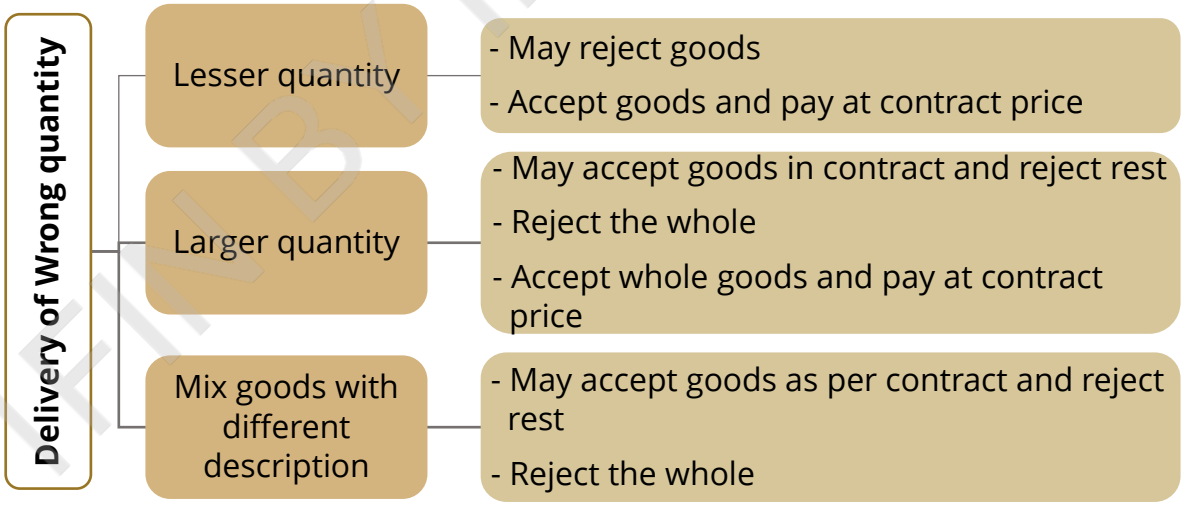
  If the buyer accepts the whole of the goods so delivered, he shall pay for them at the contract rate.

- **Delivers goods contracted mixed with goods of different description –** Where the seller delivers to the buyer, the goods he contracted to sell mixed with goods of a different description not included in the contract,

  ➔ the buyer **may accept the goods which are in accordance with the contract and reject the rest, or**
  ➔ **may reject the whole.**

The provisions of this section are subject to any usage of trade, special agreement, or course of dealing between the parties.

Example : A agrees to sell 1000 quintals of wheat to B at ₹1,000 per quintal. A delivers 1,100 quintals. B may reject the whole lot, or accept only 1,000 quintals and reject the rest or accept the whole lot and pay for them at the contract of sale.



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5.4.10 Instalment deliveries [Section 38]

The buyer does not have to accept delivery in instalments unless he has agreed to do so in the contract. If such an agreement exists, then the parties are required to determine the rights and liabilities and payments themselves.

5.4.11 Delivery to carrier [Section 39(1)]

Subject to the terms of contract, the **delivery of the goods to the carrier for transmission to the buyer, is *prima facie* deemed to be delivery to the buyer.**

5.4.12 Deterioration during transit [Section 40]

Where **goods are delivered at a distant place**, the **liability for deterioration necessarily incidental to the course of transit will fall on the buyer**, though the seller agrees to deliver at his own risk.

Example : P sold to Q a certain quantity of iron rods which were to be sent by proper vessel. It was rusted before it reached the buyer. The rust of the rod was so minimal and was not affecting the merchantable quality and the deterioration was not necessarily incidental to its transmission. It was held that Q was bound to accept the goods.

5.4.13 Buyer's right to examine the goods [Section 41]

The buyer has the right to ascertain that the goods delivered to him are in conformity with the contract. The seller is bound to honor the buyer's request for a reasonable opportunity of examining the goods unless the contrary is specified in the contract.

5.5 Rule related to Acceptance of Delivery of Goods [Section 42]

Acceptance is deemed to take place when the buyer

- **Intimates to the seller** that he had accepted the goods; or
- **Does any act to the goods, which is inconsistent with the ownership** of the seller; or
- **Retains the goods after the lapse of a reasonable time, without intimating** to the seller that he has rejected them.

5.6 Buyer not bound to return rejected goods [Section 43]

Where goods are delivered to the buyer and he refuses to accept them, having the right so to do, he is not bound to return them to the seller, but **it is sufficient if he intimates to the seller that he refuses to accept them.**

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5.7 Liability of buyer for neglecting or refusing delivery of goods [Section 44]

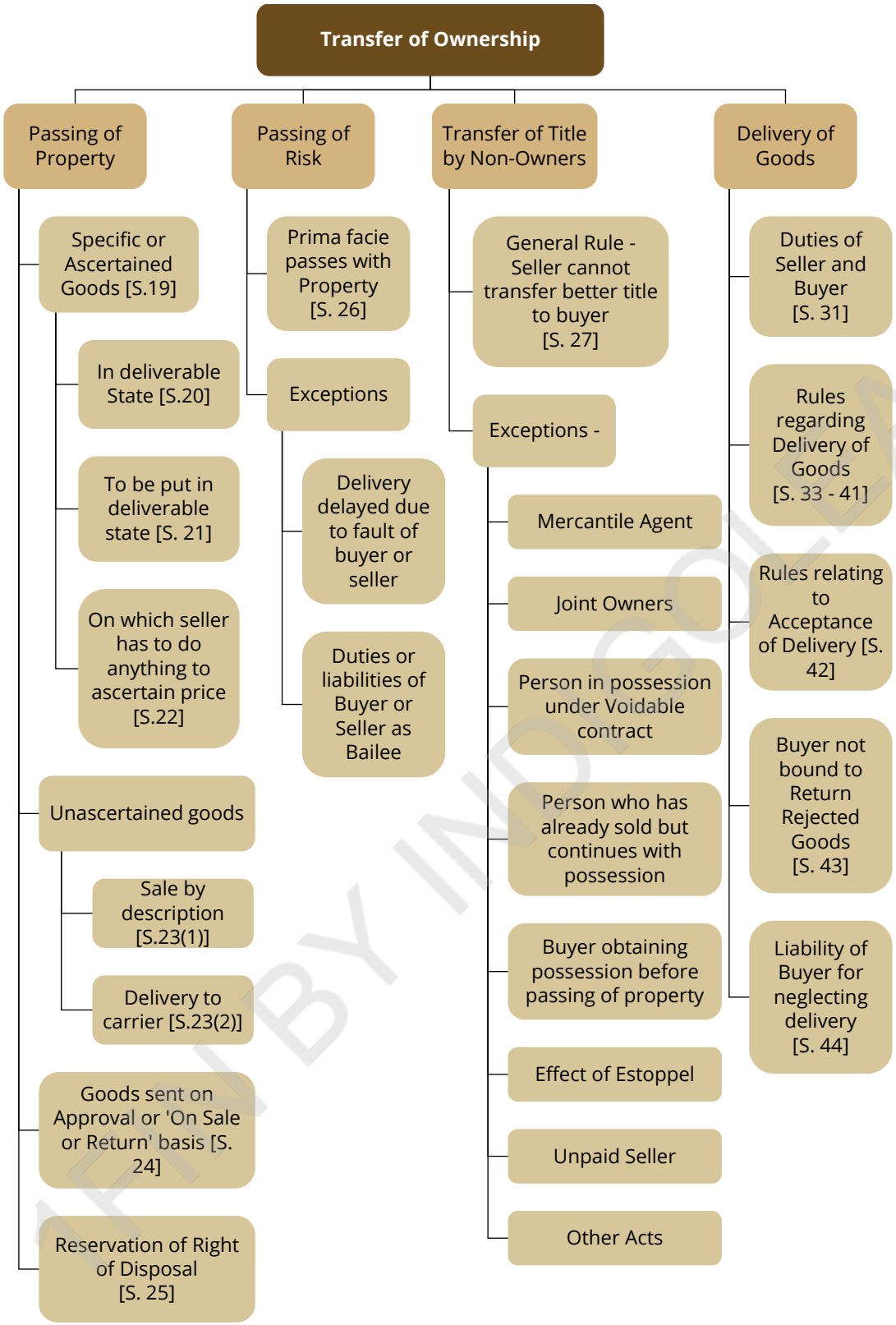
When the **seller is ready and willing to deliver the goods** and requests the buyer to take delivery, and the **buyer does not within a reasonable time after such request take delivery** of the goods, **he is liable to the seller**

- **For any loss** occasioned by his neglect or refusal to take delivery **and**
- Also for a **reasonable charge for the care and custody of the goods**.

The provisions of this section shall not affect the rights of the seller where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract.

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6. Overview



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CH-2: UNIT 4 – UNPAID SELLER

Learning Outcomes –

- Unpaid Seller.
- Rights of Unpaid Seller.
- Effect of Sub-sale or Pledge by the Buyer.
- Right of Lien Vs. Right of Stoppage in Transit.
- Remedies of Buyer against the Seller.
- Sale by Auction.
- Inclusion of Taxes.

1. Unpaid Seller [Section 45]

The seller of goods is **deemed to be an 'Unpaid Seller'** when-

i) The **whole of the price has not been paid** or tendered **and the seller had an immediate right of action for the price**.

Example : X sold certain goods to Y for ₹ 50,000. Y paid ₹ 40,000 but fails to pay the balance. X is an unpaid seller.

ii) When a bill of exchange or other **negotiable instrument has been received as conditional payment**, and the **condition on which it was received has not been fulfilled** by reason of the dishonour of the instrument or otherwise [Section 45(1)].

Example : P sold some goods to R for ₹ 60,000 and received a cheque for the full price. On presentment, the cheque was dishonoured by the bank. P is an unpaid seller.

"Unpaid Seller"

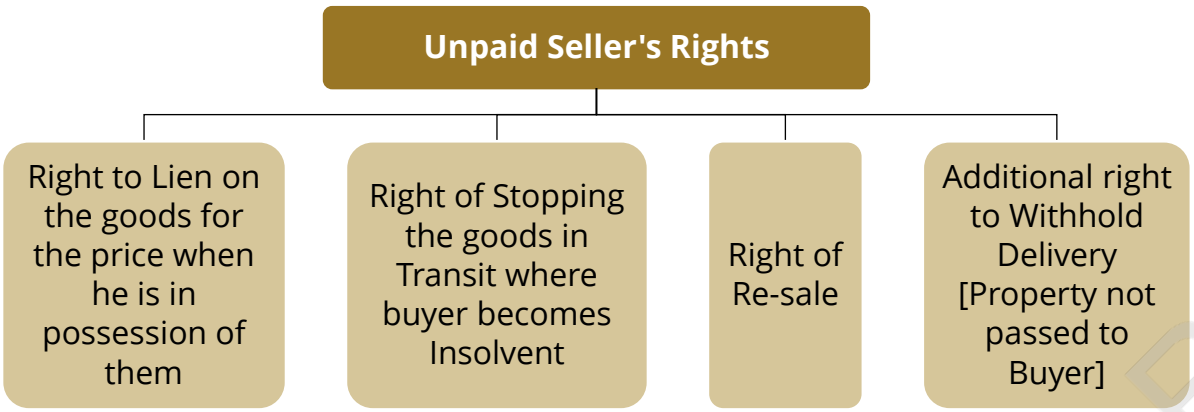
- Part payment done
- No payment done at all.

Negotiable instrument is an instrument issued by parties to fulfil their payment obligations. It serves as an unconditional undertaking or promise that the person signing shall be under an obligation to pay. It is transferable. The different types of negotiable instruments are Bills of exchange, Promissory Note and Cheque.

The term **'seller ' here includes any person who is in the position of a seller**, such as, an agent of the seller to whom the bill of lading has been endorsed, or a consignor or agent who has himself paid, or is directly responsible for, the price [Section 45(2)].

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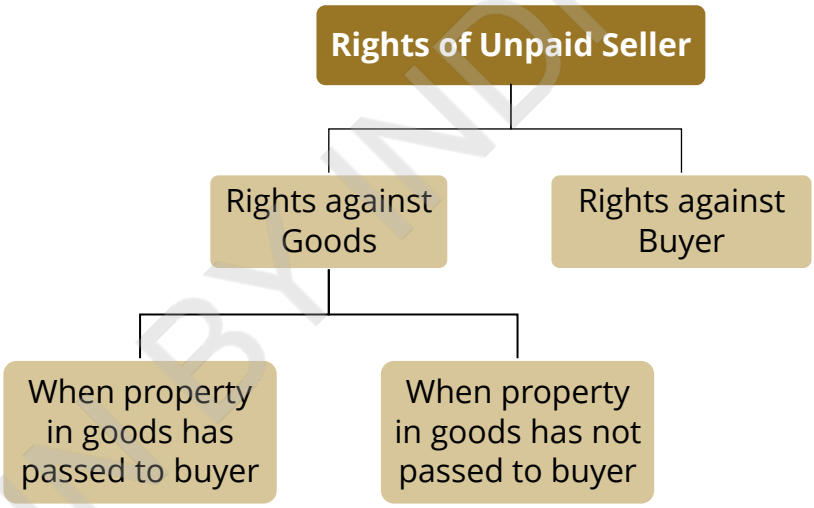
2. Rights of an Unpaid Seller



An unpaid seller has been expressly given the **rights against the goods as well as the buyer personally.**

3. Right of Unpaid Seller Against the Goods

The right of unpaid seller against goods can be **categorized under two headings** with respect to property being passed to the Buyer –



3.1 Seller's lien [Section 47]

- The unpaid seller of goods **who is in possession** of them is entitled to **retain possession of them until payment or tender of the price.**

"**Lien**" – A right to keep possession of property until a debt owed is paid off.

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- This right **can be exercised by him in the following cases only** –



- The seller may **exercise his right of lien even where he is in possession of the goods as agent or bailee for the buyer.**
- **The unpaid seller's lien is a possessory lien** i.e., the lien can be exercised as long as the seller remains in possession of the goods.
- **Right of lien** is exercised only to recover the unpaid amount of the Price, no other expense.
-

Example : A sold certain goods to B for a price ₹ 50,000 and allowed him to pay the price within one month. B becomes insolvent during this period of credit. A, the unpaid seller, can exercise his right of lien.

The term **insolvent** refers to "a person is said to be insolvent **who has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due,** whether he has committed an act of insolvency or not".

3.1.1 Part delivery [Section 48]

Where an unpaid seller has made part delivery of the goods, he may **exercise his right of lien on the remainder**, unless such part delivery has been made under such circumstances as to show an agreement to waive the lien.

3.1.2 Termination of lien [Section 49]

- **The unpaid seller loses his right of lien under the following circumstances** –
  - i) When he **delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer** without reserving the right of disposal of the goods.
  - ii) Where the **buyer or his agent lawfully obtains possession** of the goods.
  - iii) Where **seller has waived the right** of lien.

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iv) **By Estoppel** i.e., where the seller so conducts himself that he leads third parties to believe that the lien does not exist.

- Once seller has parted with goods, right to lien cannot be exercised.
- **Exception:** The unpaid seller of the goods, having a lien thereon, **does not lose his lien by reason only that he has obtained a decree for the price** of the goods.

  Example : A, sold a car to B for ₹ 1,00,000 and delivered the same to the railways for the purpose of transmission to the buyer. The railway receipt was taken in the name of B and sent to B. Now A cannot exercise the right of lien.

3.2 Right of stoppage in transit

According to Section 50 of the Sale of Goods Act, 1930 –

"Subject to the provisions of this Act, **when the buyer of goods becomes insolvent**, the unpaid seller who has parted with the possession of the goods has the **right of stopping them in transit**, that is to say, he may resume possession of the goods as long as they are in the course of transit, and may **retain them until paid or tendered price of the goods**".

- The right of stoppage in transit **means the right of stopping the goods while they are in transit, to regain the possession and to retain them till the full price is paid.**
- When the unpaid seller has **parted with the goods to a carrier** and the **buyer has become insolvent**, he can exercise this right of asking the carrier to return the goods back, or not to deliver the goods to the buyer.

"The Right of Stoppage in Transit" is the **extension of the right of lien** because it entitles the seller to regain possession even when the seller has parted with the possession of the goods.

Example : A of Mumbai sold certain goods to B of Delhi. He delivered the goods to C, a common carrier for the purpose of transmission of these goods to B. Before the goods could reach him, B became insolvent and A came to know about it. A can stop the goods in transit by giving a notice of it to C.

Essentials for excercising the Right of Stoppage in Transit **(T-I-P-U)**

[Section 50]

- Goods are in **Transit**
- Buyer has become **Insolvent**
- Seller has **Parted** with goods
- Seller is **Unpaid** seller

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Example : B at Delhi, orders goods of A, at Mumbai. A consigns and forwards the goods to B. On arrival at Delhi, they are taken to B's warehouse and left there. B refuses to take these goods and stop payment. The goods are in transit and the unpaid seller can take them back.

3.2.1 Duration of transit [Section 51]

The goods **are deemed to be in course of transit** fro**m the time when they are delivered to a carrier** or other bailee for the purpose of transmission to the buyer, **until the buyer or his agent in that behalf takes delivery** of them from such carrier or other bailee.

- **Goods rejected by the buyer when the carrier continues to be in possession** – The **transit is not deemed to be at an end**, even if the seller has refused to receive them back.
- **Goods delivered to a ship chartered by the buyer** – It is a question **depending on the circumstances** of the particular case, whether they are in the possession of the **master as a carrier or as agent of the buyer**.
- **Part delivery has been made to the buyer or his agent** - The **remainder of the goods may be stopped in transit** unless such part delivery has been given in such circumstances as to show an agreement to give up possession of the whole of the goods.

3.2.2 When does the transit come to an end?

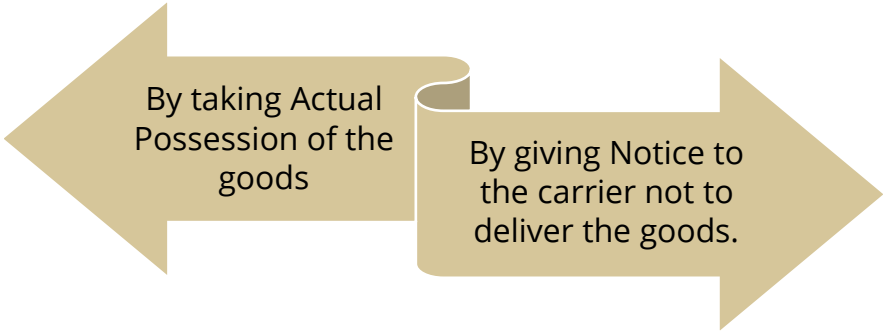
The right of stoppage in transit is lost when transit comes to an end. Transit comes to an end in the following cases –

- Buyer or other bailee obtains delivery.
- Buyer obtains delivery before the arrival of goods at destination.
- When carrier acknowledges to the buyer / his agent that he holds the goods when the goods are loaded on the ship.
- Carrier wrongfully refuses to deliver the goods to the buyer.
- Goods delivered to the carrier hired or ship chartered by the buyer.
- Where part delivery has been made to the buyer, transit ends for the remaining goods (in the course of transmission).

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3.2.3 How stoppage in transit is effected [Section 52]

There are **two modes of stoppage in transit** by an unpaid seller –



- When giving a **notice, to be effectual**, it shall be **given at such time** and in such circumstances, **that the principal**, by the exercise of reasonable diligence, **may communicate it to his servant or agent in time to prevent a delivery to the buyer**.
- Where the notice of stoppage in transit is given by the seller to the carrier or other bailee in possession of the goods, he shall **re-deliver the goods to, or according to the directions of, the seller**. **The expenses of such redelivery shall be borne by the seller.**
- The main intention of stoppage in transit is to receive the payment due but not to recover other expenses.

3.3 Distinction between Right of Lien and Right of Stoppage in Transit

Right of Lien	Right of Stoppage in Transit
The essence of a right of lien is to **retain possession.**	The essence of a right of stoppage in transit is to **regain possession.**
To exercise the right of lien the **seller must be in possession** of the goods.	To exercise the right of stoppage in transit – i) **Seller should have parted with the possession**, ii) **Possession should be with a carrier**, and **iii) Buyer should not have acquired the possession.**
Can be exercised even when the **buyer is not insolvent**.	Can be exercised only when the **buyer is insolvent.**
Comes to an end when goods go out of the possession of the seller**.**	**Comes to an end as soon as the goods are delivered** to the buyer.

Right of stoppage in transit begins when the right of lien ends. Thus, the end of the right of lien is the starting point of the right of stoppage in transit.

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3.4 Effects of sub-sale or pledge by buyer [Section 53]

- The **right of lien or stoppage in transit is not affected** by the buyer selling or pledging the goods **unless the seller has assented to it.**

  Example : A sold certain goods to B of Mumbai and the goods are handed over to railways for transmission to B. In the meantime, B sold these goods to C for consideration. B becomes insolvent. A can still exercise his right of stoppage in transit.

> ***Case Law: Mount D. F. Ltd. vs Jay & Jay (Provisions) Co. Ltd***
> **Facts:** A entered into a contract to sell cartons in possession of a wharfinger to B and agreed with B that the price will be paid to A from the sale proceeds recovered from his customers. Now B sold goods to C and C duly paid to B. But anyhow, B failed to make the payment to A. A wanted to exercise his right of lien and ordered the wharfinger not to make delivery to C.
> **Judgement:** The Court held that the seller had assented to the resale of the goods by the buyer to the sub-buyers. As a result A's right to lien is defeated.

- The seller loses right to lien / stoppage when:
  - The seller himself assets to the sub-sale/ pledge.
  - Transfer of document of title from seller to buyer
- When a **document of title to goods has been transferred to the buyer** and the **buyer transfers the documents to a person who has bought goods in good faith and for a consideration**, then –
  - **If the last mentioned transfer is by way of sale**
    - Right of lien or stoppage in transit is **defeated**
  - **If the last mentioned transfer is by way of pledge**
    - The unpaid seller's right of lien or stoppage be **exercised subject to the rights of the pledgee.**

  However, the pledgee may be required by the unpaid seller to use in the first instance, other goods or securities of the pledger available to him to satisfy his claims.

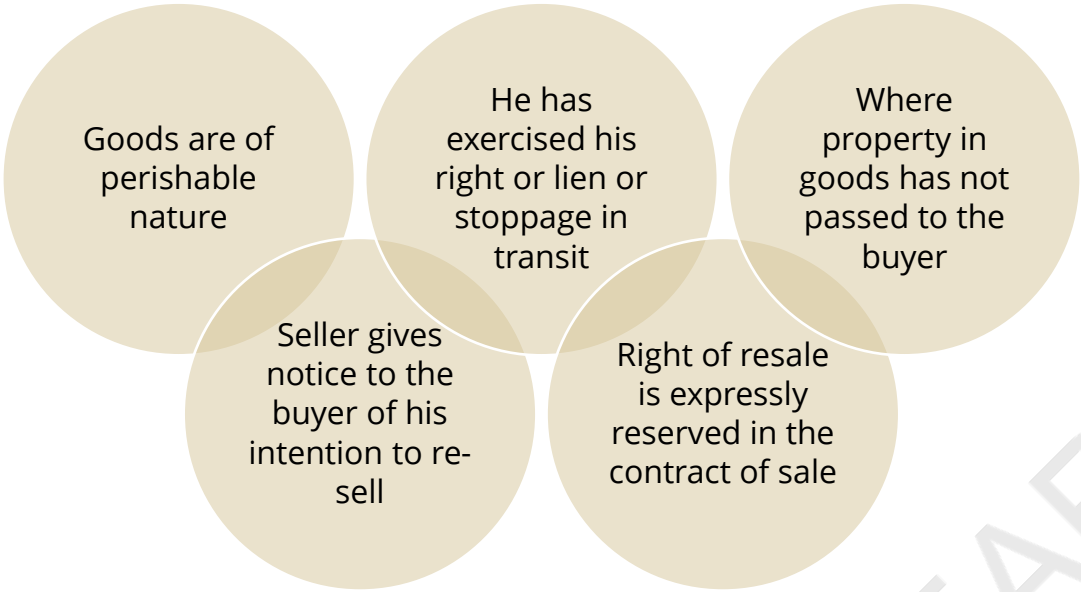
3.5 Effect of stoppage

- **The contract of sale is not rescinded** when the seller exercises his right of stoppage in transit.
- The contract still remains in force and the **buyer can ask for delivery of goods on payment of price.**

3.6 Right of Re-sale [Section 54]

The unpaid seller can **exercise the right to re-sell the goods under the following conditions:**

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3.6.1 Where the goods are of a perishable nature

Where the goods are of a perishable nature, the **buyer need not be informed of the intention of resale.**

3.6.2 Where he gives notice to the buyer of his intention to re-sell the goods

If **after the receipt of such notice the buyer fails within a reasonable time to pay** or tender the price, the seller **may resell** the goods.

- In such cases, on the resale of the goods, **the seller is also entitled to:**
    a) **Recover the difference** between the contract price and resale price, from the original buyer, **as damages**.
    b) **Retain the profit** if the resale price is higher than the contract price.
- If the **goods are resold by the seller without giving any notice** to the buyer –
    - He **cannot recover the loss** suffered on resale
    - If there is **any profit on resale**, he must **return it to the original buyer**,

3.6.3 Where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods

The **subsequent buyer acquires the good title** thereof as against the original buyer, **despite the fact that the notice of re-sale has not been given** by the seller to the original buyer.

3.6.4 Where a right of re-sale is expressly reserved in a contract of sale

- In such cases, the seller is said to have reserved his right of resale, and he may **resell the goods on buyer's default**.
- Also, the seller is **not required to give notice of resale**.

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- He is **entitled to recover damages** from the original buyer even if no notice of resale is given.

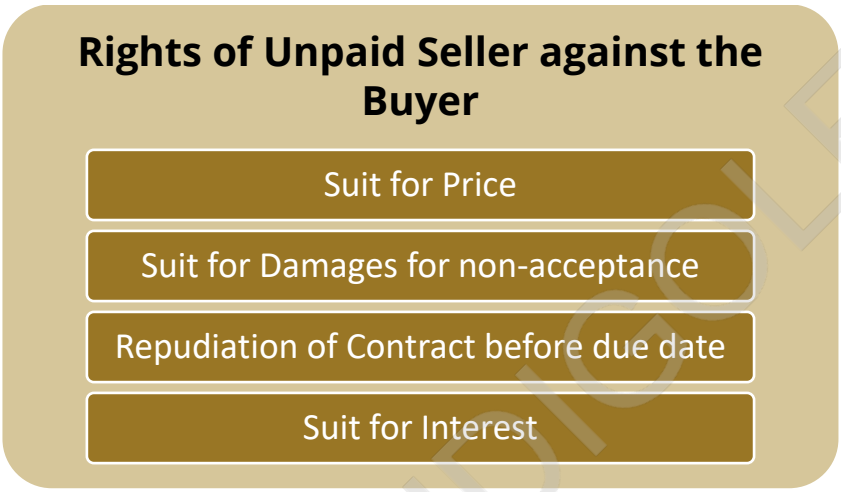
3.6.5 Where the property in goods has not passed to the buyer

The unpaid seller has in addition to his remedies a **right of withholding delivery** of the goods. This right is similar to lien and is called **"Quasi-lien".**

Under this, both ownership and possession are with the seller as the property has not passed to the buyer.

4. Rights of Unpaid Seller Against the Buyer

- Rights of unpaid seller against the buyer are otherwise known as **seller's remedies for breach of contract of sale.** These are in addition to his right against the goods.



4.1 Suit for Price [Section 55]

i) **Property has passed to the buyer –** Where under a contract of sale, the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, **the seller may sue him for the price of the goods**.

ii) **Price payable on a certain day irrespective of delivery –** Where under a contract of sale, the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, **the seller may sue him for the price although the property in the goods has not passed and the goods have not been appropriated to the contract.**

4.2 Suit for Damages for Non-acceptance [Section 56]

Where the **buyer wrongfully neglects or refuses to accept and pay** for the goods, the seller may sue him for damages for non-acceptance.



Damages shall be measured in accordance with the provisions of Section 73 of the Indian Contract Act, 1873.

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4.3 Repudiation of contract before due date [Section 60]

Where the buyer repudiates the contract before the date of delivery, the seller may **treat the contract as rescinded and sue for damages** for the breach [**Rule of Anticipatory Breach of Contract**].

4.4 Suit for Interest [Section 61]

- **Where there is specific agreement** between the seller and the buyer as to interest on the price of the goods **from the date on which payment becomes due, the seller may recover interest from the buyer**.
- However, **in case there is no specific agreement** to this effect, the seller may **charge interest on the price when it becomes due from such day as he may notify to the buyer.**
- **In the absence of a contract to the contrary**, **the court may award interest** to the seller in a suit by him at such rate as it thinks fit on the amount of the price from the date of tender of goods or from the date on which the price was payable.

5. Remedies of Buyer Against the Seller

5.1 Breach of contract by seller

The seller breaches a contract of sale, where he –

- **Fails to deliver** the goods at the time or in the manner prescribed,

  Example: Ramesh sells shoes to Suresh on 10th March and agrees to deliver on 12th of March but fails to send the shoes even till 15th March.

- **Repudiates the contract**, or

  Example: Ramesh sells shoes to Suresh, on 10th March and agrees to deliver on 12th of March but later decides to sell it to Ravi and delivers the shoes to Ravi on 13th March.

- **Delivers non-configuring goods** and the buyer rejects and revokes the acceptance of such goods

  Example: Ramesh sells running shoes to Suresh, on 10th March and agrees to deliver on 12th of March but later delivers normal canvas shoes on 13th March which Suresh rejects to accept.

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5.2 Rights of the buyer against the seller

Where the seller commits a breach of contract, the buyer gets the following rights against the seller

- **Rights of the Buyer**
  - Damages for Non-delivery
  - Suit for Specific Performance
  - Suit for Breach of Warranty
  - Suit for Anticipatory Breach
  - Suit for Interest

5.2.1 Damages for Non-delivery [Section 57]

Where the **seller wrongfully neglects or refuses to deliver the goods** to the buyer, the buyer may sue the seller for damages for non-delivery.

Example : 'A', a shoe manufacturer, agreed to sell 100 pairs of shoes to 'B' at the rate of ₹1,050/- per pair. 'A' knew that 'B' wanted the shoes for the purpose of further reselling them to 'C' at the rate of ₹1,100/- per pair. On the due date of delivery, 'A' failed to deliver the shoes to 'B'. In consequence, 'B' could not perform his contract with 'C' for the supply of 100 pairs of shoes. In this case, 'B' can recover damages from 'A' at the rate of ₹ 50/- per pair (the difference between the contract price and resale price).

[The damages could be recovered based on current market price in case the resale is not done.]

5.2.2 Suit for Specific Performance [Section 58]

Where the **seller commits of breach of the contract of sale**, the buyer can appeal to the court for specific performance. This remedy is **allowed by the court** subject to following conditions –

- The contract must be for the sale of **specific and ascertained goods**.
- The power of the court to order specific performance is subject to **provisions of Specific Relief Act of 1963.**
- Specific performance can be **ordered where damages would not be an adequate remedy.**
- It will be granted as remedy if **goods are of special nature or are unique**.

Example : 'A' agreed to sell a rare painting of Mughal period to 'B'. But on the due date of delivery, 'A' refused to sell the same. In this case, 'B' may file a suit against 'A' for obtaining an order from the Court to compel 'A' to perform the contract.

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5.2.3 Suit for Breach of Warranty [Section 59]

When there is breach of warranty by the seller, or when the buyer elects to treat breach of condition as breach of warranty, **the buyer is prevented from rejecting the goods only on that basis.**

The buyer has two options in that case –

i) **Set up against the seller the breach of warranty** in diminution or extinction of the price; or

ii) **Sue the seller for damages** for breach of warranty.

5.2.4 Repudiation of Contract before due date [Section 60]

When either party to a contract of sale repudiates the contract before the date of delivery the other party may either –

- **Treat the contract as subsisting and wait** till the date of delivery, or
- **Treat the contract as rescinded and sue** for damages for the breach.

5.2.5 Suit for Interest

The Act specifically states that nothing in this Act will affect the **right of the seller or the buyer to recover interest or special damages** due to him by the contract.

In the absence of a contract to the contrary, the **court may award interest at such rate as it thinks fit on the amount of the price** to the buyer in a suit for the refund of the price in a case of a breach of the contract on the part of the seller **from the date on which the payment was made**.

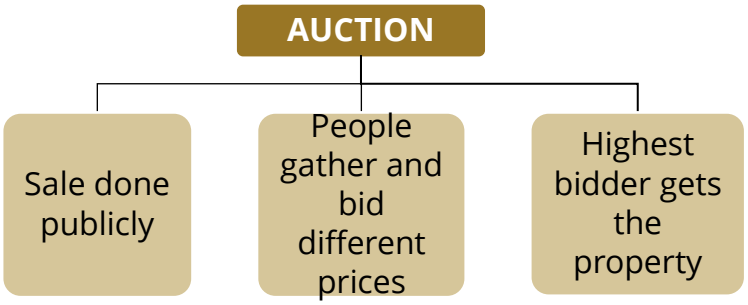
Example : In case of a sale of cigarettes which turned out to be mildewed and unfit for consumption, damages were awarded on the basis of the difference between the contract price and the price released.

Example : In case of absence of transfer of title or registration, the purchaser cannot claim damages for breach of conditions and warranties relating to sale.

6. Auction Sale [Section 64]

- 'Auction Sale' is a mode of selling property by **inviting bids publicly** and the **property is sold to the highest bidder.**

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- When the **Auctioneer** sells, he is only the **agent of the seller**.
- The **Auctioneer may also sell his own property as the principal** and need not disclose the fact that he is so selling.
- The **rules to regulate the Sale by Auction** are as follows –

Goods sold in Lots	• Each lot is prima facie deemed to be subject of a separate contract of sale.
Completion of the Contract of Sale	• When the auctioneer announces its completion by the fall of the hammer or in any other customary manner. • Until such announcement is made, a bidder may retract from his bid.
Reserving the Right to Bid	• The right to bid may be reserved expressly by, or on behalf of, the seller in which case the seller or any one person on his behalf, may bid at the auction.
Sale not notified to be subject to a right to bid by the seller	• In that case it shall not be lawful for the seller to bid himself/employ any person to bid at such sale, or for the auctioneer knowingly to take any such bid. • A sale in contravention of this rule shall be treated as fraudulent by the buyer.
Reserved Price	• The sale may be notified to be subject to a reserve or upset price
Pretended Bidding	• If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

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Example : P sold a car by auction. It was knocked down to Q who was only allowed to take it away on giving a cheque for the price and signing an agreement that ownership should not pass until the cheque was cleared. Meanwhile before the cheque was cleared, Q sold the car to R. It was held that the property was passed on the fall of the hammer and therefore R had a good title to the car. Both sale and sub-sale are valid in favour of Q and R respectively.

7. Inclusion of Increased or Decreased Taxes in Contract of Sale [Section 64A]

- This Section deals with the event where any tax is being imposed, increased, decreased, or remitted in respect of any goods after the making of a contract of sale
- Unless a different intention appears from the terms of the contract, in the event of **any tax** is being
    - imposed,
    - increased,
    - decreased, or
    - remitted

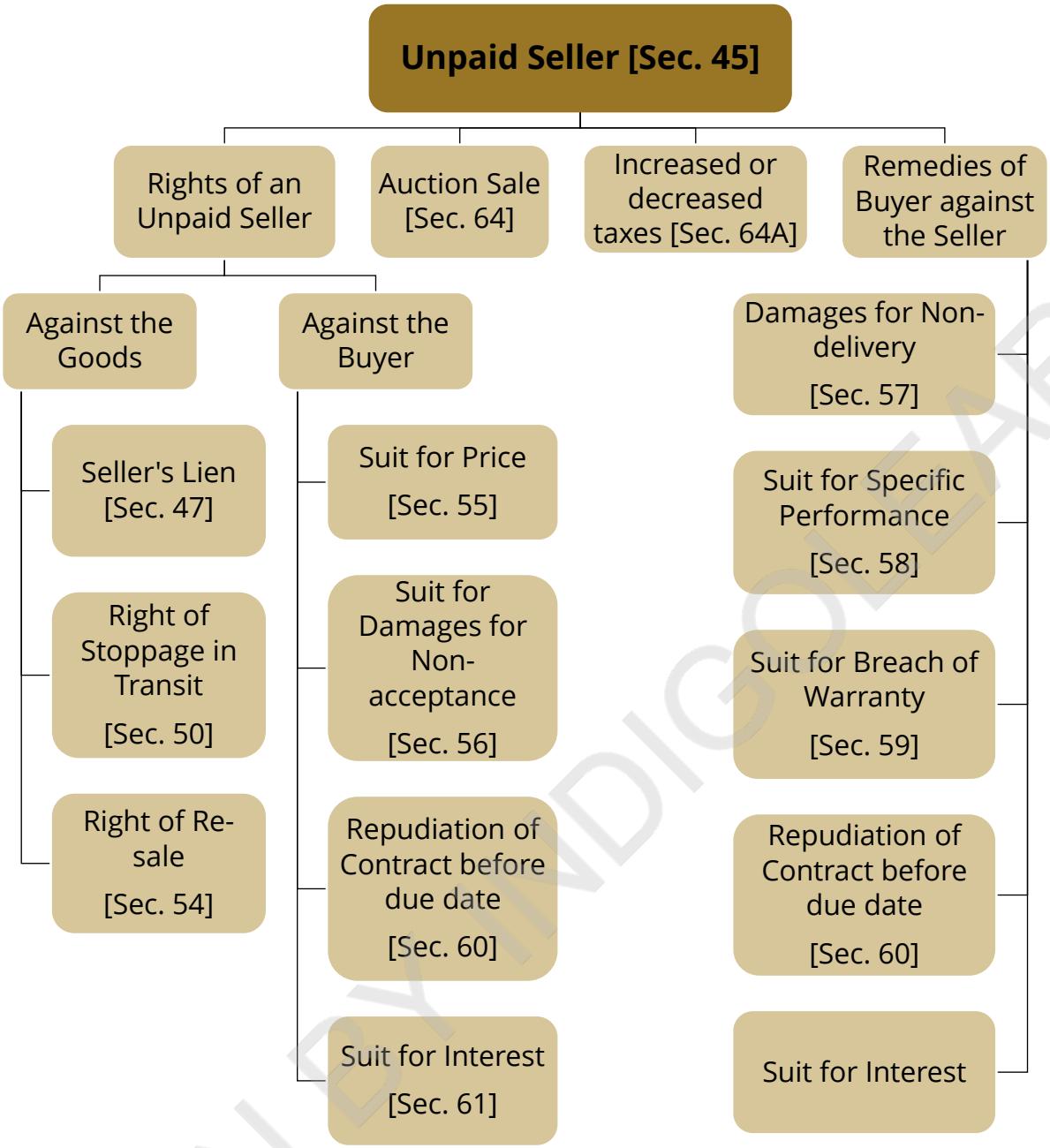
  in respect of any goods **after the making of any contract** for the sale without stipulation / terms as to the payment of tax [i.e. where tax was not chargeable at the time of the making of the contract]-

  (a) if such imposition or increase increases the amount due - the seller may add so much to the contract price as will be equivalent to the amount paid or payable in respect of such tax or increase of tax, and he shall be entitled to be paid and to sue for and recover such addition; and

  (b) if such decrease or remission decreases the amount due - the buyer may deduct so much from the contract price as will be equivalent to the decrease of tax or remitted tax, and he shall not be liable to pay, or be sued for, or in respect of, such deduction.
- The provisions of this section apply to the following taxes, namely;––
    - ✓ Any duty of customs or excise on goods
    - ✓ Any tax on sale or purchase of goods
- The **buyer would have to pay the increased price** where the tax increases and may derive the benefit of reduction if taxes are curtailed.
- **The effect of provision can, however, be excluded by an agreement to the contrary.** It is open to the parties to stipulate anything or agree on terms with regard to taxation.

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8. Overview



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CH-3: UNIT 1 – GENERAL NATURE OF PARTNERSHIP

Learning Outcomes –

- Concept of Partnerships & its essentials
- 'Principal – Agent' relationship among partners
- Distinction with other forms of organization
- Kinds of Partnerships
- Types of Partners

1. Definitions [Section 4]

Partnership	Partners and Firm	Firm Name
The **relation between persons who have agreed to share the profits of a business** carried on by all or any of them acting for all.	Persons entering into partnership with one another are individually called as **'partners'** and collectively called **'a firm'**.	The name under which the business is carried on is called the **'Firm name'**.

2. Elements of Partnership

2.1 Association of two or more persons

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- Partnership is an association of 2 or more persons.
- Only persons recognized by law can enter into an agreement of partnership –
    - **A firm cannot be a partner** as it is not recognized as a person in the eyes of law.
    - **A minor cannot be a partner** in a firm, **but with the consent of all the partners,** may be admitted to the **benefits** of partnership.

The limit on **maximum number of partners** is **50** which is put by Sec 464 and related rules of the Companies Act, 2013

The Partnership Act 1932 is silent in this regard.

2.2 Agreement

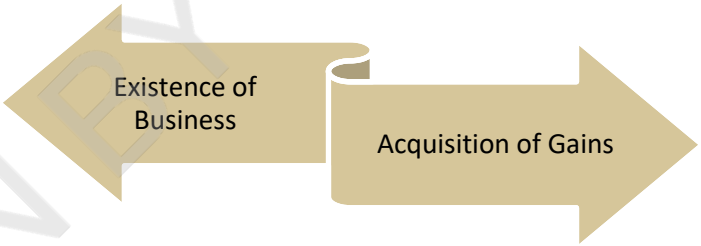
- There must be an agreement **entered into by all the persons concerned**.
- The nature of the partnership is **voluntary** and **contractual**.
- The agreement from which relationship of partnership arises may be **express**. It may be **oral or in writing.**

2.3 Business

Two propositions must be kept in mind –

- Firstly, there must exist a **business**,
    - The term '**business**' includes every trade, occupation and profession, and
- Secondly, the **motive** of the business is **to earn profits**.

Therefore, there can be no partnership where there is no intention to carry on the business and to share the profit thereof.



2.4 Agreement to Share Profits

- There can be no partnership where only one of the partners is entitled to the whole of the profits of the business. **Partners must agree to share the profits in any manner they choose.**
- **Agreement to share losses** - An agreement to share losses is **not an essential element**.
    - It is open to one or more partners to agree to share all the losses.
    - However, in the event of losses, unless agreed otherwise, these must be borne in the profit-sharing ratio.

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2.5 Business carried on by all or any of them acting for all

- The business must be carried on by all the partners or by anyone or more of the partners acting for all. **This is the cardinal principle of the Partnership Law.**
- There should be a **binding contract of mutual agency** between the partners.
- An act of one partner in the course of the business of the firm is an act of all partners**. Each partner carrying on the business is the principal as well as the agent for all the other partners.**

True test of partnership is mutual agency rather than sharing of profits.
If element of mutual agency is absent, then there will be no partnership.

Case Law: K D Kamath & Co.

The Supreme Court has held that **two essential conditions** to be satisfied are that:

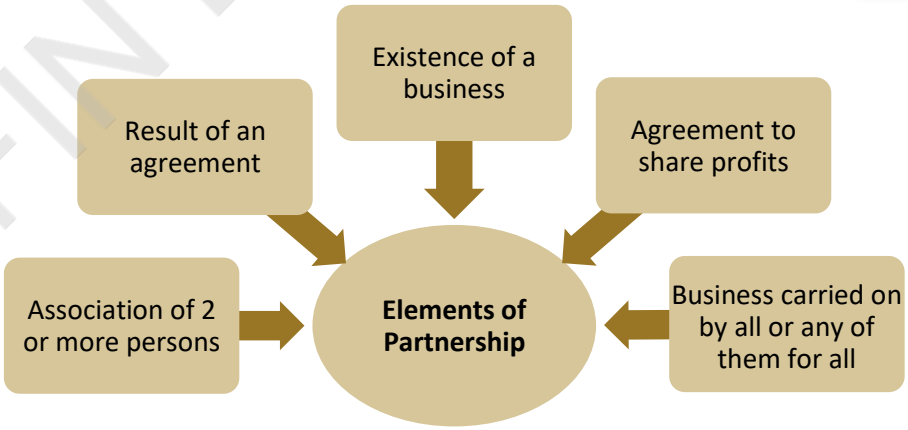
- There should be an agreement to share the profits as well as the losses of business and
- Business must be carried on by all or any of them acting for all, within the meaning of definition of 'partnership' u/s 4.

The fact that **exclusive power and control**, by agreement of the parties, is vested in one partner or the further circumstance that only one partner can operate bank account or borrow on behalf of the firm are **not destructive of the theory of partnership provided the two essential conditions are satisfied.**

Example : Co-owners who share amongst themselves the rent derived from a piece of land are not partners, because there does not exist any business.

Example : X and Y buy certain bales of cotton which they agree to sell on their joint account and to share the profits equally. In thesecircumstances, X and Y are partners in respect of such cotton business

'Partnership Agreement' is also known as 'Partnership Deed'.



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3. True Test of Partnership [Section 6]

In determining whether a group of persons is or is not a firm, or whether a person is or not a partner in a firm, **regard shall be had to the real relation between the parties.**

To determine the existence of partnership, it must be proved that –

- ✓ The agreement was to **share the profits** of a business
- ✓ The business was **carried on by all or any of them** acting for all
- ✓ There was an agreement between all the persons concerned.

3.1 Agreement

Partnership is **Created by agreement** and **not by status [Section 5]**

Example : The members of a Hindu Undivided family carrying on a family business as such, or a Burmese Buddhist husband and wife carrying on a business as such are not partners in such business.

3.2 Sharing of Profit

- The **sharing of profits** or of gross returns arising from property by persons holding a joint or common interest in that property **does not of itself make such person partners.**
- The **receipt by a person of a share of the profits** of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business, **does not of itself make him a partner with the persons carrying on the business**; and in particular, the **receipt of such share or payment-**

  (a) **by a lender of money to persons engaged** or about to engage in any business,

  (b) **by a servant or agent** as remuneration,

  (c) **by a widow or child of a deceased partner**, as annuity, or

  (d) **by a previous owner or part owner of the business**, as consideration for the sale of the goodwill or share thereof,

  does not of itself make the receiver a partner with the persons carrying on the business.

  Sharing of profit is an essential element to constitute a partnership. But it is only a prima facie evidence and not conclusive evidence, in that regard.

- To share the profit of a business and the business is being carried on by all or any of them acting for all, if there is –

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Express agreement between partners	No specific agreement
There is no difficulty in determining the existence or otherwise of partnership.	For testing the existence or otherwise of partnership relation, Sec 6 has to be referred.

- According to **Section 6**, regard must be had to the **real relation between the parties** as shown by all relevant facts taken together.
- **Cumulative effect of all relevant facts** such as written or verbal agreement, real intention and conduct of the parties, other surrounding circumstances etc., **are to be considered while deciding the relationship between the parties and ascertaining the existence of partnership.**

3.3 Agency

- **Each partner carrying on the business is the principal as well as an agent of other partners**. So, the act of one partner done on behalf of firm, binds all the partners.
- If the elements of **mutual agency relationship exist** between the parties constituting a **group formed with a view to earn profits by running a business**, a **partnership may be deemed to exist**.

Case Law: Santiranjan Das Gupta Vs. Dasyran Murzamull (SC)

In this case, the following factors weighed upon the Supreme Court to reach the **conclusion that there is no partnership between the parties**:

➔ Parties have not retained any record of terms and conditions of partnership.

➔ Partnership business has maintained no accounts of its own, which would be open to inspection by both parties.

➔ No account of the partnership was opened with any bank.

➔ No written intimation was conveyed to the Deputy Director of Procurement with respect to the newly created partnership.

4. Partnership Distinguished from Other Forms of Organisation

4.1 Partnership Vs. Joint Stock Company

Basis	Partnership	Joint Stock Company

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Legal status	No legal personality distinct its constituent members.	Separate legal entity distinct from its members
Agency	Every partner is an agent of the other partners as well as of the firm.	A member is not an agent of the other members or of the company.
Distribution of profits	Distributed among the partners according to terms of partnership deed.	There is no such compulsion to distribute its profits among its members.
Extent of liability	Liability of the partners is unlimited.	Limited liability – limited by shares or limited by guarantee.
Property	The firm's property is the 'joint estate' of all the partners.	In a company, its property is separate from that of its members.
Transfer of shares	A share in a partnership cannot be transferred without the consent of all the partners.	Unrestricted in case of public companies. In private companies, it shall be subject to provisions contained in the Articles.
Management	In the absence of express agreement to contrary, all partners are entitled to participate in management	Members are not entitled to take part in management unless they are appointed as directors. They, however, enjoy right of attending general meeting and voting where they can decide questions such as election of directors, appointment of auditors, etc.
Registration	Not compulsory	Comes into existence only after it is registered under the Companies Act, 2013.
Winding up	Can be dissolved at any time if all the partners agree.	Either wound up by the NCLT or its name is struck off by the ROC.

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Number of members	Restricted by the Companies Act, 2013 and Rules thereon to 50.	Public Co. – May have any number of members but not less than 2. Private Co. – Minimum 2 members and maximum 200. Can also be formed as One Person Company.
Duration of existence	Death, retirement, or insolvency of a partner results in the dissolution of the firm.	Perpetual succession

4.2 Partnership Vs. Club

Basis	Partnership	Club
Definition	An association of persons formed for earning profits from a business carried on by all or any one of them acting for all.	An association of persons formed with the object of promoting some beneficial purposes, and not for earning profit.
Relationship	A partner of a firm is an agent for other partners.	A member of a club is not agent of other members.
Interest in the property	Partner has interest in the property of the firm.	A member of club has no interest in property of club.
Dissolution	A change in partners of the firm affect its existence.	A change in membership of a club does not affect its existence.

4.3 Partnership vs. Hindu Undivided Family

Basis	Partnership	Hindu Undivided Family
Mode of creation	By an agreement.	Right in business is created by birth in the family.
Death of a member	Leads to the dissolution of partnership.	Does not give rise to dissolution of the family business.
Management	All the partners are equally entitled to take part in the partnership business.	The right of management of joint family business generally vests in the Karta.

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Authority to bind	Every partner can, by his act, bind the firm.	Karta or manager, has the authority to contract for the family business and the other members.
Liability	The liability of a partner is unlimited.	Only the liability of Karta is unlimited, and other coparceners are liable only to extent of their share in profits of family business.
Calling for accounts on closure	A partner can bring a suit against firm for accounts, provided he also seeks the dissolution of the firm.	On separation of the joint family, a member is not entitled to ask for the account of family business.
Governing Law	Indian Partnership Act, 1932	The Hindu Law.
Minor's capacity	A minor cannot become a partner, though he can be admitted to benefits of partnership.	A minor becomes a member of the ancestral business by the incidence of birth.
Continuity	A firm gets dissolved by death or insolvency of a partner.	A Joint Hindu family has continuity till it is divided.
Number of Members	Should not exceed 50.	Members may be unlimited in number.
Share in the business	Each partner has a defined share by agreement between the partners.	In a HUF, no coparceners have a definite share. The share fluctuate.

4.4 Partnership Vs. Co-Ownership or joint ownership

Co-Ownership or joint ownership is the relation which subsists between persons who own property jointly or in common.

Basis	Partnership	Co-Ownership
Formation	Partnership always arises out of a contract, express or implied.	Co-ownership may arise either from agreement or by the operation of law, such as by inheritance.
Implied agency	A partner is the agent of the other partners.	A co-owner is not the agent of other co-owners.

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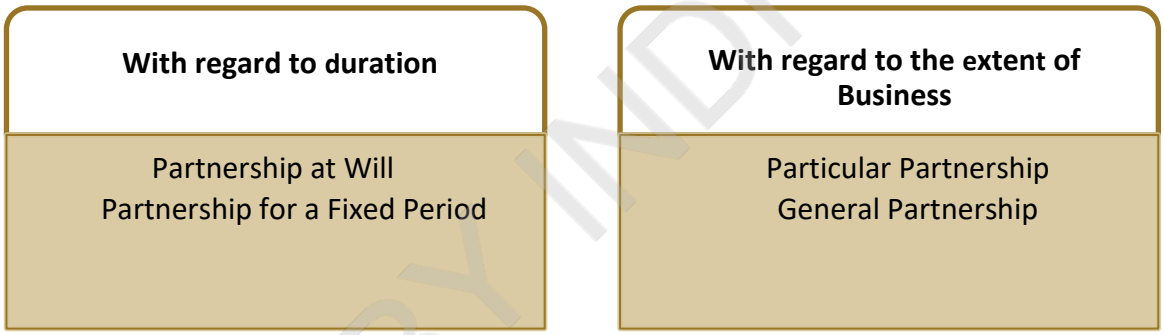
Nature of interest	There is a community of interest which means that profits and losses must have to be shared.	Co-ownership does not necessarily involve sharing of profits and losses.
Transfer of interest	A share in the partnership is transferred only by the consent of other partners.	A co-owner may transfer his interest/ rights in property without consent of other co-owners.

4.5 Partnership vs. Association

Partnership	Association
Partnership means and **involves setting up relation of agency** between two or more persons who have **entered into a business for gains**, with the **intention to share profits** of such a business.	Association **evolves out of social cause** where there is **not** necessarily a motive **to earn and share profits**. The intention is not to enter in a business for gains.

5. Kinds of Partnerships

5.1 Various kinds of Partnership



5.1.1 Partnership at will [Section 7]

- Partnership at will is a partnership when –
  a) **No fixed period has been agreed** upon for the duration of the partnership, **and**
  b) There is **no provision made as to the determination of the partnership duration.**
- Where a **partnership entered into for a fixed term** is **continued after the expiry of such term**, it is to be treated as having become a partnership at will.
- A partnership at will may be **dissolved** by any partner **by giving notice in writing to all the other partners** of his intention to dissolve the same.

5.1.2 Partnership for a fixed period

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- Where **a provision is made by a contract for the duration of the partnership**, the partnership is called 'partnership for a fixed period'.
- Such a partnership comes to an **end on the expiry of the fixed period**.

5.1.3 Particular partnership

- Where a person becomes a partner with another person in any **particular adventure or undertaking**, the partnership is called 'particular partnership'.
- Particular partnership is, subject to any agreement, **dissolved by the completion of the adventure or undertaking.**

5.1.4 General partnership

- Where a partnership is **constituted with respect to the business in general**, it is called a general partnership.
- Unlike a particular partnership in a general partnership the **scope of business to be carried out is not defined.** So, all partners will be liable for all the actions of the partnership.

5.2 Partnership Deed

- No particular formalities are required for a partnership agreement.
- It may be in writing or formed verbally
- **The document in writing containing the various terms and conditions as to the relationship of the partners** to each other is called the 'partnership deed'.
- Where the partnership comprises immovable property, the instrument of partnership must be in **writing**, **stamped and registered** under the Registration Act.

> **Partnership deed** should be drafted with care and be stamped according to the provisions of the Stamp Act, 1899.

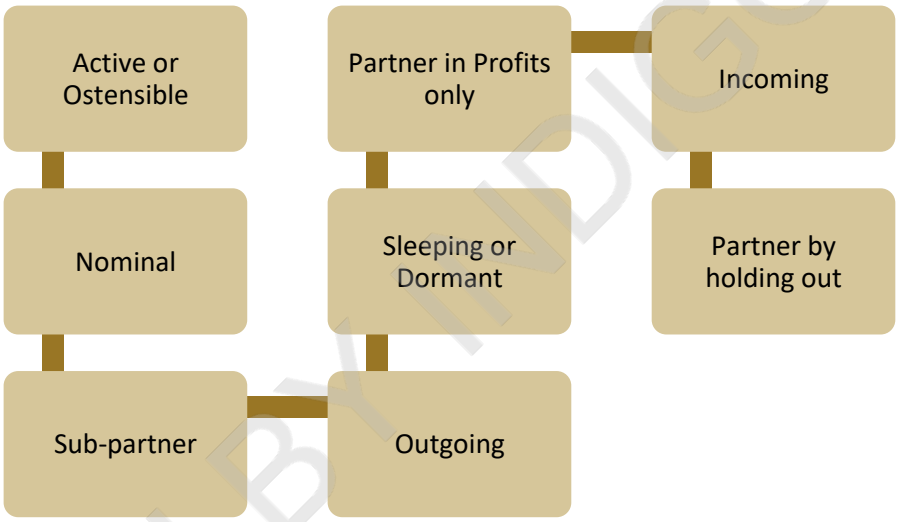
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Contents of a Partnership Deed

- Name of the Partnership Firm.
- Names of all the partners.
- Nature and place of business of the firm.
- Date of Commencement of partnership.
- Duration of the partnership firm.
- Capital contribution of each partner.
- Profit sharing ratio of the partners.
- Admission and retirement of a partner.
- Rates of Interest on capital, drawings and loans.
- Provisions for settlement of accounts in the case of dissolution of the firm.
- Provisions for salaries or commissions, payable to the partners
- Provisions for expulsion of a partner in case of breach of duty or fraud.

Partnership firm may add or delete any provision according to needs of the firm.

6. Types of Partners



6.1 Active or Actual or Ostensible partner

- It is a person who has **become a partner by agreement**, and who **actively participates in the conduct of the partnership.**
- In the event of his retirement, he must give a public notice in order to absolve himself of liabilities for acts of other partners done after his retirement.

6.2 Sleeping or Dormant Partner

- It is a person who is a **partner by agreement**, and who **does not actively take part in the conduct of the partnership business.**

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- They share profits and losses and are liable to the third parties for all acts of the firm. They are, however not required to give public notice of their retirement from the firm.

6.3 Nominal Partner

- A person who **lends his name to the firm, without having any real interest** in it, is called a nominal partner.
- He is **not entitled to share the profits** of the firm.
- He **does not take part in the conduct of the business**.
- He is, however, **liable to third parties** for all acts of the firm.

6.4 Partner in profits only

A partner who is **entitled to share the profits only without being liable for the losses** is known as the partner for profits only and **also liable to the third parties for all acts of the profits only.**

6.5 Incoming partners

- A person who is **admitted as a partner into an already existing firm** with the consent of all the existing partners is called an "incoming partner".
- Such a partner is **not liable for any act of the firm done before his admission** as a partner.

6.6 Outgoing partner

- **A partner who leaves a firm** in which the rest of the partners continue to carry on business is called a retiring or outgoing partner.
- Such a partner **remains liable to third parties for all acts of the firm until public notice is given of his retirement.**

6.7 Partner by holding out [Section 28]

- Where a man **holds (represents) himself out as a partner, or allows others to do it**, he is then stopped from denying the character he has assumed and upon the faith of which creditors may be presumed to have acted.
- Partnership by holding out is also known as **partnership by estoppel.**

> The rule given in Section 28 is **also applicable to a former partner who has retired from the firm without giving proper public notice** of his retirement.

Example : X and Y are partners in a partnership firm. X introduced A, a manager, as his partner to Z. A remained silent. Z, a trader believing A as a partner supplied 100 TV sets to the firm on credit. After the expiry of the credit period, Z did not get the amount of TV sets sold to the partnership firm. Z filed a suit against X and A for the recovery of

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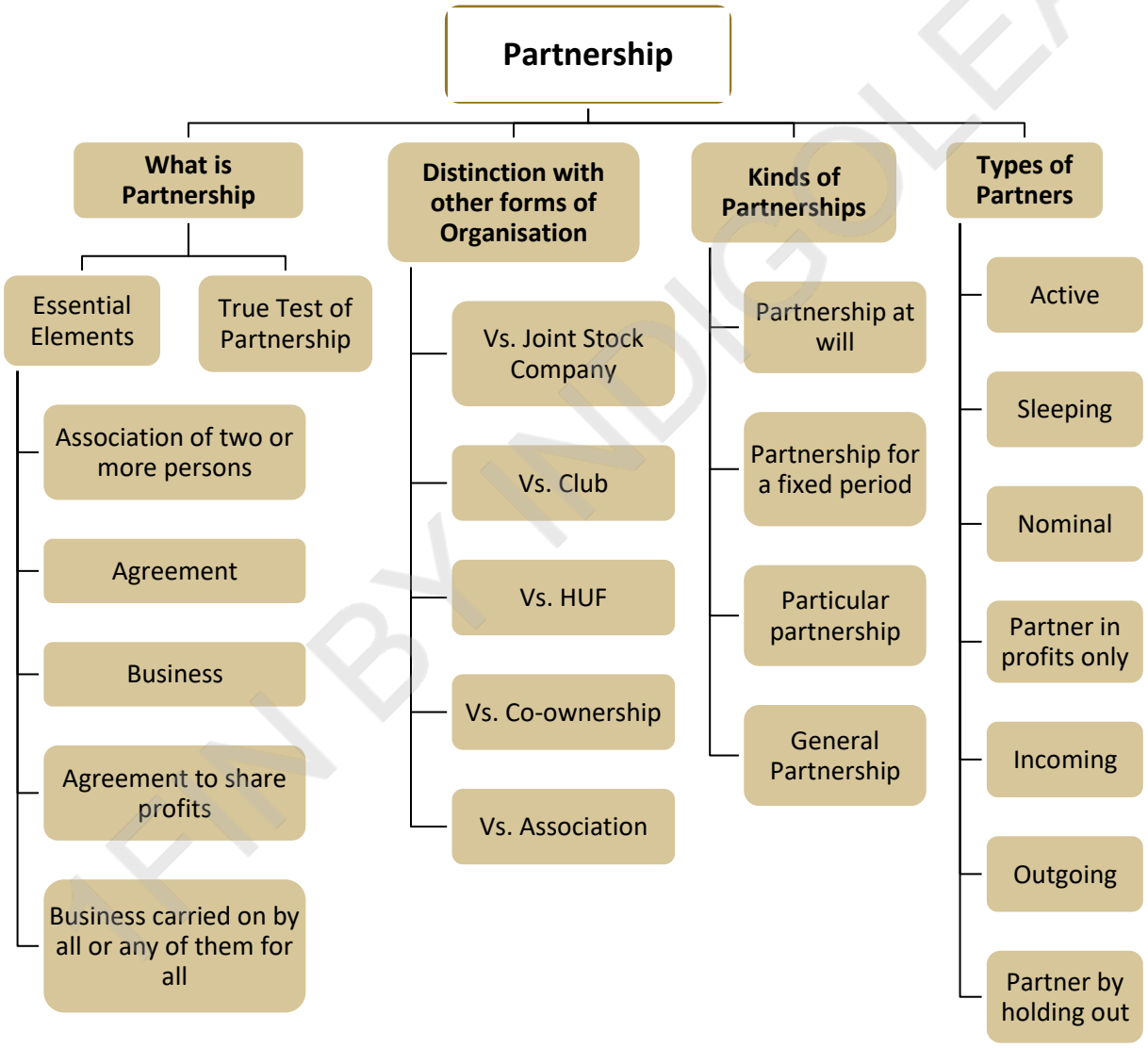
price. Here, in the given case, A, the Manager is also liable for the price because he becomes a partner by holding out.

- **It is only the person to whom the representation has been made and who has acted thereon that has right to enforce liability arising out of 'holding out'.**

  Example : A partnership firm consisting of P, Q, R and S. S retires from the firm without giving public notice and his name continues to be used on letterheads. Here, S is liable as a partner by holding out to creditors who have lent on the faith of his being a partner.

- For fixing liability on a **person who has, by representation, led another to act,** it is not necessary to show that he was actuated by a fraudulent intention.

7. Overview



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CH-3: UNIT 2 – RELATIONS OF PARTNERS

Learning Outcomes –

- Relations of Partners to one another and with Third Parties
- Implied Authority of a Partner
- Situations – Change in the constitution of a Firm and its effects
- Rights and Obligations of Transferee of a Partners' Share

1. Relation of Partners to One Another

1.1 General Duties of Partners [Section 9]

- To **carry on the business** of the firm to the greatest common advantage of the firm and its partners.
- To **observe utmost good faith** in his dealings with the other partners.
- To **render to any partner** or his legal representatives **full information of all things affecting the firm.**

> Where some of the accounts are kept by one of the partners, prima facie he would be the proper person to explain and give full information about them.

Example : In a transaction between partners for the sale and purchase of a share in the business, if one of them is better acquainted with the accounts than the other, it is his duty to disclose all material facts.

1.2 Duty to Indemnify for Loss caused by Fraud [Section 10]

Every partner shall **indemnify the firm** for any loss caused to it by his fraud in the conduct of the business of the firm. The amount so brought in the partnership should be **divided between the partners.**

An act of a partner imputable (i.e., chargeable) to the firm or the principles of agency, **which is a fraud on his co-partners**, entitles the co-partners as between themselves, to make the partner responsible for consequences.

1.3 Determination of Rights and Duties of Partners by Contract between the Partners [Section 11]

- The rights and duties of the partners may be determined by contract between the partners, whether express or implied.

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- Such contract may **be varied by consent of all the partners, which may also be express or implied.**
- **Agreements in restraint of trade** – The contract of partnership may provide that a partner shall not carry on any business other than that of the firm while he is a partner.

1.4 The Conduct of the Business [Section 12]

Rights of the Partners in relation to Conduct of the Business

- Every partner has the right to take part in the conduct of the business
- Every partner is bound to attend diligently to his duties in the conduct of the business
- Every partner has the right to express opinion on difference arising as to ordinary matters
- Every partner has the right to have access to and inspect the books of the firm
- In the event of death of any partners, legal representative or heir or authorised agents shall have right to access and inspect the books.

1.4.1 Right to take part in the conduct of the Business [Section 12(a)]

Every partner has the right to take part in the business of the firm, **provided there is no contract to the contrary between the partners.**

In case of **partnership agreements which**

- **gives only limited power** of management to a partner **or**
- contains a term that the **management of the partnership will remain with one or more of the partners** to the exclusion of others,

the Court will normally be unwilling to intervene in the management with such partner or partners, **unless it is clearly made out that something was done illegally or in breach of the trust** reposed in such partners.

> Partnership business is a business of the partners, and their management powers are generally co-extensive.

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1.4.2 Right to be consulted [section 12(c)]

- Where any **difference arises between the partners** with regard to the business of the firm, it shall be **determined by the views of the majority** of them, and **every partner shall have the right to express his opinion before the matter is decided.**

In routine matters, the **opinion of the majority** of the partners will prevail.

- However, no **change in the nature of the business of the firm** can be made without the consent of all the partners. In such a case, the **unanimous consent of the partners is needed.**

1.4.3 Right of access to books [Section 12 (d)]

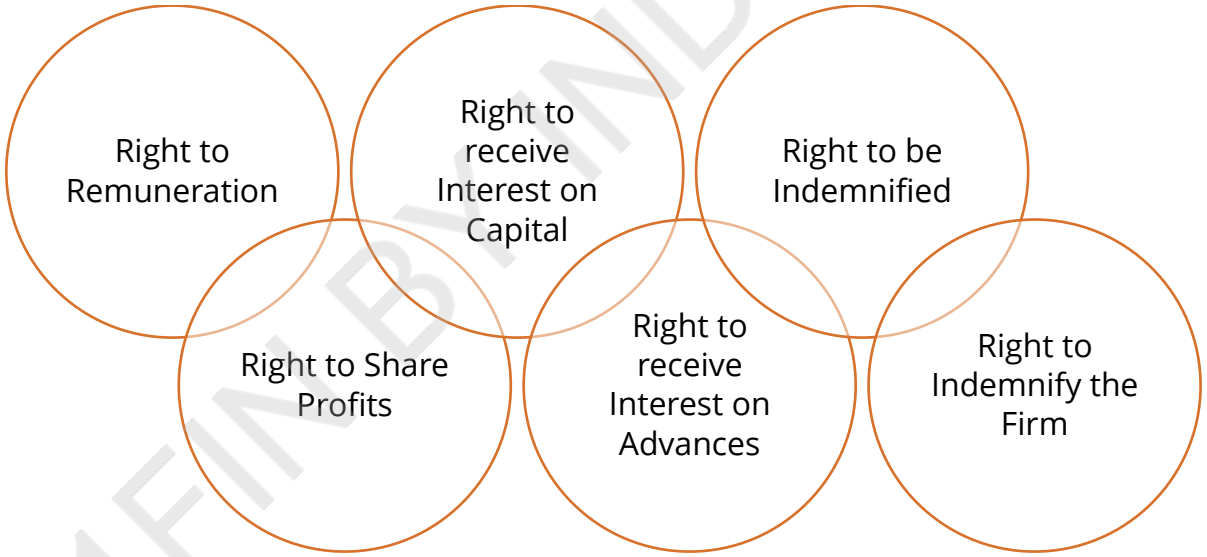
Every partner **whether active or sleeping** is entitled to have **access** to any of the books of the firm and to **inspect** and to **copy any of the books thereof.**

The right must, however, be exercised **bona fide.**

1.4.4 Right of legal heirs/ representatives/ their duly authorised agents [Section 12(e)]

In the event of the death of a partner, his heirs or legal representatives or their duly authorised agents shall have a **right of access to and to inspect and copy any of the books of the firm.**

1.5 Mutual Rights and Liabilities [Section 13]



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1.5.1 Right to remuneration [Section 13(a)]

- **No partner is entitled to receive any remuneration in addition to his share in the profits of the firm** for taking part in the business of the firm.
- However**, this rule can always be varied by an express agreement, or by a course of dealings**, in which event the partner will be entitled to remuneration.

Where it is customary to pay remuneration to a partner for conducting the business of the firm he can claim it even in the absence of a contract for the payment of the same.

1.5.2 Right to share Profits [Section 13 (b)]

Partners are **entitled to share in the profits** earned and so also to **contribute to the losses** sustained by the firm.

The amount of a partner's share must be ascertained by enquiring whether there is any agreement in that behalf between the partners.

The profits and losses are shared equally in absence of an agreement.

There is no connection between the proportion in which the partners shall share the profits and the proportion in which they have contributed towards the capital of the firm.

1.5.3 Interest on Capital [Section 13 (c)]

The partners of a firm shall be entitled to interest on moneys brought by him in the partnership business, **provided, there is –**

a) **An express agreement** to that effect, or practice of the particular partnership or

b) **Any trade custom** to that effect; or

c) **A statutory provision** which entitles him to such interest.

In the absence of any agreement, no interest on capital is payable.

1.5.4 Interest on advances [Section 13 (d)]

Where a partner makes an advance to the firm in addition to the amount of capital to be contributed by him, he shall **be entitled to claim interest thereon @ 6% per annum, unless agreed otherwise.**

Interest on capital account ceases to run on dissolution, whereas, the **interest on advances keep running even after dissolution and up to the date of payment.**

1.5.5 Right to be indemnified [Section 13 (e)]

Every partner has the right to be indemnified by the firm in respect of –

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a) **Payments made and liabilities incurred by him in the ordinary and proper conduct of the business of the firm**, and also

b) **Payment made in the performance of an act in an emergency for protecting the firm from any loss**, if the payments, liability, and act are such as a prudent man would make, incur, or perform in his own case, under similar circumstances.

1.5.6 Right to indemnify the firm [Section 13 (f)]

A partner must indemnify the firm **for any loss caused to it by wilful neglect** in the conduct of the business of the firm.

2. Partnership Property

2.1 The Property of the Firm [Section 14]

- The property of the firm, in the absence of any agreement between the partners showing contrary intention, is **comprised of the following items**:
    i. **All property, rights, and interests which partners may have brought into the common stock** as their contribution to the common business,
    ii. **All the property, rights and interest acquired or purchased by or for the firm,** or for the purposes and in the course of the business of the firm, and
    iii. **Goodwill** of the business.
- The determination of the question **whether a particular property is or is not 'property' of the firm** ultimately depends on the **real intention or agreement of the partners.**

Property of the firm is also referred to as 'partnership property', 'partnership assets', 'joint stock', 'common stock' or 'joint estate'.

Mere fact that property of a partner is being used for purposes of the firm shall not by itself make it partnership property, unless it is intended to be treated as such.

- Partners may, **by an agreement** at any time, convert the property of any partner or partners or the separate property of any partner into a partnership property.
- **Goodwill –**
    - **Defined as** value of the reputation of a business house in respect of profits expected in future over and above normal level of profits earned by undertaking belonging to the same class of business.
    - Goodwill is a **part of the property of the firm**.

Such conversion, if made in good faith, would be effectual between partners and against creditors of firm.

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- It **can be sold separately or along with the other properties** of the firm.
- Any partner may upon the **sale of the goodwill of a firm**, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits.

2.2 Application of the Property of the Firm [Section 15]

Subject to contract between partners, the property of the firm shall be held and used **exclusively for the purpose of the firm.**

During the subsistence of the partnership, **a particular partner does not have any proprietary interest in the assets of the firm.**

3. Personal Profit Earned by Partners [Section 16]

1) Where a partner derives any profit for himself **from any transaction of the firm or from the use of the property or business connection of the firm or firm name**, he must account for that profit and pay it to the firm. This rule, however, is **subject to a contract between partners.**

   Example : A, B, C & D established partnership business for refining sugar. A, who was himself a wholesale grocer, was entrusted with the work of selection and purchase of sugar. As a wholesale grocer, A was well aware of the variations in the sugar market and had the suitable sense of propriety as regards purchases of sugar. He had already in stock sugar purchased at a low price which he sold to the firm when it needed some, without informing the partners that the sugar sold had belonged to him. It was held that A was bound to account to the firm for the profit so made by him.

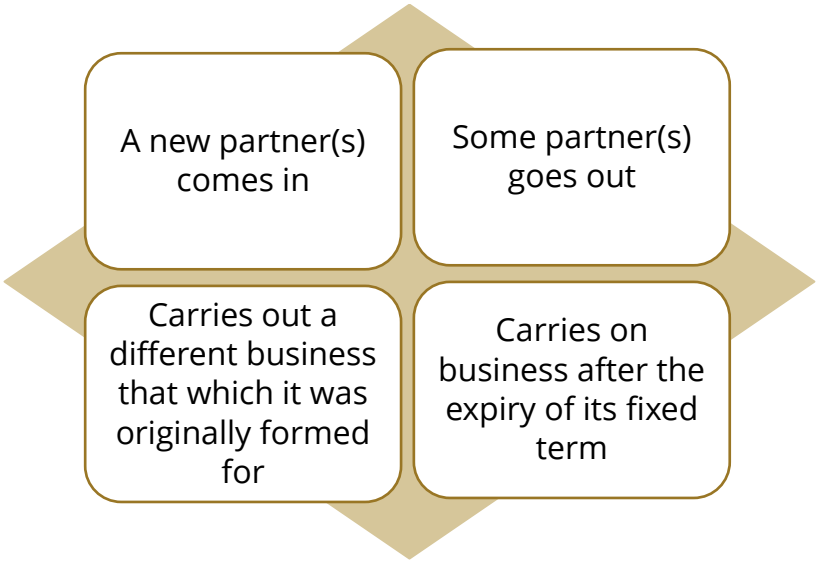
2) **Where a partner carries on a competing business**, he must account for and pay to the firm all profits made by him in that business. This rule is **also subject to a contract between the partners.**

   Example : A, B, C and D started a business in partnership for importing salt from foreign ports and selling it at Chittagong. A struck certain transactions in salt on his own account, which were found to be of the same nature as the business carried on by the partnership. It was held that A was liable to account to the firm for profits of the business so made by him.

4. Rights and Duties of Partners after a Change in the Constitution of the Firm [Section 17]

The constitution of a firm changes in the following four ways –

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- Where a change occurs in the constitution of a firm, **the mutual rights and duties of the partners in the reconstituted firm remain the same** as they were immediately before the change.

These are subject to contract between partners.

- Where a **firm constituted for a fixed term continues to carry on business after the expiry of that term**, the **mutual rights and duties** of the partners **remain the same** as they were before the expiry.
- Where a **firm** constituted to carry out one or more adventures or undertakings **carries out other adventures or undertakings, the mutual rights and duties of the partners are the same** as those in respect of the original adventures or undertakings.

5. Relation of Partners to Third Parties

5.1 Partner to be Agent of the Firm [Section 18]

Subject to the provisions of the Act, **a partner is the agent of the firm for the purpose of the business of the firm.**

The rule that a partner is the agent of the firm for the purpose of the business of the firm cannot be applied to all transactions and dealings between the partners themselves. It is **applicable only to the act done by partners for the purpose of the business of the firm.**

5.2 Implied Authority of Partner as Agent of the Firm [Section 19]

- Subject to the provisions of section 22, **the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm.** The authority of a partner to bind the firm conferred by this section is called his "**implied authority**".
- **Section 22:** In order to bind a firm, an act or instrument done or executed by a partner or other person on behalf of the firm shall be **done or executed in the firm name, or in any other manner expressing or implying an intention to bind the firm**

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Sec 19(2): In the absence of any usage or custom of trade to the contrary, **the implied authority of a partner does not empower him to –**

- ☐ Submit a dispute relating to the business of the firm to arbitration,
- ☐ Open a banking account on behalf of the firm in his own name,
- ☐ Compromise or relinquish any claim or portion of a claim by the firm,
- ☐ Withdraw a suit or proceedings filed on behalf of the firm,
- ☐ Admit any liability in a suit or proceedings against the firm,
- ☐ Acquire immovable property on behalf of the firm,
- ☐ Transfer immovable property belonging to the firm, and
- ☐ Enter into partnership on behalf of the firm.

Example : X, a partner in a firm of solicitors, borrows money and executes a promissory note in the name of firm without authority. The other partners are not liable on the note, as it is not part of the ordinary business of a solicitor to draw, accept, or endorse negotiable instruments.

- If partnership be of a **general commercial nature**, any partner may
  - **Pledge or sell the partnership property**,
  - **Buy goods** on account of the partnership,
  - **Borrow money, contract debts and pay debts** on account of the partnership,
  - **Draw, make, sign, endorse, transfer, negotiate and procure to be discounted, Promissory notes, bills of exchange, cheques and other negotiable papers** in the name and on account of the partnership.

5.3 Extension and Restriction of Partners' Implied Authority [Section 20]

- **The implied authority of a partner may be extended or restricted by contract between the partners.**
- Under the following conditions, restrictions imposed on the implied authority of a partner by agreement shall be effective against third party –
  - The third party knows about the restrictions, and
  - The third party does not know that he is dealing with a partner in a firm.
- However, such extension or restriction is only possible with the **consent of all the partners**. Any one partner, or even a majority of the partners, cannot restrict or extend the implied authority.

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Example : A, a partner, borrows from B ₹1,000 in the name of the firm but in excess of his authority, and utilizes the same in paying off the debts of the firm. Here, the fact that the firm has contracted debts suggests that it is a trading firm, and as such it is within the implied authority of A to borrow money for the business of the firm. This implied authority, as you have noticed, may be restricted by an agreement between him and other partners. Now if B, the lender, is unaware of this restriction imposed on A, the firm will be liable to repay the money to B. On the contrary, B's awareness as to this restriction will absolve the firm of its liability to repay the amount to B.

5.4 Partner's Authority in an Emergency [Section 21]

In case of an emergency, a partner has authority to **do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence**, in his own case, acting under similar circumstances, and such acts bind the firm.

6. Effect of Admissions by a Partner [Section 23]

- An admission or representation made by a partner **concerning the affairs of the firm is evidence against the firm** if it is made in the **ordinary course of business**.
- However, an admission or representation by a partner **will not bind** the firm if **his authority on the point is limited and the other party knows of the restriction.**

Example : X and Y are partners in a firm dealing in spare parts of different brands of motorcycle bikes. Z purchases a spare part for his Yamaha motorcycle after being told by X that the spare part is suitable for his motorcycle. Y is ignorant about this transaction. The spare part proves to be unsuitable for the motorcycle and it is damaged. X and Y both are responsible to Z for his loss.

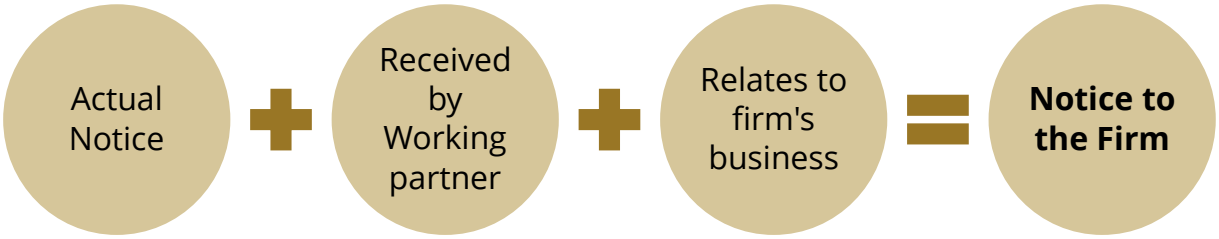
7. Effect of Notice to Acting Partner [Section 24]

- Notice to a partner who habitually acts in the business of the firm of any **matter relating to the affairs of the firm** operates as **notice to the firm**.
- The only **exception** is in the case of a **fraud on the firm committed by or with the consent of that partner.**

Example : P, Q, and R are partners in a business for the purchase and sale of second-hand goods. R purchases a second-hand car on behalf of the firm from S. In the course of dealings with S, he comes to know that the car is a stolen one and it actually belongs to X. P and Q are ignorant about it. All the partners are liable to X, the real owner.

Example : A, a partner who actively participates in the management of the business of the firm, bought for his firm, certain goods, while he knew of a particular defect in the goods. His knowledge as regards the defect, ordinarily, would be construed as the knowledge of the firm, though the other partners in fact were not aware of the defect. But because A had, in league with his seller, conspired to conceal the defect from the other partners, the rule would be inoperative and the other partners would be entitled to reject the goods, upon detection by them of the defect.

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8. Liability to Third Parties

8.1 Liability of a Partner for acts of the Firm [Section 25]

- Every partner is liable, **jointly** with all the other partners **and also severally**, **for all acts of the firm done while he is a partner.**
- The **expression 'act of firm'** connotes **any act or omission by all the partners or by any partner or agent of the firm,** which gives rise to a right enforceable by or against the firm.

> To bring a case under Section 25, it is necessary that the act of the firm, in respect of which liability is brought to be enforced against a party, must have been done while he was a partner.

Example : Certain persons were found to have been partners in a firm when the acts constituting an infringement of a trademark by the firm took place, it was held that they were liable for damages arising out of the alleged infringement, it being immaterial that the damages arose after the dissolution of the firm.

8.2 Liability of the Firm for Wrongful Acts of a Partner [Section 26]

The firm is liable to the same extent as the partner for any loss or injury caused to a third party by the wrongful acts of a partner, if they are **done by the partner while acting –**

- **in the ordinary course** of the business of the firm, or
- **with the authority of the partners.**

> If act fall within these 2 categories, fact that method employed by partner in doing it was unauthorized/wrongful, doesn't matter.

Furthermore, **all the partners in a firm are liable to a third party for loss or injury caused to him by the negligent act of a partner** acting in the ordinary course of the business.

Example : One of the two partners in coal mine who acted as a manager was guilty of personal negligence in omitting to have the shaft of the mine properly fenced. As a result thereof, an injury was caused to a workman. The other partner was also held responsible for the same.

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8.3 Liability of Firm for Misapplication by Partners [Section 27]

- Where-

  a) a **partner acting within his apparent authority** receives money or property from a third party and misapplies it, or

  b) a firm **in the course of its business** receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm,

  the firm is liable to make good the loss.

- **If receipt of money by one partner is not within the scope of his apparent authority**, his receipt **cannot be regarded as a receipt by the firm** and the **other partners will not be liable**, unless the money received comes into their possession or under their control.

Example : A, B, and C are partners of a place for car parking. P stands his car in the parking place, but A sold out the car to a stranger. For this loss, the firm is liable for the acts of A.

9. Rights of Transferee of a Partner's Interest [Section 29]

A share in a partnership is transferable like any other property, but as the partnership relationship is based on mutual confidence, **the assignee of a partner's interest** by sale, mortgage or otherwise **cannot enjoy the same rights and privileges as the original partner.**

The rights of such a transferee are as follows –

During the Continuance of Partnership	• The transferee is not entitled to - interfere with the conduct of the business, or to require accounts, or to inspect books of the firm. • Only entitled to receive the share of the profits of the transferring partner. • He cannot challenge the accounts.
On Dissolution of the firm/ Retirement of transferring partner	• Entitled to receive the share of the assets of the firm, and • for this purpose, to an account as from the date of the dissolution.

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A partner cannot by transferring his own interest, make anybody else a partner in his place, unless the other partners agree to accept that person as a partner.

10. Minors Admitted to the Benefits of Partnership [Section 30]

A minor cannot become a partner in a firm; however, he **can be admitted to the benefits of partnership** under Section 30 of the Act, with the **consent of all the partners** for the time being.

In such a case, the rights and liabilities of a minnow are as follows –

10.1 Rights of the Minor

i) A minor partner has a **right to his agreed share of the profits** and of the firm.
ii) He can have **access to, inspect and copy the accounts** of the firm.
iii) He can **sue the partners for accounts or for payment of his share** but only when severing his connection with the firm, and not otherwise.
iv) **On attaining majority he may within 6 months elect to become a partner or not to become a partner**.
   - If he elects to become a partner, then he is entitled to the share to which he was entitled as a minor.
   - If he does not, then his share is not liable for any acts of the firm after the date of the public notice served to that effect.

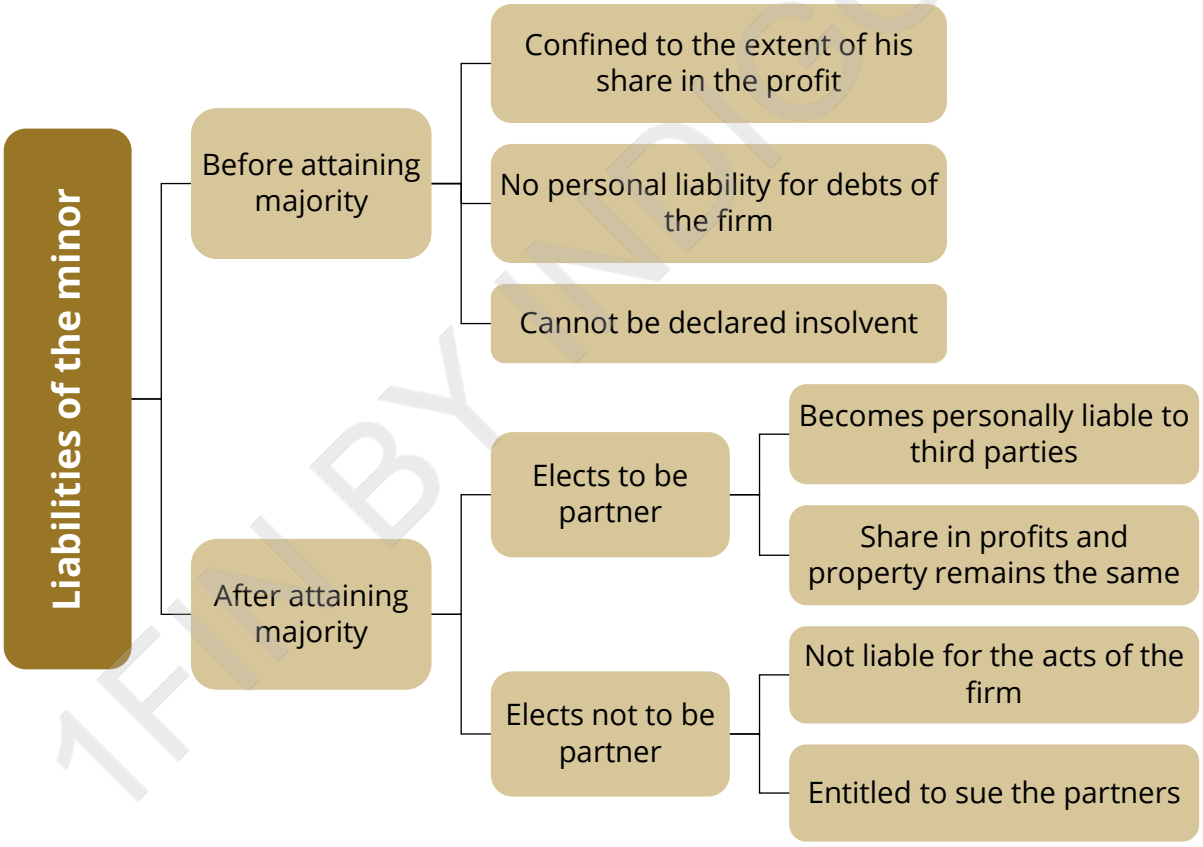


10.2 Liabilities of the Minor

- **Before attaining majority –**
  - Liability is **confined only to the extent of his share in the profits and the property** of the firm.
  - Minor has **no personal liability for the debts of the firm** incurred during his minority.
  - Minor **cannot be declared insolvent**, but if the firm is declared insolvent his share in the firm vests in the Official Receiver/Assignee.

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- **After attaining majority –**
    - **When he becomes partner –**
        i) He **becomes personally liable to third parties** for all acts of the firm done since he was admitted to the benefits of partnership.
        ii) His **share in the property and the profits of the firm remains the same** to which he was entitled as a minor.
    - **When he elects not to become a partner –**
      Where he has elected not to become partner he shall **give public notice** that he has elected not to become partner and such notice shall determine his position as regards the firm. **If he fails to give such notice he shall become a partner** in the firm on the expiry of the said 6 months.
        i) His **rights and liabilities continue** to be those of a minor up to the date of giving public notice.
        ii) His share shall **not be liable for any acts of the firm done after the date of the notice**.
        iii) He shall be **entitled to sue the partners** for his share of the property and profits.



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11. Legal Consequences of Partner Coming In and Going Out

11.1 Introduction of a Partner [Section 31]

- Subject to a contract between partners and to the provisions regarding minors, **no person shall be introduced as a partner** into a firm **without** the **consent of all the existing partners.**
- **Rights and liabilities of new partner** –
    - The **liabilities** of the new partner ordinarily **commence from the date when he is admitted as a partner**, unless he agrees to be liable for obligations incurred by the firm prior to the date.
    - The new firm, including the new partner who joins it, **may agree to assume liability for the existing debts** of the old firm, **and creditors may agree to accept the new firm as their debtor** and discharge the old partners. **The creditor's consent is necessary in every case to make the transaction operative.**
    - An **agreement between the partners and the incoming partner** that he shall be liable for existing debts **will not ipso facto give creditors of the firm any right against him.**



The technical term in a contract for substituted liability is Novation. *[refer chapter 1]*

This section does not apply to a partnership of two partners which is automatically dissolved by the death of one of them.

11.2 Retirement of a Partner [Section 32]

- A partner is said to retire when he ceases to be a member of the firm without bringing to an end the subsisting relations between the other members, or between the firm and third parties.
- **Retirement of a partner from a firm does not dissolve it.**

A partner may retire		
With the consent of all the other parties, or	In accordance with express agreement by the partners, or	In case of Partnership at Will - by giving notice in writing of all the other partners

Example: Mere retirement of a partner, who was the tenant of the premises in which the partnership business was carried out, would not result in assignment of the tenancy rights in

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favour of the remaining partners even though the retiring partner ceases to have any right, title or interest in the business as such.

Case Law: Vishnu Chandra Vs. Chandrika Prasad (SC)

The Supreme Court held that the expression 'if any partner wants to dissociate from the partnership business', in a clause of the partnership deed which was being construed, comprehends a situation where a partner wants to retire from the partnership. The expression clearly indicated that in the event of retirement, the partnership business will not come to an end.

- **Liabilities of an outgoing partner –**
  - A retiring partner **continues to be liable to third party for acts of the firm after his retirement until public notice** of his retirement has been given either by himself or by any other partner.
  - But the retired partner will not be liable to any third party if the latter deals with the firm without knowing that the former was partner.
  - As regards the **liability for acts of the firm done before his retirement**, the retiring partner **remains liable** for the same, **unless there is an agreement made by him with the third party concerned and the partners of the reconstituted firm.** Such an agreement may be implied by a course of dealings between the third party and the reconstituted firm after he had knowledge of the retirement.
- If the **partnership is at will**, the partner by **giving notice in writing to all the other partners** of his intention to retire will be **deemed to be relieved as a partner without giving a public notice to this effect.**

11.3 Expulsion of a Partner [Section 33]

The **expulsion is not deemed to be in bona fide interest** of the business of the firm, **unless all the following conditions are present** –

- The **power of expulsion** must have **existed in a contract between the partners**,
- The power has been **exercised by a majority of the partners**, and
- It has been exercised in **good faith.**

If a partner is otherwise expelled, the expulsion is null and void.

The test of good faith as required u/s 33(1) includes 3 things –

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The expulsion of partners does not necessarily result in dissolution of the firm. The invalid expulsion of a partner does not put an end to the partnership even if the partnership is at will and it will be deemed to continue as before.

Example : A, B and C are partners in a Partnership firm. They were carrying their business successfully for the past several years. Spouses of A and B fought in ladies club on their personal issue and A's wife was hurt badly. A got angry on the incident and he convinced C to expel B from their partnership firm. B was expelled from partnership without any notice from A and C. According to the test of good faith as required u/s 33(1), expulsion of Partner B is not valid.

The provisions of Section 32(2), 32(3), 32(4) shall apply to an expelled partner as if he were a retired partner.

11.4 Insolvency of a Partner [Section 34]

- Where a partner in a firm is adjudicated as an insolvent he **ceases to be a partner on the date on which the order of adjudication is made**, whether or not the firm is hereby dissolved.
- **Ordinarily**, but not invariably, the **insolvency of a partner results in dissolution of a firm**, but the **partners are competent to agree among themselves that the adjudication of a partner as an insolvent will not give rise to dissolution of the firm.**
- The **estate of such partner** (which thereupon vests in the official assignee) **ceases to be liable for any act of the firm done after the date of the order.**
- The **firm** also is **not liable for any act of such a partner** after such date.

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11.5 Liability of Estate of Deceased Partner [Section 35]

Ordinarily, the effect of the death of a partner is the **dissolution** of the partnership, **but the partners are competent to agree that the death of one will not have the effect of dissolving the partnership** as regards the surviving partners unless the firm consists of only two partners.

Where under a contract between the partners, the firm is not dissolved by the death of a partner, the **estate of a deceased partner is not liable for any act of the firm done after his death.** It is not necessary to give any notice either to the public or the persons having dealings with the firm.

Example : X was a partner in a firm. The firm ordered goods in X's lifetime; but the delivery of the goods was made after X's death. In such a case, X's estate would not be liable for the debt; a creditor can have only a personal decree against the surviving partners and a decree against the partnership assets in the hands of those partners. A suit for goods sold and delivered would not lie against the representatives of the deceased partner. This is because there was no debt due in respect of the goods in X's lifetime.

12. Rights of Outgoing Partner to carry on Competing Business [Section 36]

- An outgoing partner **may carry on business competing** with that of the firm and he may advertise such business.
- However, **he may not –**
    - use the firm name,
    - represent himself as carrying on the business of the firm or
    - solicit the custom of persons who were dealing with the firm before he ceased to be a partner.
- The partner may **agree with his partners** that on his ceasing to be so, **he will not carry on a business similar to that of the firm within a specified period or within specified local limits**.

  Such an agreement will **not be in restraint of trade if the restraint is reasonable.**

13. Right of Outgoing Partner in certain cases to Share Subsequent Profits [Section 37]

- Where any person ceases to be a partner because of his death or retirement, and the other **partners continue the business of the firm without final settlement of accounts**, in such a situation the outgoing partner or his representatives are entitled to either –
    i) **Share in the profits** of the firm made since he ceased to be a partner as attributable to the use of his share of property of the firm, or
    ii) **Interest at the rate of 6% per annum** on the amount of his share in the property of the firm.
- Where, by a contract between the partners, an option is given to surviving or **continuing partners to purchase the interest of a deceased or outgoing partner,** and that option is duly exercised, **the estate of the deceased partner/ outgoing partner/ his estate**, is not entitled to any further or other share of profits.

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Example : A, B and C are partners in a manufacture of machinery. A is entitled to three-eighths of the partnership property and profits. A becomes bankrupt whereas B and C continue the business without paying out A's share of the partnership assets or settling accounts with his estate. In this case, A's estate is entitled to three-eighths of the profits made in the business, from the date of his bankruptcy until the final liquidation of the partnership affairs.

Example : A, B and C are partners. C retires after selling his share in the partnership firm. A and B fail to pay the value of the share to C as agreed to. The value of the share of C on the date of his retirement from the firm would be pure debt from the date on which he ceased to be a partner as per the agreement entered between the parties. C is entitled to recover the same with interest.

14. Revocation of Continuing Guarantee by Change in Firm [Section 38]

Mere **changes in the constitution of the firm**, in the absence of an agreement to the contrary, **operates to revoke a continuing guarantee** given to a firm or a to a third party **as to all future transactions**.

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CH-3: UNIT 3 – REGISTRATION AND DISSOLUTION OF A FIRM

Learning Outcomes –

- Mode of Registration of a Firm
- Effect of Registration
- Consequences of Non-Registration
- Circumstances when a firm is dissolved
- Consequences of Dissolution

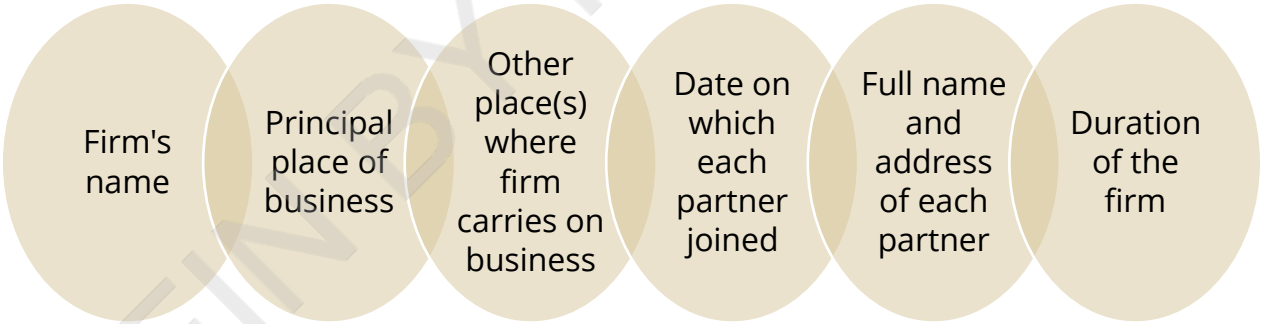
1. Registration of Firms

The registration of a partnership is optional, and one partner cannot compel another partner to join in the registration of the firm.

It is not essential that the firm should be registered from the very beginning. When the partners decide to get the firm registered as per the provisions of **Section 58 of the Indian Partnership Act, 1932**, they have to file the statement in the prescribed form.

1.1 Application for Registration [Section 58]

- The **registration of a firm** may be effected **at any time** by sending by post or **delivering to the Registrar** of the area in which any place of business of the firm is situated or proposed to be situated, **a statement in the prescribed form** and accompanied by the prescribed fee.
- **Contents in the application for registration** –



- The statement shall be **signed by all the partners**, or by their agents specially authorised in this behalf. Each person signing the statement **shall also verify it** in the manner prescribed.
- **Subsequent alterations** in the name, place, constitution, etc., of the firm that may occur during its continuance **should also be registered.**

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A firm name shall not contain any of the following words – 'Crown', 'Emperor', 'Empress', 'Empire', 'Imperial', 'King', 'Queen', 'Royal', or words expressing or implying the sanction, approval or patronage of Government except when the State Government signifies its consent to the use of such words as part of the firm-name by order in writing.

1.2 Registration [Section 59]

- When the Registrar is **satisfied that the provisions of section 58 have been duly complied with,** he shall **record an entry** of the statement in a register called the **Register of Firms,** and shall file the statement.
- Then he shall issue a certificate of Registration.
- **The Firm when registered shall use the bracket and word (Registered) immediately after its name.**
- Registration may also be effected even after a suit has been filed by the firm but in that case it is necessary to withdraw the suit first and get the firm registered and then file a fresh suit.

Registration is deemed to be completed as soon as application form is delivered to the Registrar. The recording of an entry in the register of firms is a routine duty of Registrar.

1.3 Late Registration on Payment of Penalty [Section 59A-1]

According to **Section 58(1A) of the Indian Partnership Act, 1932** –

"The statement under sub-section (1) [i.e., for the purpose of registration of firm] shall be sent or delivered to the Registrar within a period of **one year** from the **date of constitution** of the firm".

In case of failure to send and deliver the statement within a **time specified in sub-section (1A) of Section 58,** the firm may get registration on payment of **₹ 100/- per year of delay or part thereof as penalty** to the Registrar of Firms.

2. Consequences of Non-Registration [Section 69]

The Indian Partnership Act does not make the registration of firms compulsory nor does it impose any penalty for non-registration. However, **u/s 69 non-registration of partnership gives rise to a number of disabilities** which are as follows –

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2.1 No suit in a civil court by firm or other co-partners against third party

The firm or any other person on its behalf **cannot bring an action against the third party** for breach of contract entered into by the firm, **unless** –

- ✓ The **firm is registered,** and
- ✓ The **persons suing are or have been shown in the register** of firms as partners in the firm.

2.2 No relief to partners for set-off of claim

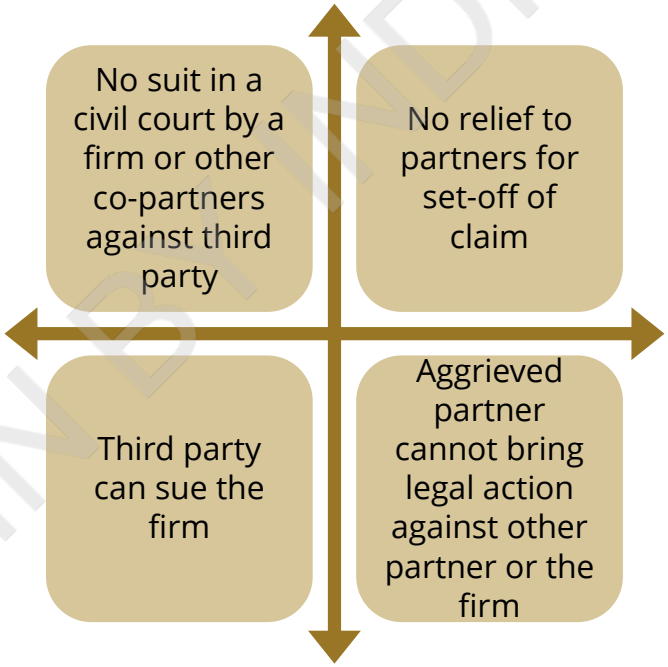
If an **action is brought against the firm by a third party**, then **neither the firm nor the partner can claim any set-off,** if the suit be valued for more than ₹ 100 **or pursue other proceedings** to enforce the rights arising from any contract.

2.3 Aggrieved partner cannot bring legal action against other partner or the firm

A partner of an unregistered firm (or any other person on his behalf) **cannot bring any legal action against the firm or any other partner.**

2.4 Third party can sue the firm

Even if the firm is unregistered, a third party may bring an action against the firm.



2.5 Exceptions – Rights not affected by non-registration of a firm

Non-registration of a firm does not, however effect the following rights –

- ✓ The right of **third parties to sue the firm or any partner**.

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- ✓ The right of partners to **sue for the dissolution** of the firm **or for the settlement of the accounts** of a dissolved firm, **or for realization of the property** of a dissolved firm.
- ✓ The power of an **Official Assignees, Receiver of Court to release the property of the insolvent partner** and to bring an action.
- ✓ The right to **sue or claim a set-off if the value of suit does not exceed ₹ 100** in value.
- ✓ The right to suit and proceeding instituted by **legal representatives or heirs of the deceased partner** of a firm **for accounts** of the firm **or to realise the property** of the firm.

Example: A & Co. is registered as a partnership firm in 2017 with A, B and C partners. In 2018, A dies. In 2019, B and C sue X in the name and on behalf of A & Co. without fresh registration. To decide whether the suit is maintainable, the test applied was whether the plaintiff satisfied the only two requirements of Section 69 (2) of the Act namely –

- the suit must be instituted by or on behalf of the firm which had been registered,
- the person suing had been shown as partner in the register of firms.

In view of this position of law, the suit is in the case by B and C against X in the name and on behalf of A & Co. is maintainable.

Now, in this example, if in 2019 B and C had taken a new partner, D, and then filed a suit against X without fresh registration, it will not be valid. The firm cannot sue as D's (new partner's) name has not been entered in the register of firms.

3. Dissolution of Firm

3.1 Meaning of 'Dissolution of the Firm' [Section 39]

The **dissolution of partnership between all partners** of a firm is called the **'dissolution of the firm'.**

- Thus, the dissolution of firm means the **discontinuation of the legal relation existing between all the partners** of the firm.
- But, when **only one or more partners retires or becomes incapacitated** from acting as a partner due to death, insolvency or insanity, the partnership, i.e. **the relationship between such a partner and other is dissolved, but the rest may decide to continue.** In such cases, there is in practice, no dissolution of the firm.

3.2 Dissolution of Firm Vs. Dissolution of Partnership

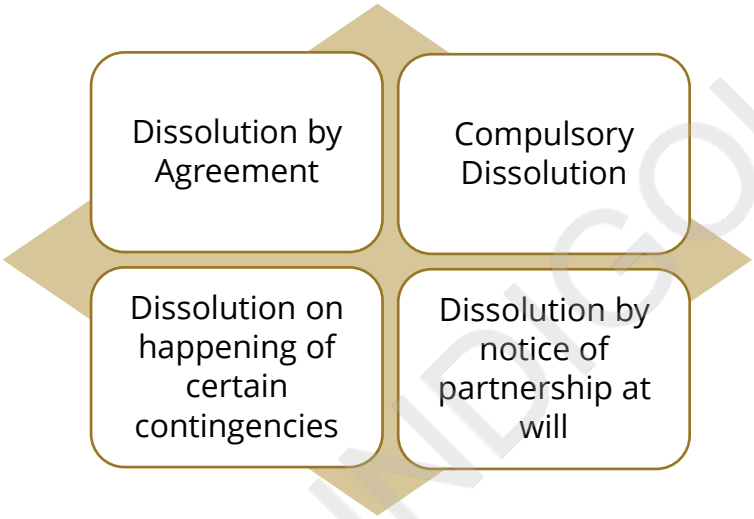
Basis of Difference	Dissolution of Firm	Dissolution of Partnership
Continuation of business	It involves discontinuation of business in partnership.	It does not affect continuation of business. It involves only reconstitution of the firm.

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Winding up	It involves winding up of the firm and requires realization of assets and settlement of liabilities.	It involves only reconstitution and requires only revaluation of assets and liabilities of the firm.
Order of court	A firm may be dissolved by the order of the court.	Dissolution of partnership is not ordered by the court.
Scope	It necessarily involves dissolution of partnership.	It may or may not involve dissolution of firm.
Final closure of books	It involves final closure of books of the firm.	It does not involve final closure of the books of the firm.

3.3 Modes of Dissolution of a firm

3.3.1 Dissolution without the Order of the Court or Voluntary Dissolution



a) Dissolution by Agreement [Section 40]

A firm may be dissolved –

- With the **consent of all the partners**, or
- **In accordance with a contract** between the partners.

> **Contract between the partners** means a contract already made.

b) Compulsory dissolution [Section 41]

A firm is compulsorily dissolved –

- ✓ by the **adjudication of all the partners or of all the partners but one as insolvent**, or

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- ✓ by the **happening of any event which makes it unlawful for the business of the firm to be carried on** or for the partners to carry it on in partnership.

Example: A firm is carrying on the business of trading a particular chemical and a law is passed which bans on the trading of such a particular chemical. The business of the firm becomes unlawful and so the firm will have to be compulsorily dissolved.

Where more than one separate adventure or undertaking is carried on by the firm – the **illegality of one or more shall not of itself cause the dissolution of the firm** in respect of its lawful adventures and undertakings.

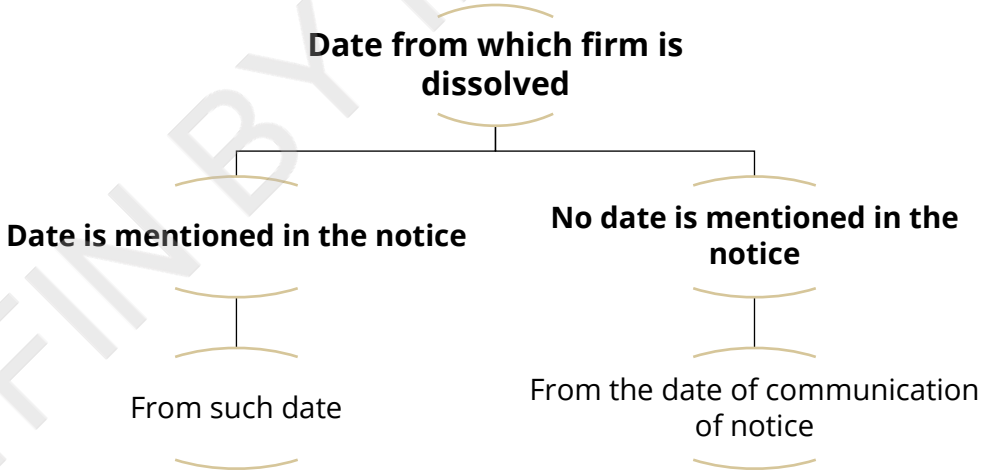
c) Dissolution on the happening of certain contingencies [Section 42]

Subject to contract between the partners, a firm can be dissolved on the **happening of any of the following contingencies** –

- Where the **firm is constituted for a fixed term**, on the **expiry of that term.**
- Where the **firm is constituted to carry out one or more adventures** or undertaking, then by **completion thereof.**
- By the **death of a partner**.
- By the **adjudication of a partner as an insolvent**.

d) Dissolution by notice of partnership at will [Section 43]

Where the partnership is at will, the firm may be dissolved by any partner **giving notice in writing to all the other partners** of his intention to dissolve the firm.



3.3.2 Dissolution by the Court [Section 44]

Court may, at the **suit of the partner**, dissolve a firm on any of the **following ground –**

a) Insanity/unsound mind

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Where a partner **(not a sleeping partner)** has become of unsound mind, the court may dissolve the firm on a suit of the other partners or by the next friend of the insane partner.

Temporary sickness is no ground for dissolution of firm.

b) Permanent incapacity

When a partner, other than the partner filing the suit, has become **in any way permanently incapable of performing his duties as partner**, then the court may dissolve the firm. **Such permanent incapacity may result from physical disability or illness etc.**

c) Misconduct

Where a partner, other than the partner filing the suit, is **guilty of conduct which unreasonably affects the business of the firm**, the court may order dissolution of the firm, giving regard to the nature of the business.

Nature of business will decide whether an act is misconduct or not.

d) Persistent breach of agreement

When a partner, other than the partner filing the suit,

- **wilfully or continuously commits breach of agreements** relating to the management of the affairs of the firm or conduct of the business, or
- **so conduct himself in matters relating to the business that it is not reasonably practicable for other partners to carry on the business** in partnership with him,

then the court may dissolve the firm at the instance of any of the partners.

Following comes into the category of breach of contract:

- Embezzlement
- Keeping erroneous accounts
- Holding more cash than allowed
- Refusal to show accounts despite repeated requests.

Example : If one of the partners keeps erroneous accounts and omits to enter receipts or if there is continued quarrels between the partners or there is such a state of things that destroys the mutual confidence of partners, the court may order for dissolution of the firm.

e) Transfer of interest

Where a partner, other than the partner filing the suit, has **transferred whole of his interest to a third party** or **has allowed his share to be charged or sold by the court for recovery of arrears of land revenue** due by him, the courts may dissolve the firm at the instance of any other partner.

f) Continuous/Perpetual losses

Where the **business of the firm cannot be carried on except at a loss in future also**, the court may order for its dissolution.

g) Just and equitable grounds

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Where the court considers any other ground just and equitable for dissolution of the firm, it may dissolve the firm. The following are the **cases of just and equitable grounds –**

- **Deadlock in the management**
- **Partners not in talking terms**
- **Loss of substratum**
- **Gambling by a partner on stock exchange**



4. Consequences of Dissolution

Consequent to the dissolution of a partnership firm, the **partners have certain rights and liabilities**, as are discussed –

4.1 Liability for acts of partners done after dissolution [Section 45]

- Even after the dissolution of a firm, the partners continue to be **liable as such to third parties** for any act done by any of them which would have been an act of the firm if done before the dissolution, **until public notice is given of the dissolution.**
- This provision has two objectives –
    i) It seeks to **protect third parties** dealing with the firm **who had no notice of prior dissolution** and

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ii) It also seeks to **protect partners** of a dissolved firm from liability towards third parties.

- **Exceptions –** Even where notice of dissolution has not been given, there will be **no liability for subsequent acts in the case of** –
    - **The estate of a deceased partner,**
    - **An insolvent partner, or**
    - **A dormant partner,** i.e., a partner who was not known as a partner to the person dealing with the firm.

4.2 Right of partners to have business wound up after dissolution [Section 46]

On the dissolution of a firm **every partner or his representative is entitled**, as against all the other partners or their representative –

- **To have the property of the firm applied in payment of the debts** and liabilities of the firm, and
- **To have the surplus distributed** among the partners or their representatives according to their rights.

4.3 Continuing authority of partners for purposes of winding up [Section 47]

After the dissolution of a firm the **authority of each partner to bind the firm, and the other mutual rights and obligations of the partners, continue** so far as may be **necessary**

- **to wind up** the affairs of the firm **and**
- **to complete transactions begun** but unfinished at the time of the dissolution, but not otherwise.

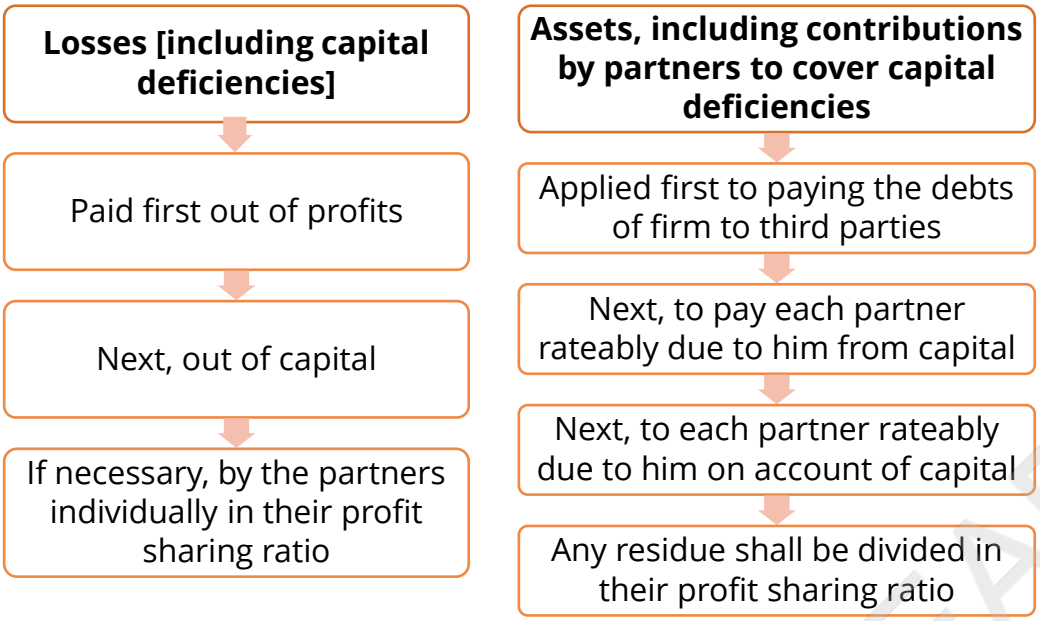
However, the **firm is in no case bound by the acts of a partner** who has been **adjudicated insolvent.**

4.4 Mode of Settlement of partnership accounts [Section 48]

Prima facie, accounts between the partners shall be settled in the manner prescribed by partnership agreement. However, any such agreement cannot affect the rights of the creditors of the firm.

In settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed –

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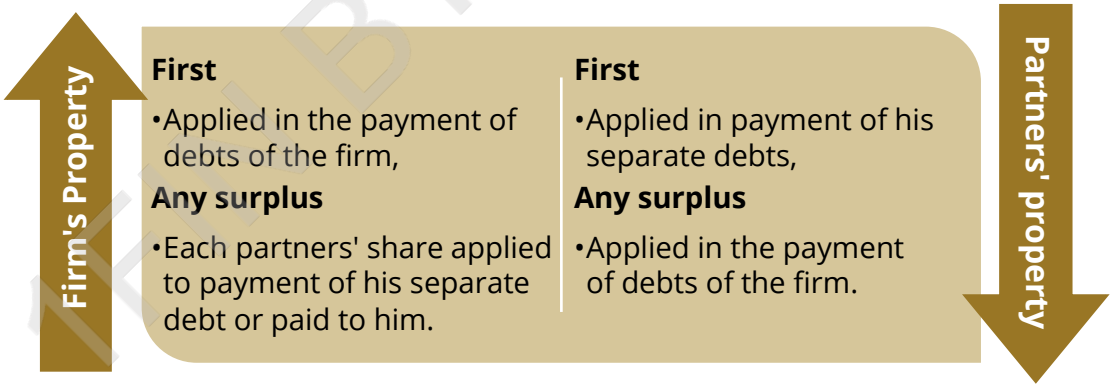


Example : X and Y were partners **sharing profits and losses equally** and X died. On taking partnership accounts, it transpired that he contributed ₹ 6,60,000 to the capital of the firm and Y only ₹40,000. The assets amounted to ₹ 2,00,000. In such situation, the deficiency (₹ 6,60,000 + ₹ 40,000 – ₹ 2,00,000 i.e. ₹ 5,00,000) would have to be shared equally by Y and X's estate.

However, if the agreement provided that on dissolution surplus assets would be divided between the partners according to their respective interests in the capital, then the assets would be divided between the partners in proportion to their capital with the result that X's estate would be the main loser.

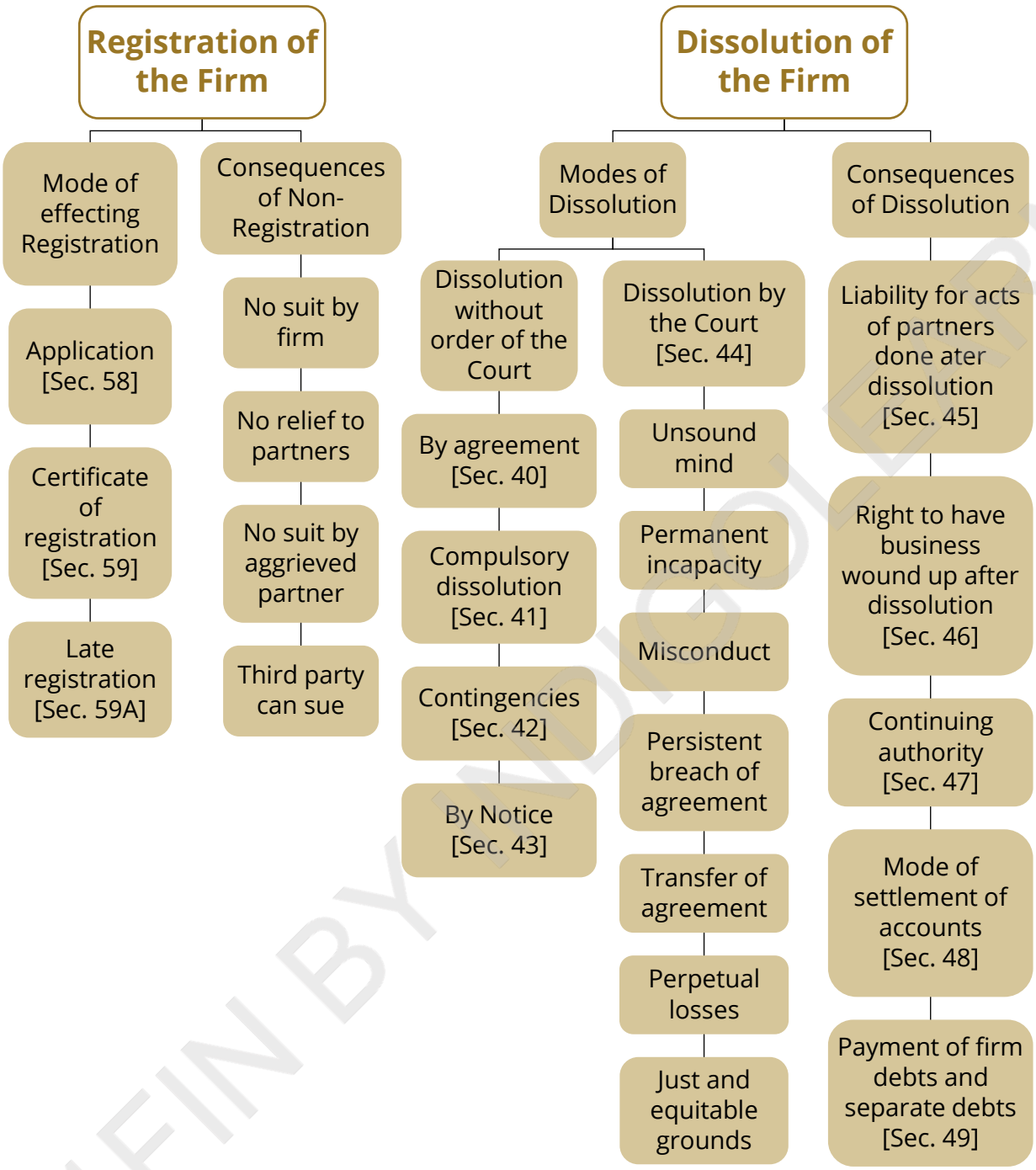
4.5 Payment of firm debts and of separate debts [Section 49]

Where there are joint debts due from the firm and also separate debts due from any partner, it shall be settled in the following manner –



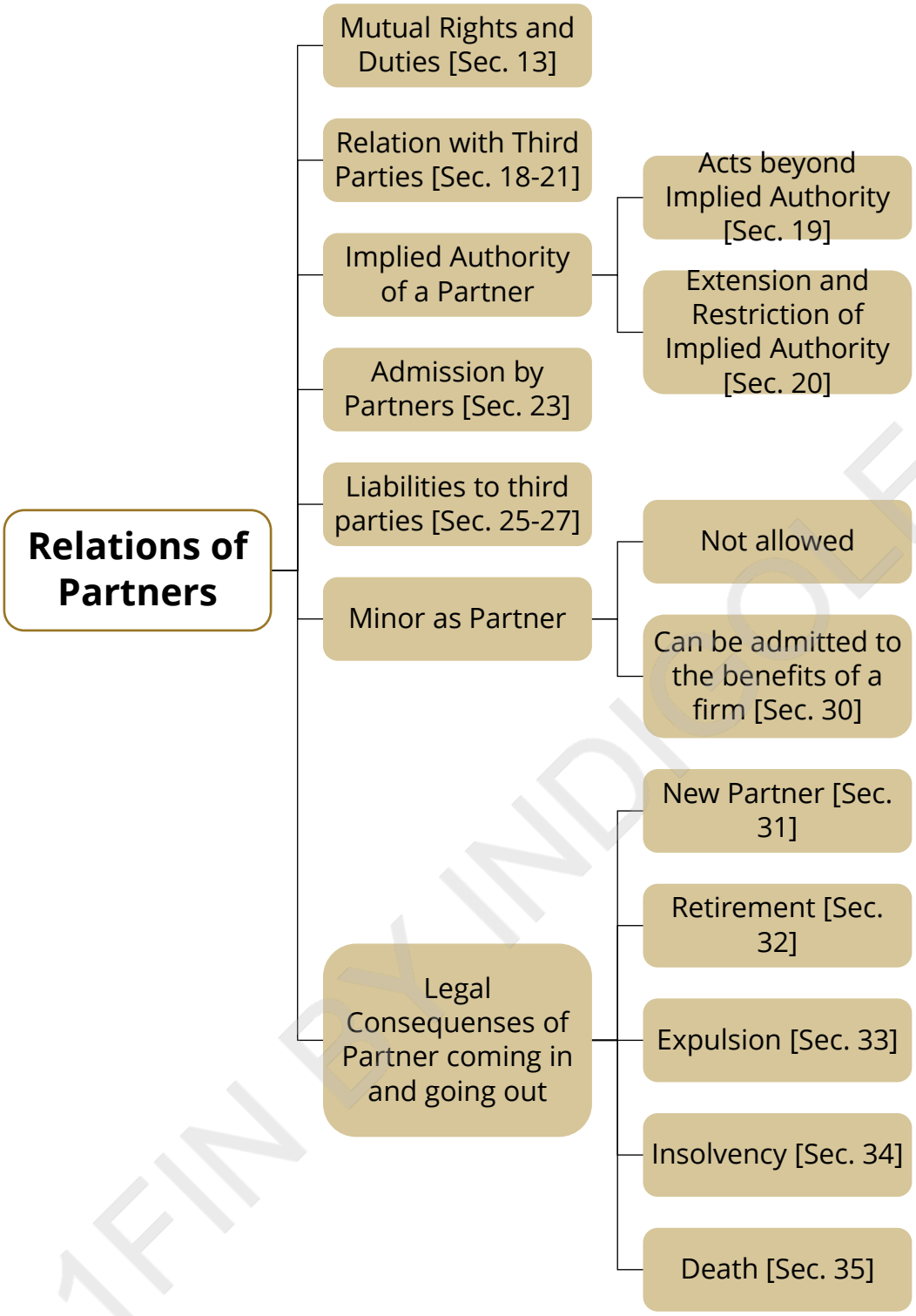
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5. Overview



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6. Overview



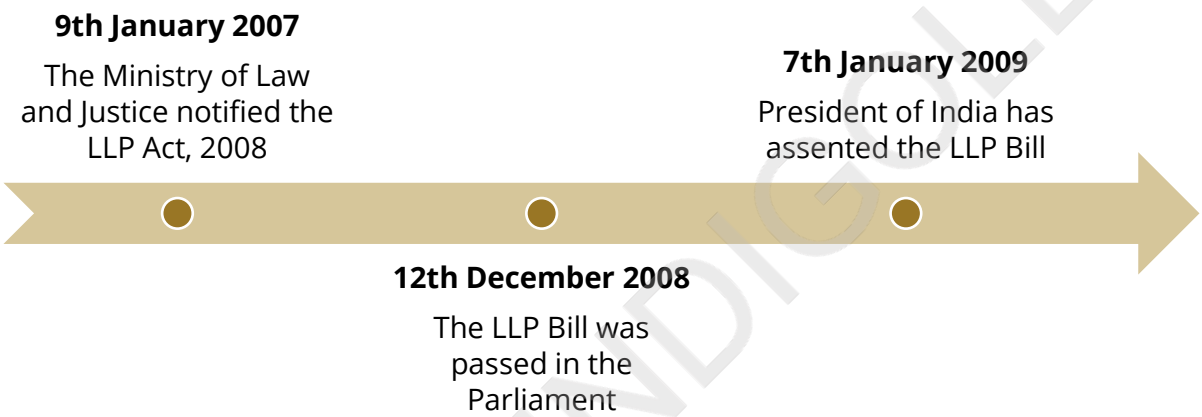
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CH-4 – THE LIMITED LIABILITY PARTNERSHIP ACT, 2008

Learning Outcomes –

- Meaning and characteristics of Limited Liability Partnership
- Incorporation of LLP
- Partners and their relations
- Financial Disclosures
- Conversion into LLP
- Winding up and Dissolution of LLP
- Difference with other forms of organisations

1. Introduction



- **The Limited Liability Partnership Act, 2008 is applicable to the whole of India.**
- The LLP Act, 2008 has **81 sections and 4 schedules.**

First Schedule	Mutual rights and duties of partners, as well limited liability partnership and its partners where there is absence of a formal agreement with respect to them.
Second Schedule	Conversion of a firm into LLP.
Third Schedule	Conversion of a private company into LLP.
Fourth Schedule	Conversion of unlisted public company into LLP.

- The **Ministry of Corporate Affairs and the Registrar of Companies (ROC)** are entrusted with the task of **administrating the LLP Act, 2008.**
- The **Central Government** has the authority to **frame the Rules** with regard to the LLP Act, 2008, and can **amend** them by notifications in the Official Gazette, from time to time.

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The Indian Partnership Act, 1932 is not applicable to LLPs [Section 4]

- **Need for new form of Limited Liability Partnership**

  In order to meet the **contemporary growth** of the Indian Economy, the lawmakers contemplated the need for bringing out the new legislation for creation of LLP.

  LLP is an alternative corporate business form that **gives the benefits of limited liability company and the flexibility of partnership.** In order to enable professional expertise and entrepreneurial initiative and combine, organize and operate in flexible, innovative and efficient manner, the LLP Act, 2008 was enacted.

  LLP as a form of business organization is an **alternative corporate business vehicle.** LLPs allow for a partnership structure where each partner's liability is limited to the amount they put in the business. Owing to **flexibility in its structure and operation**, LLP is a suitable vehicle for small enterprises and for investment by venture capital. LLPs are common in professional business like law firms, accounting firms, and wealth managers.

2. Limited Liability Partnership – Meaning and Concept

Section 2(n) of the Limited Liability Partnership Act, 2008 defines **Limited Liability Partnership** –

"Limited Liability Partnership means a partnership formed and registered under this Act".

The LLP is a separate legal entity and, while the **LLP itself will be liable for the full extent of its assets**, the liability of the partners will be limited.

Since LLP contains elements of both 'a corporate structure' as well as 'a partnership firm structure' LLP is called a **hybrid between a company and a partnership.**

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Limited Liability Partnership				
New form of legal business entity with limited liability	Alternative corporate business vehicle	Allows the partners flexibility of organising their internal structure	LLP itself will be liable for the full extent of its assets	Liability of partners will be limited

Small Limited Liability Partnership – Section 2(1)(ta)

It means a limited liability partnership –

(i) Contribution of which does not exceed ₹ **25 lakh** or such higher amount, not exceeding ₹ **5 crore**, as may be prescribed; and

(ii) Turnover of which as per Statement of Accounts and Solvency for immediately preceding financial year, does not exceed ₹ **40 lakh** or such higher amount, not exceeding ₹ **50 crore**, as may be prescribed; or

(iii) Which meets other requirements as may be prescribed, and fulfils such terms and conditions as may be prescribed.

2.1 Partners [Section 5]

Section 2(1)(q) of the LLP Act, 2008 defines **Partner –**

"Partner, in relation to a LLP, means **any person who becomes a partner in the LLP in accordance with the LLP agreement**".

- Any **individual or body corporate may be a partner** in a LLP.
- However, an individual shall **not be capable of becoming a partner** of a LLP, if –
  a) he has been found to be of **unsound mind** by a Court of competent jurisdiction and the finding is in force,
  b) he is an **undischarged insolvent**, or
  c) he has **applied to be adjudicated as an insolvent** and his application is pending.

2.2 Minimum number of partners [Section 6]

- Every LLP shall have **at least 2 partners**.
- **Person carrying on business with less than 2 partners** –

  If at any time the number of partners of a LLP is reduced below 2 and the **LLP carries on business for more than 6 months while the number is so reduced**, the person, who is the **only partner of the LLP** during such time and has the knowledge of the fact that it is carrying

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on business with him alone, **shall be liable personally for the obligations of the LLP incurred during that period.**

Section 2(1)(e) of the Limited Liability Partnership Act, 2008 defines **business-** "Business" includes every trade, profession, service and occupation except any activity which the Central Government may, by notification, exclude.

2.3 Designated partners [Section 7]

Section 2(1)(j) of the Limited Liability Partnership Act, 2008 defines **Designated Partner–**

Any partner designated as such pursuant to section 7.

- Every LLP shall have **at least 2 designated partners** who are **individuals** and **at least one of them shall be a resident in India. [Section 7(1)]**
- If in LLP, all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, **at least 2 individuals who are partners of such LLP or nominees of such bodies corporate shall act as designated partners.**
- **Resident in India** – A person who has stayed in India for a period of not less than 120 days during the financial year.

  Example: There is an LLP by the name Indian Helicopters LLP having 5 partners namely Mr. A (Non-resident), Mr. B (Non-resident), Ms. C (resident), Ms. D (resident) and Ms. E (resident).

  In this case, at least 2 should be named as Designated Partner out of which 1 should be resident. Hence, if Mr. A and Mr. B are designated then it will not serve the purpose. One of the designated partners should be there out of Ms. C, Ms. D and Ms. E.

- Subject to the provisions of Sub-section(1),
  - **If the incorporation document**,
    - Specifies who are to be designated partners, such persons shall be designated partners on incorporation; or
    - States that each of the partners from time to time of LLP is to be designated partner, every partner shall be a designated partner.
  - Any partner may become a designated partner by and in accordance with the **LLP Agreement** and a partner may cease to be a designated partner in accordance with LLP agreement.

- An individual shall not become a designated partner in any limited liability partnership unless he has given his **prior consent** to act as such to the limited liability partnership in such form and manner as may be prescribed.

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- Every limited liability partnership shall file with the Registrar the **particulars of every individual who has given his consent** to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.

- An individual eligible to be a designated partner shall **satisfy such conditions** and requirements as may be prescribed.

- Every designated partner of a limited liability partnership shall obtain a **Designated Partners Identification Number (DPIN)** from the Central Government and the provisions of sections 153 to 159 (both inclusive) of the Companies Act, 2013 shall apply mutatis mutandis for the said purpose.

2.4 Characteristic of LLP

2.4.1 LLP is a body corporate

Section 3 of LLP Act provides that a LLP is a **body corporate** formed and incorporated under this Act and is a legal entity separate from that of its partners.

Section 2(1)(d) of the LLP Act states that **Body Corporate means –**

"**A company** as defined in clause (20) of Section 2 of the Companies Act, 2013 and **includes** –

i) a LLP registered under this Act,
ii) a LLP incorporated outside India, and
iii) a company incorporated outside India,

but **does not include** –

i) a corporation sole,
ii) a co-operative society registered under any law for the time being in force, and
iii) any other body corporate (not being a company as defined in Section 2(20) of the Companies Act, 2013 or LLP as defined in this Act) which the Central Government may, by notification in the Official Gazette, specify in this behalf ".

2.4.2 Perpetual Succession

The LLP can continue its existence irrespective of changes in partners. Death, insanity, retirement or insolvency of partners has no impact on the existence of LLP.

2.4.3 Separate Legal Entity

The LLP as a separate legal entity, **is liable to the full extent of its assets but liability of the partners is limited** to their agreed contribution in the LLP. Creditors of LLP shall be the creditors of LLP alone.

2.4.4 Mutual Agency

Partners act as agents of the LLP but not of the other partners. **No partner is liable on account of the independent or un-authorized actions of other partners**. Thus, all

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partners will be the agents of the LLP alone. No one partner can bind the other partner by his acts.

2.4.5 LLP Agreement

- **Mutual rights and duties** of the partners within a LLP are governed by an agreement between the partners.
- In the **absence of any such agreement**, the mutual rights and duties shall be **governed by the provisions of the LLP Act, 2008.**

Section 2(1)(o) of the Limited Liability Partnership Act, 2008 defines **Limited Liability partnership agreement** as –

"Any **written agreement** between the partners of the LLP or between the LLP and its partners which **determines the mutual rights and duties** of the partners and their rights and duties in relation to that LLP".

2.4.6 Artificial Legal Person

- A LLP is an artificial legal person because it is **created by a legal process** and is **clothed with all rights of an individual.**
- It can do everything which any natural person can do, except of course that, it cannot be sent to jail, cannot take an oath, cannot marry or get divorce nor can it practice a learned profession like CA or Medicine.
- A LLP is invisible, intangible, immortal (can be dissolved by law alone) but **not fictitious** because it really exists.

2.4.7 Common Seal

- **The LLP may have a common seal if it decides to have one [Section 14(c)].** Thus, it is not mandatory for a LLP to have a common seal.
- It shall remain under the custody of some responsible official and it shall be **affixed in the presence of at least 2 designated partners** of the LLP.

2.4.8 Limited Liability

Liability of the partners will be limited to their agreed contribution in LLP. Such contribution may be of tangible or intangible nature or both.

This feature has encouraged professionals like Engineering consultants, Legal Advisors and Accounting Professionals to enter into business through LLP.

2.4.9 Management of Business

The partners in the LLP are entitled to manage the business of LLP. But **only the designated partners are responsible for legal compliances.**

2.4.10 Minimum and Maximum number of Partners

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- Every LLP shall have **at least 2 partners** and shall also have **at least 2 individuals as designated partners**, of whom at least one shall be resident in India.
- There is **no maximum limit** on the partners in LLP.

2.4.11 Business for Profit Only

The essential requirement for forming LLP is carrying on a lawful business with a view to earn profit. Thus, **LLP cannot be formed for charitable or non-economic purpose.**

2.4.12 Investigation

The **Central Government** shall have powers to investigate the affairs of an LLP by appointment of competence authority for the purpose.

2.4.13 Compromise or Arrangement

Any compromise or agreements including merger and amalgamation of LLPs shall be **in accordance with the provisions of the LLP Act, 2008**.

2.4.14 Conversion into LLP

A firm, private company, or an unlisted public company are allowed to be converted into LLP in accordance with the provisions of LLP Act, 2008.

2.4.15 E-Filling of Documents

Every form or application of document required to be filed or delivered under the act and rules made thereunder, shall be filed in computer readable electronic form on its **website www.mca.gov.in** and **authenticated by a partner or designated partner** of LLP by the use of electronic or digital signature.

2.4.16 Foreign LLPs

As per section 2(1)(m), "foreign limited liability partnership" means –

a limited liability partnership **formed**, incorporated, or registered **outside India** which establishes a **place of business within India**.

- **Foreign LLP can become a partner in an Indian LLP.**

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Characteristics of LLP



2.5 Advantages of LLP form



3. Incorporation of LLP

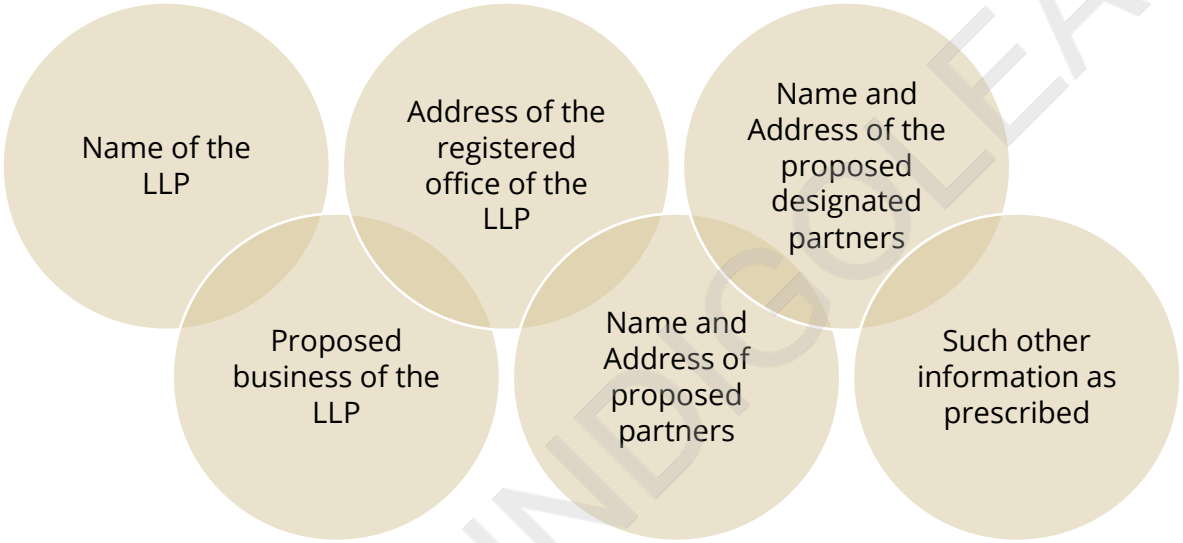
3.1 Incorporation document [Section 11]

1. For a LLP to be incorporated **two or more persons associated** for carrying on a **lawful business** with a view to **earn profit** shall **subscribe their names to an incorporation document. [Sub-section 1(a)]**
2. It shall be **filed** in such manner and with such fees, as may be prescribed **with the Registrar of the State in which the registered office of the LLP is to be situated. [Sub-section 1(b)]**
3. **Statement to be filed –**

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- Along with the incorporation document a statement in the prescribed form shall be filed **that all the requirements of this Act and the rules made thereunder have been complied with in respect of incorporation** and matters precedent and incidental thereto.
- The statement shall be **made by –**
    - Either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the LLP and
    - By anyone who subscribed his name to the incorporation document. **[Sub-section 1(c)]**

4. The incorporation document shall be **in a form as may be prescribed.**
5. **Contents of the Incorporation Document –**



6. **Penalty for false statement –**

   If a person makes a statement which he knows to be false or does not believe to be true, shall be punishable with –

   - **Imprisonment** for a term which **may extend to 2 years** and
   - **Fine** which shall **not be less than ₹ 10,000** but which **may extend to ₹ 5 lakhs.**

3.2 Incorporation by registration [Section 12]

- Where the Incorporation Document has been filed and complies with the requirements of Section 11 the **Registrar shall** retain the incorporation document and, he shall, **within a period of 14 days** –

  a) **Register the incorporation document**; and

  b) Give a **certificate,** signed by the Registrar and authenticated by his seal, that the LLP is incorporated by the name specified therein.

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- The Registrar may accept the **statement delivered u/s 11(1)(c)** as **sufficient evidence** that the requirement imposed by clause (a) of that sub-section has been complied with.
- The **certificate shall be conclusive evidence** that the LLP is incorporated by the name specified therein.

3.3 Registered office of LLP and change therein [Section 13]

1. Every LLP shall have a **registered office** to which **all communications and notices may be addressed** and where they shall be received.
2. **Serving documents on LLP or its partner or designated partner** – A document may be served on a LLP or a partner or designated partner thereof –
    - **by sending it by post under a certificate of posting or by registered post** or by any other manner, as may be prescribed,
    - **at the registered office** and any other address specifically declared by the LLP for the purpose in such form and manner as may be prescribed.
3. **Change of Registered Office –** A LLP may change the place of its registered office and **file the notice of such change with the Registrar** in such form and manner and subject to such conditions as may be prescribed and any such **change shall take effect only upon such filing**.
4. **Punishment for contravention** – If the LLP contravenes any provisions of this section, **the LLP and its every partner** shall be liable to a penalty of **₹ 500 per day** during which the default continues, subject to maximum of **₹ 50,000.**

3.4 Effect of registration [Section 14]

On registration the LLP shall, by its name, be capable of -

Suing and being sued	Acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible	Having a common seal, if it decides to have one	Doing and suffering such acts and things as bodies corporate may lawfully do and suffer

3.5 Name [Section 15]

- Every LLP shall have either the **words "Limited Liability Partnership" or the acronym "LLP"** as the **last words of its name.**
- **No LLP shall be registered by a name which**, in the opinion of the Central Government is—
    - ✓ **Undesirable**, or

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- ✓ **Identical** or too nearly resembles to that of any other LLP or company or a registered trademark of any other person under the Trade Marks Act, 1999.

3.6 Reservation of name [Section 16]

- A person may **apply in such form (e-Form 1)** and manner and accompanied by such fee as may be prescribed **to the Registrar** for the reservation of a name set out in the application as –

  a) The name of a proposed LLP; or

  b) The name to which a LLP proposes to change its name.

- Upon receipt of an application and on payment of the prescribed fee, the **Registrar** may, if he is **satisfied that the name to be reserved is not one which may be rejected** on any ground referred to in section 15, **reserve the name for a period of 3 months** from the date of intimation by the Registrar.

3.7 Change of name of LLP [Section 17]

- If through inadvertence or otherwise, a LLP on its first registration or on its registration by a new body corporate, is registered by a name–

  Identical with or too nearly resembles

  ➔ name of any other LLP or company, or
  ➔ a registered trade mark of a proprietor under the Trade Marks Act, 1999, as is likely to be mistaken for it,

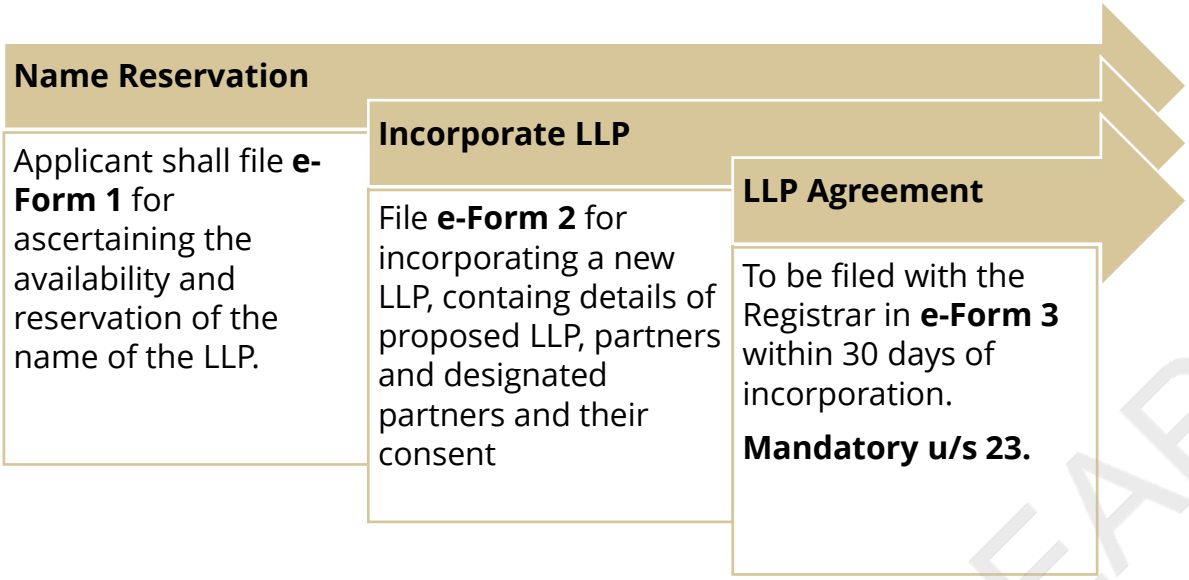
then on an application of such LLP or proprietor or a company,

the Central Government (CG) may direct such LLP to change its name.

- The LLP shall **comply** with such direction **within 3 months from the date of issue of such direction**.
- An application of the proprietor of the registered trade mark shall be maintainable within a period of 3 years from the date of incorporation or registration or change of name of the LLP under this Act.
- Where LLP changes its name or obtains a new name, it shall within a period of **15 days** from the date of such change, give **notice of the change to Registrar** along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and within **30 days** of such change in the **certificate of incorporation**, such LLP shall change its name in the LLP agreement.
- If the LLP defaults in complying with direction of the CG, the **CG shall allot a new name to the LLP** in such manner as may be prescribed and Registrar shall enter the new name in the register of LLP and issue a fresh Certificate of Incorporation.
- The LLP can subsequently change its name in accordance with the provisions of Section 16.

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3.8 Steps to incorporate LLP

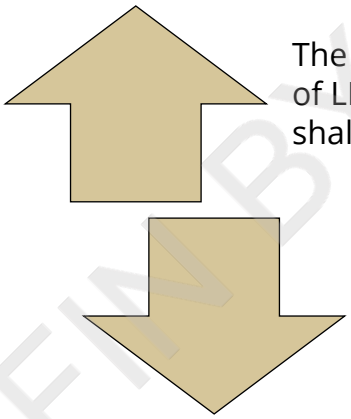


4. Partners and their Relations

4.1 Eligibility to be partners [Section 22]

- **On the incorporation** of a LLP, the **persons who subscribed their names** to the incorporation document **shall be its partners**.
- **Any other person may become a partner** of the LLP by and in accordance with the **LLP agreement.**

4.2 Relationship of partners [Section 23]



The mutual rights and duties of partners of LLP and that of LLP and its partners shall be governed by the LLP Agreement.

In the absence of agreement as to any matter, such mutual rights and duties shall be determined according to the provisions of the First Schedule.

- The **LLP agreement and any changes**, if any, made therein shall be **filed with the Registrar** in such form, manner and accompanied by such fees as may be prescribed.
- **An agreement in writing** made before the incorporation of a LLP between the persons who subscribe their names to the incorporation document **may impose obligations on the LLP**. However, such agreement **should be ratified by all the partners after the incorporation of the LLP.**

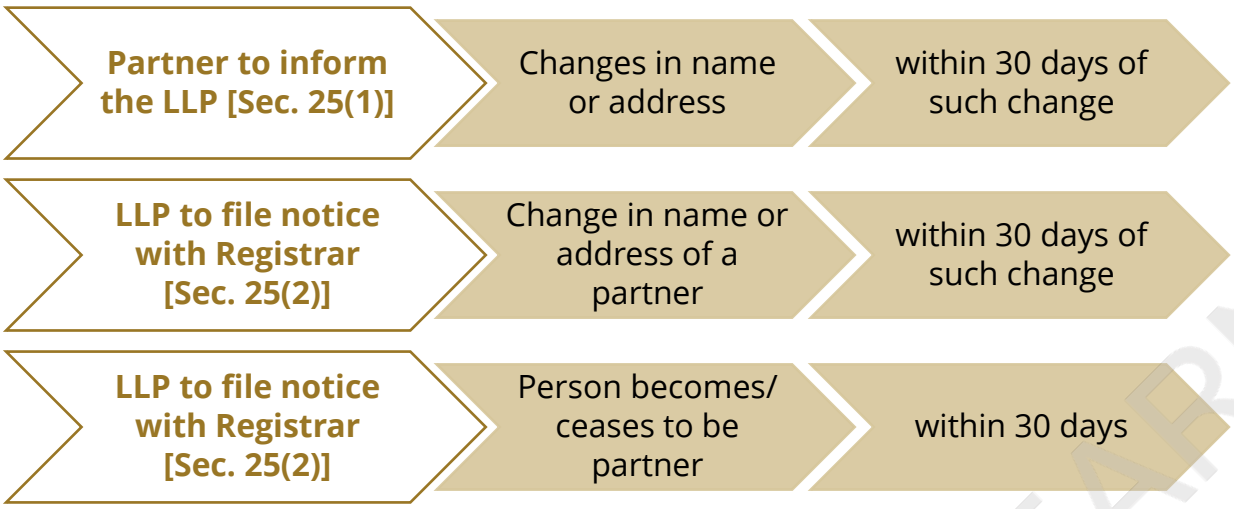
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4.3 Cessation of partnership interest [Section 24]

1. A person may cease to be a partner of a LLP –
   - **In accordance with an agreement** with the other partners **or**,
   - **In the absence of agreement** with the other partners as to cessation of being a partner, **by giving a notice in writing of not less than 30 days** to the other partners of his intention to resign as partner.
2. A person shall **cease to be a partner** of a LLP –
   a. **On his death or dissolution** of the LLP; or
   b. If he is declared to be of **unsound mind** by a competent court; or
   c. If he has applied to be adjudged as an **insolvent** or declared as an insolvent.
3. Where a person has ceased to be a partner of a LLP such partner (to be called 'former partner') shall be **regarded by a person dealing with the LLP as still being a partner of the LLP unless –**
   - ✓ The **person has notice** that the former partner has ceased to be a partner of the LLP; or
   - ✓ **Notice** that the former partner has ceased to be a partner of the LLP has been **delivered to the Registrar.**
4. **Rights and liabilities of former partner –**
   - The cessation of a partner from the LLP **does not by itself discharge the partner from any obligation** to the LLP or to the other partners or to any other person which he **incurred while being a partner.**
   - The former partner or a person entitled to his share in consequence of the death or insolvency of the former partner, shall be **entitled to receive from the LLP –**
     - ✓ An amount equal to the **capital contribution** of the former partner actually made to the LLP; and
     - ✓ **His right to share in the accumulated profits** of the LLP, after the deduction of accumulated losses, **determined as at the date the former partner ceased to be a partner.**
   - A former partner or a person entitled to his share in consequence of the death or insolvency of the former partner shall **not have any right to interfere in the management of the LLP.**

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4.4 Registration of changes in partners [Section 25]



- A notice filed with the Registrar –
    - Shall be **in such form and accompanied by such fees** as may be prescribed,
    - Shall be **signed by the designated partner** of the LLP and authenticated in a manner as may be prescribed, and
    - If it relates to an **incoming partner**, shall **contain a statement by such partner that he consents to becoming a partner**, signed by him and authenticated in the manner as may be prescribed.
- **Punishment for contravention –**

	Penalty
Contravention of Sec 25(2) – LLP & Designated Partner	₹ 10,000
Contravention of Sec 25(1) – Partner	₹ 10,000

- Any **person who ceases to be a partner of a LLP may himself file the notice with the Registrar** –
    - If he has **reasonable cause to believe that the LLP may not file the notice with the Registrar** and
    - In case of any such notice filed by a partner, the **Registrar shall obtain a confirmation to this effect from the LLP** unless the LLP has also filed such notice.

      However, where **no confirmation is given by the LLP within 15 days**, the **registrar shall register the notice made by a person ceasing to be a partner** under this section.

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5. Extent and Limitation of Liability of LLP and Partner

5.1 Partner as agent [Section 26]

Every partner of a LLP is, for the purpose of the business of the LLP, the **agent of the LLP, but not of other partners.**

5.2 Extent of liability of LLP [Section 27]

LLP is not bound by anything done by a partner in dealing with a person if -

- Partner is acting without authority
- The person knows that he has no authority or does not know or believe him to be a partner [Sub-section (1)]

LLP is liable if a partner is liable to any person -

- As a result of wrongful act or omission in the course of business, or
- Acting with its authority. [Sub-section (2)]

✓ An obligation of the LLP whether arising in contract or otherwise, shall be **solely the obligation of the LLP [Sub-section (3)].**

✓ The liabilities of the LLP shall be **met out of the property of the LLP. [Sub-section (4)]**

5.3 Extent of liability of partner [Section 28]

- A **partner is not personally liable**, directly or indirectly for an obligation referred to in section 27(3) solely by reason of being a partner of the LLP.
- **A partner shall be personally liable for his own wrongful act or omission, but a partner shall not be personally liable for the wrongful act or omission of any other partner of the LLP.**

5.4 Holding out [Section 29]

i) **Any person,**

- who by words spoken or written or by conduct,
- **represents himself**, or knowingly permits himself to be represented **to be a partner in a LLP**
- **is liable to any person**

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- **who has on the faith of any such representation**
- **given credit to the LLP**, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit.

ii) However, **where any credit is received by the LLP as a result of such representation, LLP shall**, without prejudice to the liability of person so representing himself or represented to be a partner, **be liable to extent of credit received by it or any financial benefit derived thereon.**

iii) Where after a partner's death the business is continued in the same LLP name, the **continued use of that name or of the deceased partner's name** as a part thereof **shall not of itself make his legal representative or his estate liable for any act of the LLP done after his death.**

5.5 Unlimited liability in case of fraud [Section 30]

- Where the LLP or any of its partners act with the intent to defraud creditors of the LLP or any other person, or for any fraudulent purpose, **the liability of the LLP and partners who acted with intent to defraud** creditors or for any fraudulent purpose shall be **unlimited** for all or any of the debts or other liabilities of the LLP.
- However, in case any such **act is carried out by a partner**, the **LLP is liable to the same extent as the partner** unless it is established by the LLP that such act was without the knowledge or the authority of the LLP.
- **Punishment –**

1. Every **person who was knowingly a party** to the carrying on of the business in the fraudulent manner or with the intention to defraud shall be **punishable with**
   - ✓ **Imprisonment** for a term which may extend to **5 years and**
   - ✓ **Fine** which shall not be less than **₹ 50,000** but which may extend **to ₹ 5 lakhs.**
2. **Apart from the criminal proceedings which may arise**, the LLP and any such partner or designated partner or employee shall be **liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct.**

   However, such LLP shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of LLP.

5.6 Whistle blowing [Section 31]

1. **Reduced Penalty –**

The Court or Tribunal may reduce or waive any penalty **leviable against any partner or employee of a LLP**, if it is satisfied that –

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- Such **partner or employee of a LLP has provided useful information** during investigation of such LLP; **or**
- When **any information given by any partner or employee** (whether or not during investigation) **leads to LLP or any partner or employee of such LLP being convicted** under this Act or any other Act.

2. Protection for partner/ employee –

No partner or employee of any LLP may be discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against the terms and conditions of his LLP or employment merely because of his providing information or causing information to be provided.

6. Financial Disclosures

6.1 Maintenance of books of account, other records and audit, etc. [Section 34]

Proper Books of Account			
LLP to maintain proper books as prescribed relating to its affairs for each year of its existence.	On cash basis or accrual basis.	According to double entry system of accounting	To be kept at the registered office for such period as prescribed.

Statement of Account and Solvency			
As at the last day of each F.Y.	To be prepared within 6 months of the end of the F.Y. in such form as prescribed.	To be signed by the designated partners of the LLP.	To be filed with the Registrar every year within prescribed time

Audit of Accounts	
To be audited in accordance with the prescribed rules.	CG may, by notification in the Official Gazette, exempt any class or classes of LLP

Failure to comply with Sec. 34	
LLP - Fine not less than ₹25,000/- but which may extend to ₹5 lakhs	Designated Partner - Fine not less than ₹10,000/- but which may extend to ₹ 1 lakh.

➔ Penalty for failure to file Statement of Solvency with the Registrar-

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LLP and Designated Partners – **₹ 100 per day** during which the default continues subject to maximum of **₹ 1,00,000 for LLP** and **₹ 50,000 for designated partners.**

➔ Fine in case of non-compliance with provisions of Sec 34(1), 34(2) and 34(4) –

LLP – Minimum Rs. 25,000 and Maximum – Rs. 5,00,000

Designated Partner – Minimum Rs. 10,000 and Maximum – Rs. 1,00,000

6.2 Accounting and auditing standards [Section 34A]

The Central Government may, in consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013,—

(a) prescribe the standards of accounting; and

(b) prescribe the standards of auditing,

as recommended by the Institute of Chartered Accountants of India constituted under section 3 of the Chartered Accountants Act, 1949, for a class or classes of limited liability partnerships.

6.3 Annual return [Section 35]

- Every LLP shall **file** an **annual return duly authenticated** with the **Registrar within 60 days of closure of its financial year** in such form and manner and accompanied by such fee as may be prescribed.
- **Punishment for failure to comply** –

The LLP contra-distinct from Partnership Act, 1932 has prescribed the filing of Annual Return in accordance with Companies Act, 2013.

	Minimum fine	Maximum Fine
LLP	₹ 100/day	₹ 1 lakh
Designated Partner	₹ 100/day	₹50,000

As per section 2(1)(l), "Financial Year" in relation to LLP means –

the period from the **1st day of April of a year to the 31st day of March** of the following year.

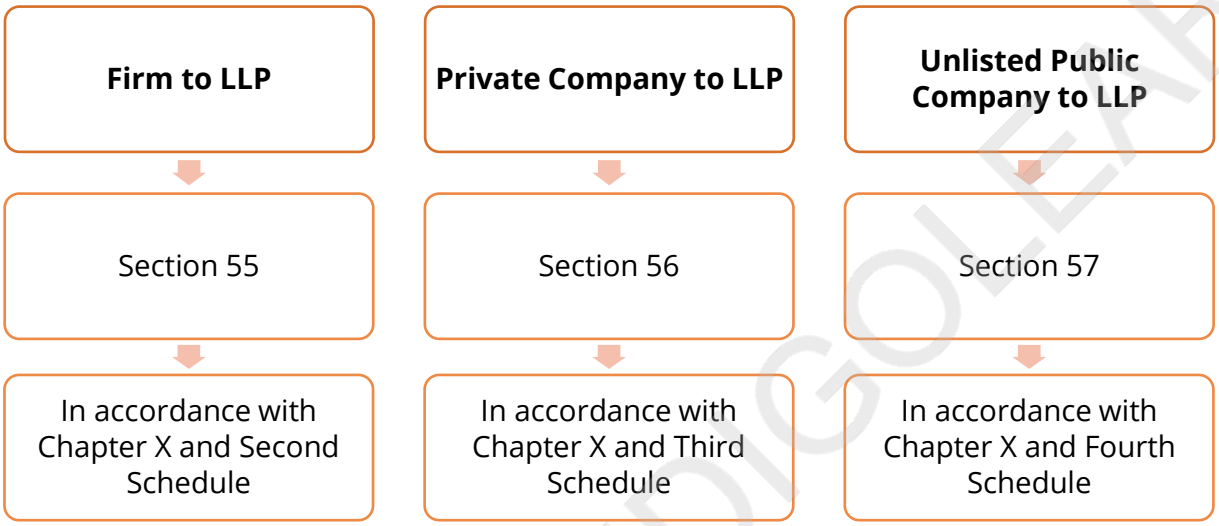
Provided that in the case of a limited liability partnership incorporated after the 30th day of September of a year, the financial year may end on the 31st day of March of the year next following that year.

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Example: If a LLP has been incorporated on 15th October, 2020, then its financial year may be from 15th October, 2020 to 31st March, 2022.

In keeping with the Income tax law, the financial year for LLP should be from 1st April to 31st March each year.

7. Conversion into LLP



1. **Certificate of Registration –**

   The **Registrar**, on satisfying that a firm, private company, or an unlisted public company, as the case may be, has complied with the provisions of the various Schedules, provisions of this Act and the rules made thereunder, **register the documents** and **issue a certificate of registration** in such form as the Registrar may determine stating that the LLP is, on and from the date specified in the certificate, registered under this Act.

2. **LLP to inform the Registrar –**

   The LLP shall, **within 15 days of the date of registration**, **inform the concerned Registrar of Firms or Registrar of Companies**, as the case may be, with which it was registered under the provisions of the Indian Partnership Act, 1932 or the Companies Act, 2013 **about the conversion** and of the particulars of the LLP in such form and manner as may be prescribed.

3. **Effects of conversion –**

   - Upon such conversion, the **partners** of the firm, the **shareholders** of private company or unlisted public company, as the case may be, the **LLP** to which such firm or such company has converted, and the **partners of the LLP** shall be **bound by the provisions of the various Schedules**, as the case may be, applicable to them.

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- On and from the date of certificate of registration, the effects of the conversion shall be such as specified in the various schedules, as the case may be.

4. **Effect of Registration –**

   i) There shall be a LLP by the name specified in the certificate of registration registered under this Act.

   ii) **All tangible and intangible property** vested in the firm or the company, **all assets, interests, rights, privileges, liabilities, obligations** relating to the firm or the company, as the case may be, **and the whole of the undertaking** of the firm or the company, as the case may be, shall be **transferred to and shall vest in the LLP** without further assurance, act or deed.

   iii) **The firm or the company**, as the case may be, shall be **deemed to be dissolved** and removed from the records of the Registrar of Firms or Registrar of Companies, as the case may be.

8. Foreign LLP [Section 59]

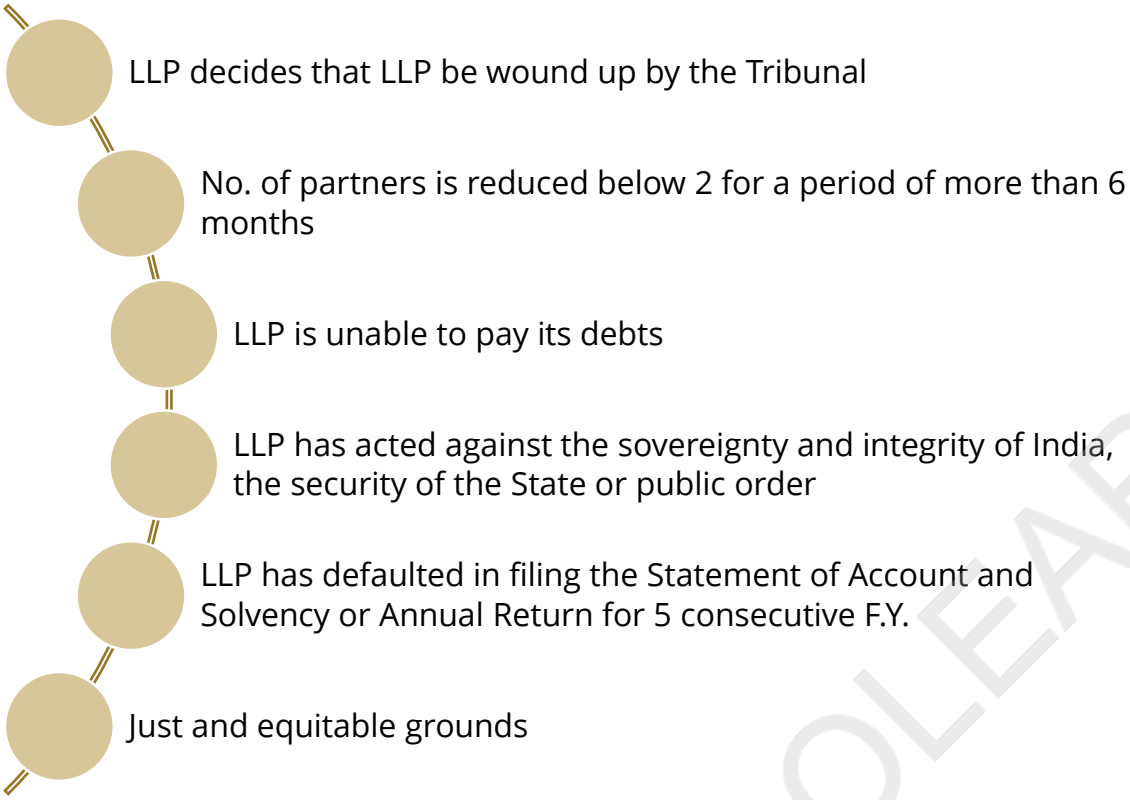
The **Central Government may make rules** for provisions in relation to –

- **Establishment of place of business** by foreign LLP within India **and**
- **Carrying on their business** therein by applying or incorporating, with such modifications, as appear appropriate, the provisions of the Companies Act, 2013 or such regulatory mechanism with such composition as may be prescribed.

9. Winding Up and Dissolution

- The winding up of a LLP may be **either voluntary or by the Tribunal** and
- LLP, so wound up may be **dissolved [Section 63].**
- **Circumstances in which LLP may be wound up by Tribunal [Section 64]**

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- The **Central Government may make rules** for the provisions in relation to winding up and dissolution of LLP [**Section 65**].

10. Miscellaneous

10.1 Business transactions of partner with LLP [Section 66]

A partner may lend money to and transact other business with the LLP and has the **same rights and obligations with respect to the loan or other transactions as a person who is not a partner.**

10.2 Application of the provisions of the Companies Act [Section 67]

- The **Central Government** may, by **notification in the Official Gazette**, direct that any of the provisions of the Companies Act, 2013specified in the notification –
  - shall apply to any LLP, or
  - shall apply to any LLP with such exception, modification and adaptation, as may be specified, in the notification.
- A **copy** of every notification proposed to be issued under sub-section (1)

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- Shall be **laid in draft before each House of Parliament**, while it is in session, **for a total period of 30 days** which may be comprised in one session or in two or more successive sessions, **and**
- **If both Houses agree in disapproving** the issue of the notification **or both Houses agree in making any modification** in the notification, **the notification shall not be issued or, as the case may be, shall be issued only in such modified form** as may be agreed upon by both the Houses.

10.3 Establishment of Special Courts **[Section 67A]**

(1) Central Government may, for the purpose of **providing speedy trial of offences** under this Act, by notification, establish or designate as many Special Courts as may be necessary for such area (s), as may be specified in notification.

(2) Special Court shall consist of—

(a) **single judge** holding office as Sessions Judge or Additional Sessions Judge, in case of offences punishable under this Act with imprisonment of 3 years or more; and

(b) **Metropolitan Magistrate or a Judicial Magistrate of the first class**, in the case of other offences, who shall be appointed by Central Government with concurrence of Chief Justice of the High Court:

➔ Provided that until Special Courts are designated or established under sub-section (1), the Courts designated as **Special Courts in terms of section 435 of Companies Act**, 2013 shall be **deemed to be Special Courts** for the purpose of trial of offences punishable under this Act

➔ Provided further that notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence committed under this Act, which is triable by a Special Court shall, until a Special Court is established under this Act or the Companies Act, 2013, be tried by a Court of Sessions or the Court of Metropolitan Magistrate or a Judicial Magistrate of the first class, as the case may be, exercising jurisdiction over the area.]

10.4 Procedure and powers of Special Court **[Section 67B]**

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, all offences specified under section 67A(1) shall be **triable only by** the Special Court established or designated for the area in which the **registered office of the LLP** is situated in relation to which the offence is committed or where there are more than one Special Courts for such area, by such one of them as may be specified in this behalf by the High Court concerned.

(2) While 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.

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(3) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, 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:

➔ Provided that in the case of any conviction in a summary trial, no sentence of imprisonment for a term exceeding 1 year shall be passed

➔ Provided further that, when at commencement of or in course of a summary trial, it appears to the Special Court that nature of the case is such that the sentence of imprisonment for a term exceeding 1 year may have to be passed or that it is, for any other reason, 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 re- hear the case in accordance with the procedure for the regular trial.

10.5 Appeal and revision **[Section 67C]**

The High Court may exercise, so far as may be applicable, **all 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 Sessions trying cases within the local limits of the jurisdiction of the High Court.

10.6 Electronic filing of documents [Section 68]

- Any document required to be filed, recorded or registered under this Act may be filed, recorded or registered in such manner and subject to such conditions as may be prescribed.
- **A copy of or an extract from any document electronically filed with or submitted to the Registrar** which is supplied or issued by the Registrar and **certified through affixing digital signature to be a true copy of or extract** from such document shall, in any proceedings, be **admissible in evidence as of equal validity with the original document**.
- Any **information supplied by the Registrar that is certified by the Registrar through affixing digital signature to be a true extract from any document filed** with or submitted to the Registrar shall, in any proceedings, be **admissible in evidence** and be presumed, unless evidence to the contrary is adduced, to be a true extract from such document.

10.7 Registration offices **[Section 68A]**

(1) For the purpose of
  - exercising such powers and
  - discharging such functions as are conferred on Central Government by or under this Act or under rules made thereunder
  - registration of LLPs under this Act,

Central Government shall, by notification, establish such number of registration offices at such places as it thinks fit, specifying their jurisdiction.

(2) Central Government may appoint such Registrars, Additional Registrars, Joint Registrars, Deputy Registrars and Assistant Registrars as it considers necessary, for the registration of LLPs and discharge of various functions under this Act.

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(3) Powers and duties of the Registrars and the terms and conditions of their service shall be such as may be prescribed.

(4) Central Government may direct Registrar to prepare a seal or seals for the authentication of documents required for, or connected with registration of LLP.

10.8 Payment of additional fee [Section 69]

If any document or return required to be filed or registered under this Act with the Registrar is **not filed or registered in time** provided therein –

- ✓ It may be filed or registered after that time on **payment of such additional fee as may be prescribed** in addition to any fee as is payable for filing of such document or return,
- ✓ Such document or return shall be filed after due date of filing, without prejudice to any other action or liability under this Act.
- ✓ A different fee or additional fee may be prescribed for different classes of LLP or for different documents or returns required to be filed under this Act or rules made thereunder.

11. Differences with other Forms of Organisation

11.1 Distinction between LLP and Partnership Firm

Basis	LLP	Partnership firm
Regulating Act	The Limited Liability Partnership Act, 2008.	The Indian Partnership Act, 1932.
Body corporate	It is a body corporate.	It is not a body corporate
Separate legal entity	It is a legal entity separate from its members.	It is a group of persons with no separate legal entity.
Creation	By a legal process called registration under the LLP Act, 2008.	By an agreement between the partners.
Registration	Registration is mandatory.	Registration is voluntary.
Perpetual succession	The death, insanity, retirement or insolvency of the partner(s) does not affect existence of LLP.	Death, insanity, retirement or insolvency of the partner(s) may affect its existence. It has no perpetual succession.
Name	Name of the LLP to contain the word limited liability partners (LLP) as suffix.	No guidelines. The partners can have any name as per their choice.
Liability	Liability of each partner limited to the extent to agreed contribution except in case of willful fraud.	Liability of each partner is unlimited. It can be extended up to the personal assets of the partners.

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Mutual agency	Each partner can bind the LLP by his own acts but not the other partners.	Each partner can bind the firm as well as other partners by his own acts.
Designated partners	At least 2 designated partners and at least one of them shall be resident in India.	There is no provision for such partners under the Partnership Act, 1932.
Common seal	It may have its common seal as its official signatures.	There is no such concept in partnership
Legal compliances	Only designated partners are responsible for all the compliances and penalties under this Act.	All partners are responsible for all the compliances and penalties under the Act.
Annual filing of documents	LLP is required to file: i) Annual statement of accounts ii) Statement of solvency iii) Annual return every year.	Partnership firm is not required to file any annual document with the registrar of firms.
Foreign partnership	Foreign nationals can become a partner in a LLP.	Foreign nationals cannot become a partner in a partnership firm.
Minor as partner	Minor cannot be admitted to the benefits of LLP.	Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners.

11.2 Distinction between LLP and Limited Liability Company

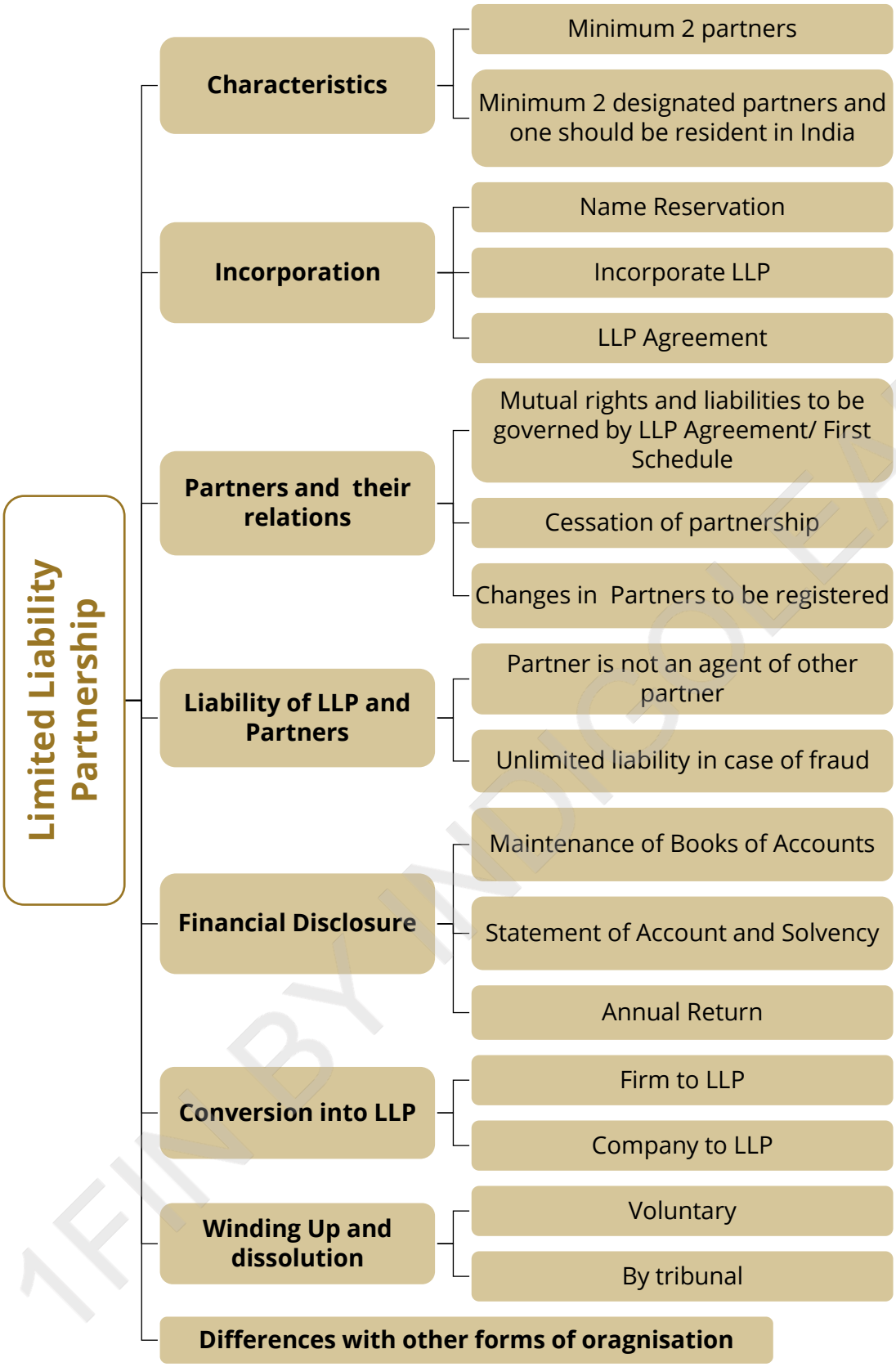
Basis	LLP	Limited Liability Company
Regulating Act	The Limited Liability Partnership Act, 2008.	The Companies Act, 2013.
Members/ Partners	The persons who contribute to LLP are known as partners of the LLP.	The persons who invest the money in the shares are known as members of the company.
Internal governance structure	Governed by contract agreement between the partners.	Regulated by statute (i.e., Companies Act, 2013).
Name	To contain word "Limited Liability partnership" or "LLP" as suffix.	To contain word "limited" and Pvt. Co. to contain the word "Private limited" as suffix.
No. of members/ partners	Minimum – 2 members Maximum – No such limit on the members in the Act.	• Private company: Minimum – 2 members Maximum 200 members • Public company:

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		Minimum – 7 members Maximum – No such limit on the members. • OPC – One member
Members	Members of the LLP can be individuals/or body corporate through the nominees.	Members can be organizations, trusts, another business form or individuals.
Liability of members/ partners	Limited to the extent of agreed contribution in except in case intention is fraud.	Limited to the amount unpaid on the shares held by them.
Management	Managed by the partners including the designated partners authorized in the agreement.	Managed by the partners including the designated partners authorized in the agreement.
Minimum number of directors/ designated partners	Minimum 2 designated partners.	Pvt. Co. – 2 directors Public co. – 3 directors

12. Overview

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CH-5 – THE COMPANIES ACT, 2013

Learning Outcomes –

- Company as a form of business organisation
- Corporate Veil Theory
- Classes of Companies
- Incorporation of Companies
- Classification of Capital and Shares
- Memorandum of Association and Articles of Association
- Doctrine of Ultra Vires and Indoor Management

1. Introduction

- The Companies Act, 2013 was enacted to consolidate and amend the law relating to the companies.
- The Companies Act, 2013 was preceded by the Companies Act, 1956.
- The Companies Act, 2013 contains **470 sections** and **7 schedules**. The entire Act has been divided into **29 chapters**.
- A substantial part of this Act is in the form of **Companies Rules.**
- The Companies Act, 2013 **aims** to improve corporate governance, simplify regulations, strengthen the interests of minority investors and for the first time legislates the role of whistle-blowers and provisions relating to class action suit.
- Applicability of the Companies Act, 2013 (Section 1) –

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- Companies incorporated under this Act or any previous Company law.
- Insurance Companies
  - Except where the Act is inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999
- Banking Companies
  - Except where the Act is inconsistent with the provisions of the Banking Regulation Act, 1949
- Companies engaged in the generation or supply of Electricity
  - Except where the Act is inconsistent with the provisions of the Electricity Act, 2003
- Any other companies governed by any Special Act for the time being in force
- Such body corporate which are incorporated by any Act for time being in force, and as the Central Government may by notification specify in this behalf.

2. Company: Meaning and its Features

2.1 Meaning of the term 'Company'

Section 2(20) of the Companies Act, 2013 defines **Company** as –

"Company means a company incorporated under this Act or under any previous company law".

In the words of **Professor Haney** "A company is an **incorporated association**, which is an **artificial person** created by law, having a **separate entity**, with a **perpetual succession** and a **common seal**."

2.2 Features of a Company

2.2.1 Separate Legal Entity

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- When a company is registered, it acquires a separate legal status. Its existence is **distinct and separate from that of its members**. Although the capital and assets are contributed by the shareholders, the company becomes the owner of its capital and assets.

Case Law: Lee V. Lee's Air Farming Co. Ltd

Facts: Mr. Lee incorporated a company Lee's Air Farming Co. Ltd. He was the Managing Director and employed as Chief Pilot of the company. One day while performing his duty as a chief pilot, he loses his life in an air crash. Mrs. Lee approaches the company to claim compensation for her husband's death under The Workmen's Compensation Act, 1922. She was denied the compensation stating that Lee cannot be both employer and employee at the same time.

Judgement: Mrs. Lee's claim was allowed stating that though Mr. Lee was the controller of the company, in the eyes of law both Lee and the company are different and therefore Mrs. Lee is entitled to receive compensation.

Note: Above case law is not mentioned in ICAI study material. It is given here for better understanding.

- **A company can own property, have bank account, raise loans, incur liabilities, and enter into contracts**.
- Even members can contract with company, acquire right against it, or incur liability to it.
- A member does not even have an insurable interest in the property of the company.

Case Law: Macaura v. Northern Assurance Co. Limited (1925)

Facts: Macaura (M) was the holder of nearly all (except one) shares of a timber company. He was also a major creditor of the company. M insured the company's timber in his own name. The timber was lost in a fire. M claimed insurance compensation.

Judgement: The Court held that the insurance company was not liable to him as no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest in them.

2.2.2 Perpetual Succession

- Members may die or change, but the company goes on till it is wound up on the grounds specified by the Act. The shareholders keep changing but that does not affect the existence of the company.
- **The existence of a company is not affected by the death or insolvency of its members.**

Example : Many companies in India are in existence for over 100 years. This is possible only due to the fact that the company has perpetual existence.

2.2.3 Limited Liability

The liability of a member depends upon the kind of company of which he is a member.

- **In case of a limited liability company** – The liability of the members of the company is limited to the extent of the nominal value of shares held by them.

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- **In case of a company limited by guarantee** – Members are liable only to the extent of the amount guaranteed by them and that too only when the company goes into liquidation.
- **In case of an unlimited company** – Liability of its members is unlimited.

2.2.4 Artificial Legal Person

- A company is an **artificial** person as it is **created by a process** other than natural birth.
- A company is **legal** or judicial as it is **created by law**.
- A company is a **person** since it is **clothed with all the rights of an individual.**
- **Further, a company is a separate legal entity.** It can do everything which any natural person can do except be sent to jail, take an oath, marry, or practice a learned profession.
- As the company is an artificial person, it can act only through some **human agency**, **(i.e.) directors**. The directors can act as a company's agency but are **not the agents of the members** of the company. They can either on their own or through a common seal authenticate the formal acts of the company.

2.2.5 Common Seal

- Common seal is the **official signature of a company**, which is affixed by the officers and employees of the company on its every document.
- The common seal is a seal used by a corporation as the **symbol of its incorporation.**
- **However, the Companies Amendment Act, 2015 has made the common seal optional.**
- **In case a company does not have a common seal**, the authorization shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary

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Separate Legal Entity

- Distinct and separate from its members

Perpetual Succession

- Not affected by the death or insolvency of its members

Limited Liability

- Liability of Company is different from that of its members

Artificial Legal Person

- Act through human agency but has its own separate legal entity

Common Seal

- Official signature of a company affixed on every document (optional)

3. Corporate Veil Theory

3.1 Corporate Veil

'**Corporate Veil**' is a legal concept which separates the identity of the company from its members. **Members of a company are shielded from liability connected to the company's actions**. If the company incurs any debts or contravenes any laws, the corporate veil concept implies that members should not be liable for those errors. **Thus, the shareholders are protected from the acts of the company.**

Salomon Vs. Salomon and Co Ltd. laid down the foundation of the concept of corporate veil or independent corporate personality.

Case Law: Salomon Vs. Salomon and Co Ltd.

Facts: Salomon incorporated a company named 'Salomon & Co. Ltd., with seven subscribers consisting of himself, his wife, four sons and one daughter. This company took over the personal business assets of Salomon for £38,782 and in turn, Salomon took 20,000 shares of £1 each, debentures worth £10,000 of the company with charge on the company's assets and the balance in cash. His wife, daughter and four sons took up one £1 share each. Subsequently, the company went into liquidation due to general trade depression. The unsecured creditors to the tune of £7,000 contended that Salomon could not be treated as a secured creditor of the company, in respect of the debentures held by him, as he was the managing director of one-man company, which was not different from Salomon and the cloak of the company was a mere sham and fraud.

Judgement: It was held that upon incorporation; a company gets legality of its own and manage it. Even though the hands receiving the profits may be the same and the same person manage the company. The company in the eyes of law is not an agent of the people who own it or manage it therefore Salomon & Co. are separate person. Hence, Salomon being a secured debenture holder is entitled to a repayment prior to other creditors.

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3.2 Lifting of Corporate Veil

Lifting the Veil means **looking behind the company as a legal person**, i.e., disregarding the corporate entity and paying regard, instead, to the realities behind the legal facade.

Where the Courts **ignore the company** and **concern themselves directly with the members or managers**, the corporate veil may be said to have been lifted.

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

3.2.1 To determine the character of the company (enemy or friend)

A company does not have mind or conscience; therefore it cannot be a friend or a foe. It **may be characterized as an enemy company if its affairs are under control of people of an enemy country**. For this purpose, the court may determine the character of persons who are in charge of the affairs of the company.

Case Law: Daimler Co. Ltd. vs. Continental Tyre & Rubber Co.

Facts: A company was formed in England (Continental Tyre & Rubber Co.) for the purpose of selling tyres made by a German Company. The German Company held the entire share capital of the English Company and majority directors of the company were German residents. During the First World War, the English Company commenced an action to recover trade debt from other English Company (Daimler Co. Ltd.). To which the other company refused to pay the amount.

Judgement: It was held that the corporate personality of the company be ignored and persons in ultimate control of the company shall be considered and in this situation the persons controlling the company i.e., Continental Tyre & Rubber Co. were enemies and hence the amount is not payable.

3.2.2 To protect revenue/tax

Where **corporate entity is used to evade or circumvent tax**, the Court can disregard the corporate entity.

Case Law: Dinshaw Maneckjee Petit

Facts: The assessee earned huge income by way of dividends and interest. So, he opened some companies and purchased their shares in exchange of his income by way of dividend and interest. This income was transferred back to assessee by way of loan.

Judgement: It was held that the company was not a genuine company at all
but merely the assessee himself disguised under the legal entity of a limited company. Court decided that the private companies were a sham and the corporate veil was lifted to decide the real owner of the income.

Other Case Laws : ***Juggilal vs. Commissioner of Income Tax, S. Berendsen Ltd. vs. Commissioner of Inland Revenue***

**Assessee is a person liable to tax,*

3.2.3 To avoid a legal obligation

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Where the courts find that there is **avoidance of welfare legislation**, it will be free to lift the corporate veil.

Case Law: Workmen of Associated Rubber Industry ltd., v. Associated Rubber Industry Ltd.

Facts: 'A Limited' purchased shares of 'B Limited by investing a sum of ₹4,50,000. The dividend in respect of these shares was shown in the profit and loss account of the company, year after year. It was considered for the purpose of calculating the bonus payable to workmen of the company. Sometime in 1968, the company transferred the shares of 'B Limited', to 'C Limited' a subsidiary, wholly owned by it. Thus, the dividend income did not find place in the Profit & Loss Account of 'A Limited', with the result that the surplus available for the purpose for payment of bonus to the workmen got reduced.

Judgement: It was found that the sole purpose for the formation of the company was to use it as a device to reduce the amount to be paid by way of bonus to workmen. Thus, the Supreme Court brushed aside the separate existence of the subsidiary company.

3.2.4 Formation of subsidiaries to act as agents

A company may sometimes be regarded as an agent or trustee of its members, or of another company, and may therefore be **deemed to have lost its individuality in favour of its principal**. Here the principal will be held liable for the acts of that company.

Case Law: Merchandise Transport Limited vs. British Transport Commission

Facts: A transport company wanted to obtain licences for its vehicles, but could not do so if applied in its own name. It therefore, formed a subsidiary company, and the application for licence was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary company.

Judgement: It was held that the parent and the subsidiary were one commercial unit and the application for licences was rejected.

3.2.5 Company formed for fraud/improper conduct or to defeat law

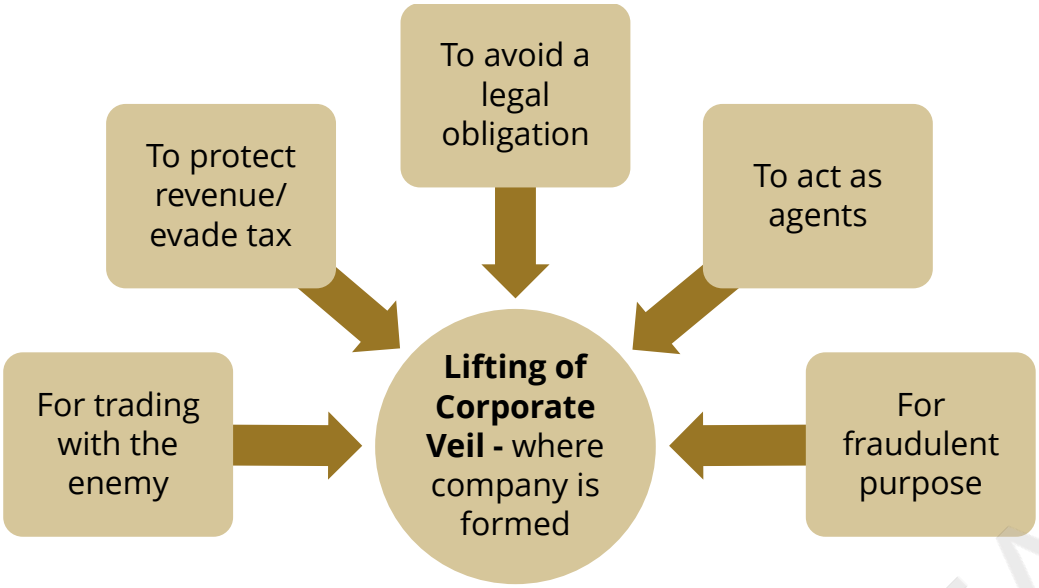
The legal personality of a company may also be disregarded in the interest of justice where the company has been **incorporated for some fraudulent purpose** like defrauding creditors or defeating or circumventing law.

Case Law: Gilford Motor Co. vs. Horne

Facts: An employee entered a contract with his employer that he will not solicit the customers of the employer after leaving the employment. After leaving the employment he incorporates a company along with his wife and starts soliciting customers of the employer.

Judgement: The courts held that the purpose of formation of the company was to avoid a legal obligation arising from a contract which was not permissible. Therefore, the company was restrained from soliciting the customers of the employer.

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4. Classes of Companies under the Act

4.1 On the basis of liability

4.1.1 Company limited by shares

When the liability of the members of a company is **limited** by its memorandum of association to the amount (if any) **unpaid on the shares held by them**, it is known as a company limited by shares [**Section 2(22)**].

Thus, for meeting the debts of the company, the shareholder may be called upon to contribute only to the extent of the amount, which remains unpaid on his shareholdings. **His separate personal property cannot be used to meet the company's debt.**

4.1.2 Company limited by guarantee

- The company having the liability of its members **limited** by the memorandum **to such amount as the members may respectively undertake by the memorandum to contribute** to the assets of the company **in the event of its being wound up** [**Section 2(21)**].

  Thus, the liability of the member of a company limited by guarantee is **limited up to a stipulated sum mentioned in the memorandum**. Members cannot be called upon to contribute beyond that stipulated sum.

Guarantee company does not raise its initial working funds from its members. Therefore, such a company may be useful only where no working funds are needed or where funds can be held from other sources like donations, fees, etc.

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In case of **a 'Company limited by Guarantee'** the members may be **called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions**; **and in case of a 'Company Limited by Shares'** they may be called upon to do so at any time, either during the company's life-time or during its winding up.

- **The right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares.** The membership of a guarantee company may carry privileges much different from those of ordinary shareholders ***[Narendra Kumar Agarwal vs. Saroj Maloo (SC)].***

4.1.3 Unlimited company

- A company **not having any limit on the liability** of its members [**Section 2(92)**]**.**
- In such a company, the **liability of a member ceases when he ceases to be a member.**
- The **liability of each member extends to the whole amount** of the company's debts and liabilities, but he will be **entitled to claim contribution from other members**.
- In case the **company has share capital**, as long as the company is a going concern the **liability on the shares is the only liability which can be enforced** by the company.

  Member can be called upon to contribute only in the event of winding up of the Company.

4.2 On the basis of members

4.2.1 One person company

- A company which has only **one person as a member** [**Section 2(62)**].
- OPC is a **private limited company** with the minimum paid up share capital as may be prescribed*and has at least one member [**Section 3(1)(c)].**
  * No limit prescribed

OPC differs from sole proprietary concern in an aspect that OPC is a separate legal entity with a limited liability of the member, whereas in the case of sole proprietary, the liability of owner is not restricted, and it extends to the owner's entire assets both official and personal.

1. Only one person as **member**.
2. **Minimum paid up capital** – no limit prescribed

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3. The memorandum of OPC shall indicate the **name of the other person (nominee)**, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.
4. Nominee shall give his **prior written consent** in prescribed form and the same shall be filed with Registrar of companies (ROC) at the time of incorporation.
5. Nominee may be given the **right to withdraw his consent.**
6. The member of OPC may **at any time change the name of nominee** by giving notice to the company and the company shall intimate the same to the Registrar. Any such change in the name of the person shall **not be deemed to be an alteration of the memorandum.**
7. Only a **natural person** who is an **Indian citizen whether resident in India or otherwise**
   - shall be **eligible to incorporate** a OPC,
   - shall be a **nominee** for the sole member of a OPC.

   Resident – person who has stayed in India for a period of **not less than 120 days** during the immediately preceding financial year.
8. No person shall be eligible to **incorporate more than one OPC** or become nominee in more than one such company.
9. **No minor shall become member or nominee** of the OPC or can hold share with beneficial interest.
10. OPC cannot be incorporated or converted into a **company under section 8 of the Act**. Though it may be converted to private or public companies any time after it's incorporation.
11. OPC **cannot carry out Non-Banking Financial Investment activities** including investment in securities of anybody corporate.
12. If OPC or any officer of such company **contravenes the provisions**, they shall be punishable with fine –
    - which may extend to ₹10,000/- and
    - with a further fine which may extend to ₹1,000/- for every day after the first during which such contravention continues.

4.2.2 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, —

  *Nothing has been prescribed.

  i) **Restricts the right to transfer its shares**, and

  ii) Except in case of one person company, **limits the number of its members to 200.**

  iii) **Prohibits any invitation to the public to subscribe for any securities of the company.**

- Where **two or more persons hold one or more shares** in a company **jointly**, they shall, for the purposes of this clause, be **treated as a single member.**

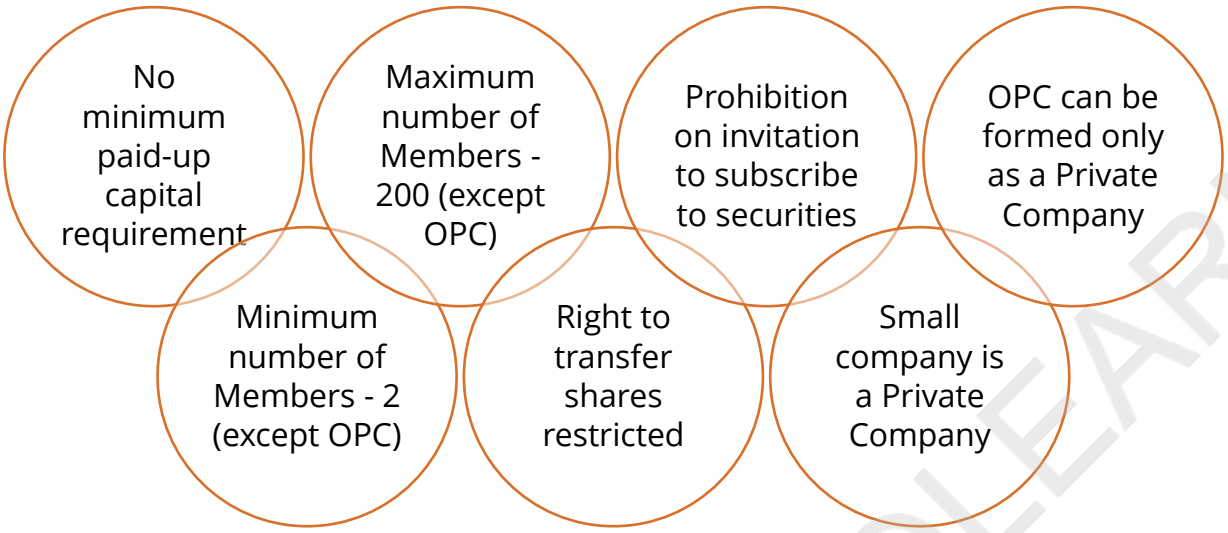
- Following persons shall **not be included in the number of members** –

  - Persons who are in the **employment** of the company; **and**

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- 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.

- **Significant Points about a Private Company –**



- **Small Company [Section 2(85)] –**

  A company, other than a public company, whose –

  i) **Paid up share capital does not exceed ₹ 2 crores**, and

  ii) **Turnover** as per the profit and loss account for the immediately preceding financial year **does not exceed ₹ 20 crores**.

  Exceptions –

  This clause shall not apply to:

  ✓ A **holding** company **or a subsidiary** company,

  ✓ A company registered under **section 8**, or

  ✓ A company or body corporate **governed by any Special Act**.

> Paid up share capital and turnover limits for small company may be increased to such higher amount as may be prescribed, but which shall not be more than ₹10 crore and ₹100 crore, respectively.

4.2.3 Public company [Section 2(71)]

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- 'Public company' means **a company which** –

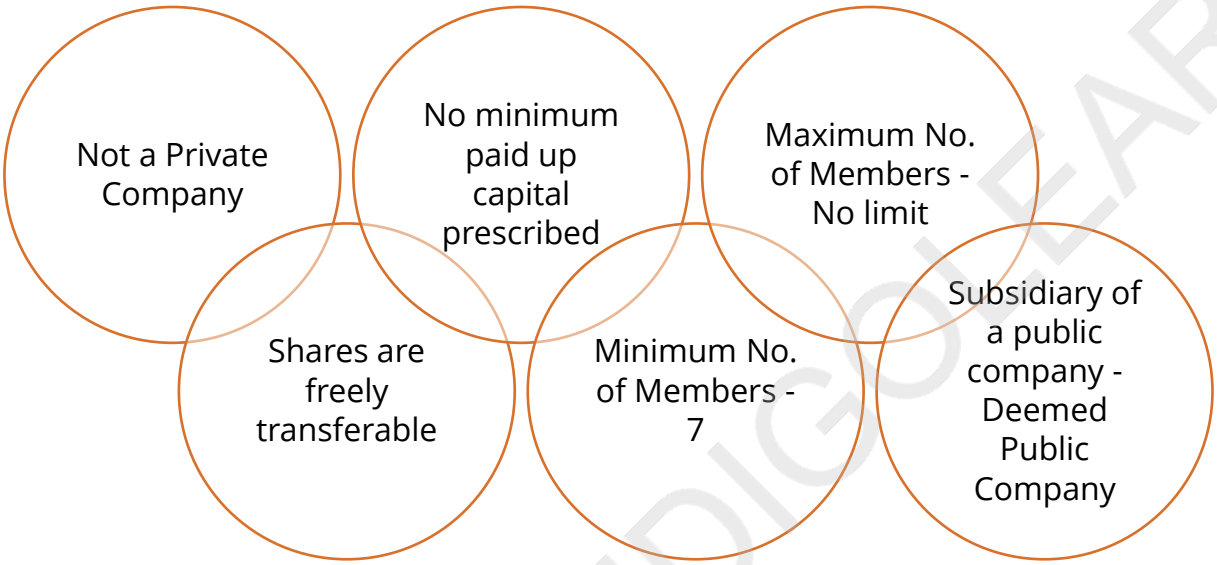
  i) is **not a private company**; and

  ii) has a **minimum paid-up share capital, as may be prescribed*.**

*Nothing has been prescribed.

- 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.

- **Significant Points about a Public Company –**



4.3 On the basis of control

4.3.1 Holding and subsidiary companies

- **Holding company** in relation to one or more other companies, means **a company of which such companies are subsidiary companies [Section 2(46)].**

- **Subsidiary company** in relation to any other 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 **[Section 2(87)].**

For Sections 2(46) & 2(87), the expression 'company' includes any 'body corporate'.

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a) A company shall be **deemed to be a subsidiary company** of the holding company **even if the control 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 **can appoint or remove all or a majority of the directors.**

Example : B Ltd. controls the composition of the Board of Directors of A Ltd. Thus, A Ltd. will be a subsidiary of B Ltd.

Example : B Ltd. holds more than 50% of the share capital of A Ltd. A Ltd. will be subsidiary of B Ltd.

Example : B Ltd. is a subsidiary of A Ltd. and C Ltd. is a subsidiary of B Ltd. In such a case, C will be the subsidiary of A.

4.3.2 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**.

Significant Influence means control of at least 20% of total voting power, or control of or participation in business decisions under an agreement.

- **Joint Venture** – A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

The **shares held by a company in another company in a 'fiduciary capacity'** shall not be counted for the purpose of determining the relationship of 'associate company' under section 2(6) of the Companies Act, 2013.

Total Share Capital = Paid-up Share Capital + Convertible Preference Share Capital

Example : A Ltd. is a Public Company and holds 23% of share capital in B Ltd. and 15% share capital of C Ltd. By virtue of the shareholding pattern –

- ✓ B Ltd. will be known as the Associate Company of A Ltd. (as the holding is more than 20%) , whereas
- ✓ C Ltd. will not be Associate as the required 20% holding is not there and hence no significant influence.

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4.4 On the basis of access to capital

4.4.1 Listed company [Section 2(52)]

Listed company is a company which **has any of its securities listed on any recognised stock exchange.**

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

Example : Tata Motors Limited is a Public Limited Company whose shares are listed in the Stock Exchange – NSE and BSE. Hence, Tata Motors Limited is a Listed Company.

4.4.2 Unlisted company

Unlisted Company means **company other than listed company.**

4.5 Other companies

4.5.1 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** –
  - i) the **Central Government**, or
  - ii) by **any State Government** or Governments, or
  - iii) **partly by the Central Government and partly by one or more State Government(s)**

For Section 2(45), **paid up share capital** shall be construed as **total voting power**, where shares with differential voting rights have been issued.

- **A company which is subsidiary of a government company as described above, is also deemed to be a government company.**

4.5.2 Foreign Company [Section 2(42)]

Any company or body corporate **incorporated outside India** which –

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

ii) **conducts any business activity in India** in any other manner.

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4.5.3 Formation of companies with charitable objects etc. [i.e., Section 8 company]

- Section 8 of the Companies Act, 2013 deals with the formation of companies which are **formed to promote the charitable objects** of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.



Examples of Section 8 Companies – FICCI, CII, ASSOCHAM, National Sports Club of India, etc.

- Such company **intends to** –
  - **Apply its profits** or other income **in promoting its objects**, and
  - Also **prohibit the payment of any dividend** to its members.
- Where these conditions specified above are satisfied, the **Central Government may register** such person or association of persons as a **company with limited liability without the addition of words 'Limited' or 'Private limited' to its name**, by **issuing licence** on such conditions as it deems fit.
- Upon registration the company shall enjoy same privileges and obligations as of a limited company.
- **Revocation of Licence by the CG** in the following cases –
  - The company **contravenes any of the requirements or the conditions** of this sections subject to which a licence is issued
  - The affairs of the company are **conducted fraudulently, or violative of the objects** of the company **or prejudicial to public interest.**
- **Before such revocation**, the Central Government must give it a **written notice** of its intention to revoke the licence and **opportunity to be heard** in the matter.
- **Upon revocation** the ROC shall **put 'Limited' or 'Private Limited' against the company's name** in the register.
- **Where a licence is revoked** there the Central Government may, in the public interest **order** –
  - The **company to be amalgamated with another Section 8 company** having similar objects, or
  - The company to be **wound up**
- Penalty/punishment for contravention –

	Minimum fine	Maximum fine
Company	₹ 10 lakhs	₹ 1 crores
	₹ 25,000/-	₹ 25 lakhs

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Directors and every officer who is in default	If it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447.

1. **Objective** – Formed for the promotion of commerce, art, science, religion, charity, protection environment, sports, etc.
2. Requirement of **minimum share capital** does not apply**.**
3. **Uses its profits** for the promotion of the objective for which formed.
4. Does not declare **dividend** to members.
5. Operates under a **special licence** from Central Government.
6. Need not use the **word Limited / Pvt. Limited in its name** and adopt a more suitable name such as club, chambers of commerce, etc.
7. Licence shall be **revoked** if conditions contravened.
8. **On revocation, Central Government may direct** it to –
   - Converts its status and change its name ,
   - Wind – up,
   - Amalgamate with another company having similar object.
9. Can call its **general meeting** by giving a clear 14 days' notice instead of 21 days.
10. Requirement of minimum number of **directors**, independent directors etc. does not apply.
11. Need not constitute **Nomination and Remuneration Committee and Shareholders Relationship Committee**.
12. A **partnership firm can be a member** of Section 8 company.

4.5.4 Dormant company [Section 455]

- The following companies may **make an application to the ROC** for obtaining the **status of a dormant company** –
  - i) **Inactive company**,
  - ii) A **company formed and registered** for
    - ✓ A **future project** or
    - ✓ To **hold an asset** or intellectual property, **and**
    - ✓ **Has no significant accounting transaction**.
- **Inactive company** – A company which
  - has **not been carrying on any business** or operation, or
  - has **not made any significant accounting transaction** during the **last 2 financial years**, or

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- has **not filed financial statements** and annual returns during the **last 2 financial years**.

- **Significant accounting transaction** – Any transaction **other than** –

  i) Payment of fees by a company to the ROC,

  ii) Payments made by it to fulfil the requirements of this Act or any other law,

  iii) Allotment of shares to fulfil the requirements of this Act, and

  iv) Payments for maintenance of its office and records.

4.5.5 Nidhi Companies [Section 406(1)]

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.



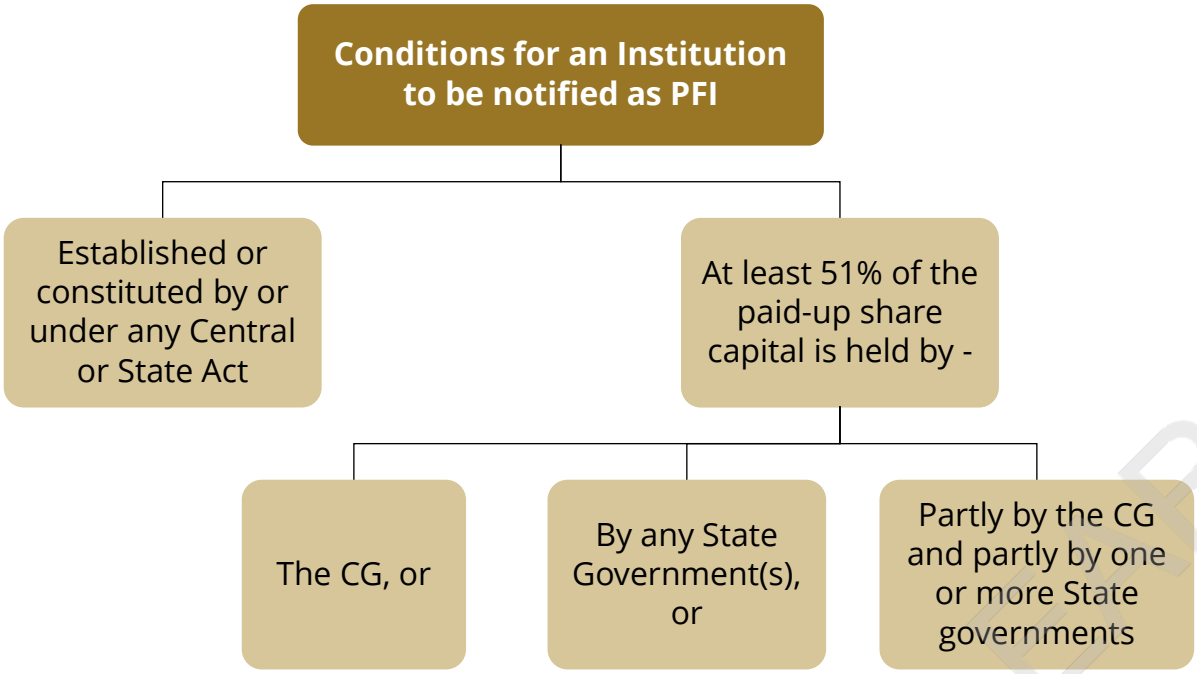
These companies are formed to promote the habit of saving among its members.

4.5.6 Public Financial Institutions (PFI) [Section 2(72)]

The following institutions are regarded as public financial institutions –

- The **Life Insurance Corporation of India**, established under the Life Insurance Corporation Act, 1956,
- The **Infrastructure Development Finance Company Limited**,
- Specified **company referred to in the Unit Trust of India** (Transfer of Undertaking and Repeal) **Act**, 2002,
- Institutions **notified by the Central Government under section 4A(2) of the Companies Act, 1956** so repealed under section 465 of this Act,
- Such **other institution as may be notified by the Central Government** in consultation with the Reserve Bank of India.

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5. Mode of Registration/Incorporation of a Company

5.1 Promoters [Section 2(69)]

Section 2(69) of the Companies Act, 2013 defines **Promoters** as **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**.

- Persons who form the company are known as promoters.
- They conceive the idea of forming the company and take all necessary steps for its registration.
- However, **persons acting in a professional capacity** such as, the solicitor, banker, accountant etc. are **not regarded as promoters**.

5.2 Formation of Company [Section 3]

A company may be formed for any lawful purpose by –

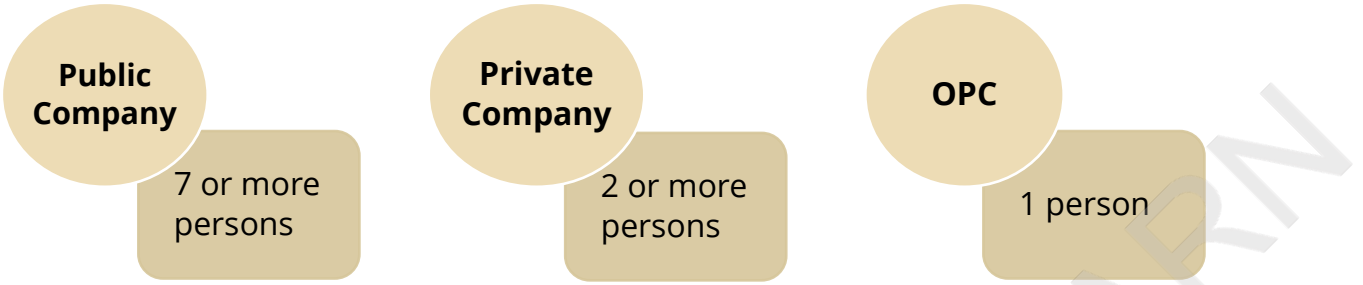
a) 7 or more persons in case of a **Public Company,**

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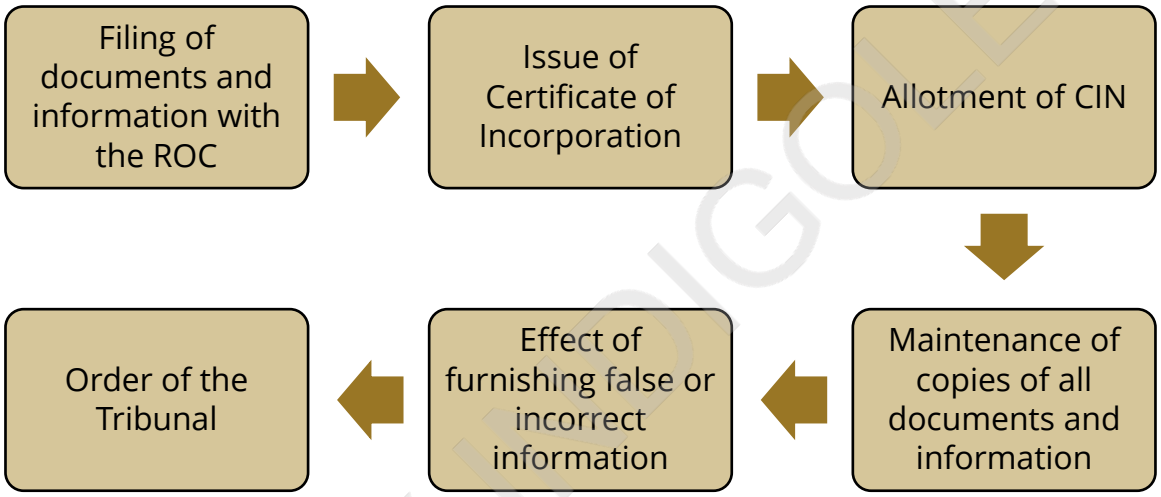
b) 2 or more persons in case of a **Private Company,** and

c) 1 person in case of a **One Person Company,**

by subscribing their names to Memorandum of Association and **complying with the requirements of this Act in respect of registration.**



5.3 Incorporation Of Company [Section 7]



5.3.1 Filing of the documents and information with the registrar

The following documents and information shall be filed with the **registrar within whose jurisdiction the registered office of the company is proposed to be situated** –

MOA and AOA	The Memorandum of Association (MOA) and the Articles of Association (AOA) **signed by all the subscribers**.
Declaration	• By a person engaged in the formation of the company (like advocate, CA, CS etc.) and a person named in the AOA (director, manager etc). • Declaration that **all the requirements of this Act and the Rules in respect of Registration have been complied with.**
Declaration from each of the Subscribers and First Directors	• He is **not convicted of any offence** in connection with the promotion, formation, or management of any company,

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	• He has **not been found guilty** of any fraud or misfeasance or of any breach of duty to any company during the last five years, and • That **all the documents filed with the Registrar** for registration of the company contain information that is **correct and complete and true** to the best of his knowledge and belief.
Address	The **address for correspondence** till its registered office is established
Particulars of every subscriber	• Including name, surname or family name, residential address, nationality, and other particulars. • **Along with proof of identity**, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.
Particulars of First Directors	Including their names, surnames, Director Identification Number (DIN), residential address, nationality etc., along with proof of identity.
Particulars of Interests	• Particulars of Interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate, and • their consent to act as directors of the company in such form and manner as may be prescribed.

5.3.2 Issue of certificate of incorporation on registration

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

5.3.3 Allotment of Corporate Identity Number (CIN)

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

5.3.4 Maintenance of copies of all documents and information

- **At its registered office**.
- **Till the company is dissolved** under this act.

5.3.5 Furnishing of false or incorrect information or suppression of material fact at the time of incorporation

If any person furnishes any false or incorrect particulars, or suppress any material information, **of which he is aware**, in any of the documents filed with the ROC in relation to registration of a company, **he shall be liable for fraud u/s 447.**

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5.3.6 Company already incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact

Where, at any time **after the incorporation of a company, it is proved that** the company has been got incorporated by

i) **furnishing any false or incorrect information** or representation **or by suppressing any material fact or information** in any of the documents or declaration filed or made for incorporating such company, **or**

ii) **any fraudulent action**,

the **promoters, the persons named as the first directors of the company and the persons making declaration** under this section shall each be **liable for action for fraud u/s 447.**

5.3.7 Order of the Tribunal

Where a company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or by any fraudulent action, the **Tribunal may, on an application made to it**, on being satisfied that the situation so warrants,—

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

b) Direct that **liability of the members shall be unlimited**; or

c) Direct **removal of the name of the company** from the register of companies; or

d) Pass an **order for the winding up** of the company; or

e) Pass **such other orders** as it may deem fit.

Before making any order –

- The **company shall be given a reasonable opportunity of being heard** in the matter; and
- The tribunal shall **take into consideration the transactions entered into by the company,** including the obligations, if any, contracted or payment of any liability.

Simplified Proforma for Incorporating Company Electronically (SPICe)

In a step towards easy setting up of business, MCA has simplified the process of filing of forms for incorporation of a company through Simplified Proforma for incorporating company electronically. Now, SPICe+ form has also been launched that further eases the registration process.

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5.4 Effect of Registration [Section 9]

From the date of incorporation,

- ✓ The subscribers to the memorandum and all other persons, who may from time to time become members of the company, shall be a **body corporate by the name contained in the memorandum**,
- ✓ **Capable of exercising all the functions of an incorporated company** under this Act, and
- ✓ **Having perpetual succession,**
- ✓ With **power to acquire, hold and dispose of property**, both movable and immovable, tangible, and intangible, **to contract and to sue and be sued, by the said name.**

Various Case Laws relating to the effect of registration of a Company	
Hari Nagar Sugar Mills Ltd. vs. S.S. Jhunjhunwala	From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from the incorporators and there comes into existence a binding contract between the company and its members as evidenced by the MOA & AOA.
State Trading Corporation of India vs. Commercial Tax Officer	A company on registration acquires a separate existence and the law recognises it as a legal person separate and distinct from its members.
Spencer & Co. Ltd. Madras vs. CWT Madras	Merely because a company purchases all shares of another company it will not serve as a means of putting an end to the corporate character of another company and each company is a separate juristic entity.
Heavy Electrical Union vs. State of Bihar	The mere fact that the entire share capital has been contributed by the Central Government and all its shares are held by the President of India and other officers of the Central Government does not make any difference in the position of registered company and it does not make a company an agent either of the President or the Central Government.

5.5 Effect of Memorandum and Articles [Section 10]

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

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6. Classification of Capital

- In relation to a company limited by shares, the word **capital means share-capital,** i.e., the capital or figure in terms of so many rupees divided into shares of fixed amount.
- **The proportion of the capital to which each member is entitled, is his share.**
- **A share is not a sum of money; it is rather an interest in the company** measured by a sum of money and made up of various rights contained in the contract.

6.1 Nominal or authorised or registered capital [Section 2(8)]

- 'Authorised capital' or 'Nominal capital' means such capital as is **authorised by the memorandum** of a company **to be the maximum amount of share capital of the company.**
- Thus, it is the maximum amount which the company is authorised to raise by issuing shares, and upon which it pays the stamp duty.

6.2 Issued capital [Section 2(50)]

- 'Issued capital' means such **capital as the company issues from time to time for subscription.**
- It is that **part of authorised capital which is offered by the company for subscription**
- It **includes** the shares allotted for consideration other than cash.

Schedule III to the Companies Act, 2013, makes it obligatory for a company to **disclose its issued capital in the balance sheet.**

6.3 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**.

Where any notice, advertisement or other official communication or any business letter, bill head or letter paper of a company states the authorised capital, the subscribed and paid-up capital must also be stated in equally conspicuous characters.

A **default** in this regard will make the company and every officer who is in default liable to pay **penalty extending ₹ 10,000 and ₹ 5,000** respectively. [**Section 60**].

6.4 Called-up capital [Section 2(15)]

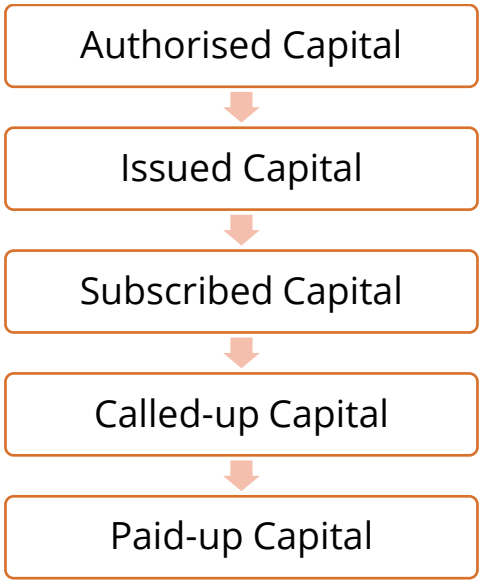
'Called-up capital' means such **part of the capital, which has been called for payment.**

6.5 Paid-up capital

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The **total amount paid or credited as paid up on shares issued**.

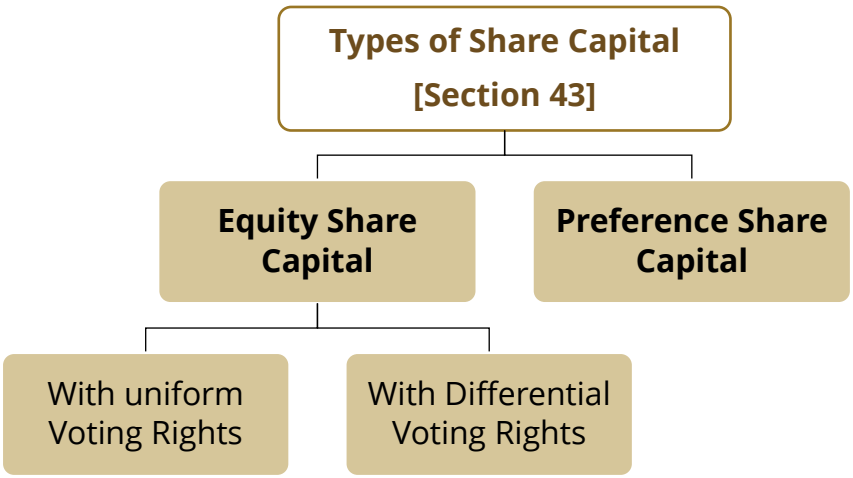
Paid-up share capital = Called-up capital – Calls in arrears



7. Shares

- **Section 2(84)** of the Companies Act, 2013 defines the term '**share'** which means a **share in the share capital of a company and includes stock.**
- Share is an interest in the company ***[Borland Trustees vs. Steel Bors. & Co. Ltd.]***
- It represents such proportion of the interest of the shareholders as the amount paid up thereon bears to the total capital payable to the company.
- It is a measure of the interest in the company's assets to which a person holding a share is entitled.
- The shares or debentures or other interests of any member in a company shall be **movable property** transferable in the manner provided by the articles of the company [**Section 44].**
- **Every share** in a company having a share capital, shall be distinguished by its **distinctive number [Section 45].** (Doesn't apply in the case of shares held in dematerialised form in the depository)

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7.1 Equity share capital

'Equity share capital', with reference to any company limited by shares, means **all share capital which is not preference share capital.** It comprises shares

(1) with voting rights; or
(2) with differential rights as to dividend, voting or otherwise in accordance with prescribed rules

Note: Tata Motors in 2008 introduced equity shares with differential voting rights called 'A' equity shares in its rights issue. In the issue, every 10 'A' equity shares carried only one voting right but would get 5 percentage points more dividend than that declared on each of the ordinary shares. Since 'A' equity share did not carry the similar voting rights, it was being traded at discount to other common shares having full voting. Such shares are called **equity shares with differential voting rights (DVRs).**

7.2 Preference share capital

- 'Preference share capital', with reference to any company limited by shares, means that **part of the issued share capital of the company which carries or would carry a preferential right** with respect to—

  a) **payment of dividend**, either as a fixed amount or an amount calculated at a fixed rate, and

  b) **repayment, in the case of a winding up or repayment of capital**, of the amount of the share capital paid-up or deemed to have been paid-up.

- Capital shall be **deemed to be preference capital** despite that it is entitled to either or both of the following rights –

  i) that **in respect of dividends**, in addition to the preferential rights to the amounts specified as above, **it has a right to participate with capital not entitled to the preferential right aforesaid,**

  ii) that **in respect of capital**, in addition to the preferential right to the repayment, on a winding up, of the amounts specified above, **it has a right to participate with capital**

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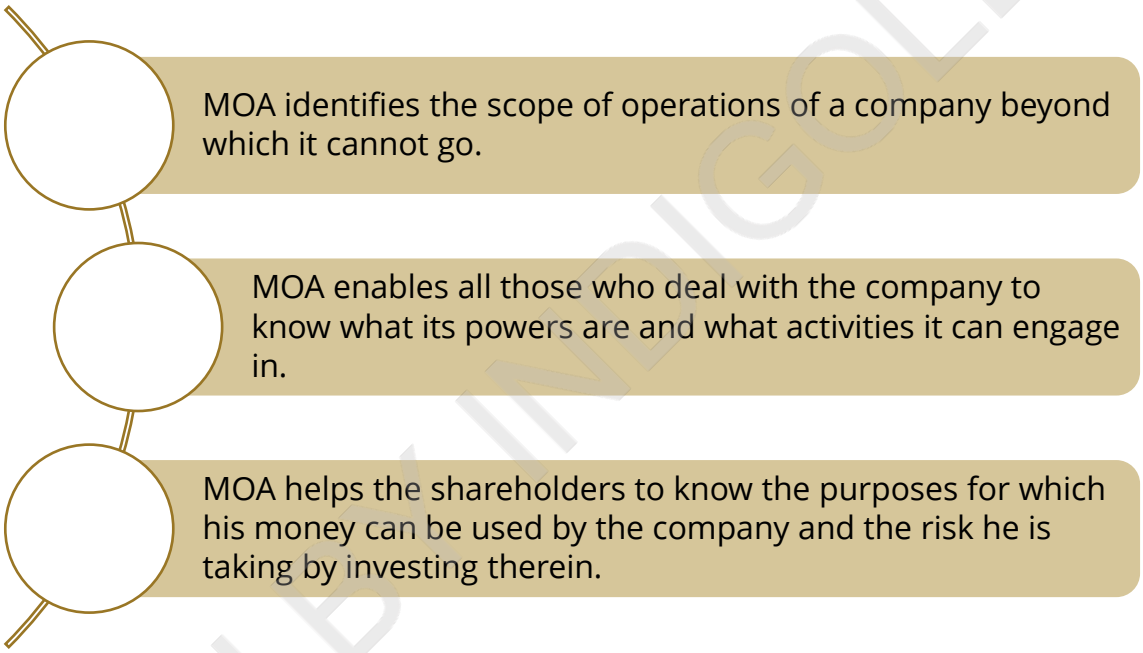
not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

In case of private company, Section 43 shall not apply where memorandum or articles of association of the private company so provides.

8. Memorandum of Association

The Memorandum of Association **defines the company's constitution and the scope of the powers of the company** with which it has been established under the Act. It is the very foundation on which the whole edifice of the company is built.

8.1 Object of registering a memorandum of association



- **A company cannot enter into a contract or engage in any trade or business, which is beyond the power confessed on it by the memorandum**. If it does so, it would be ultra vires the company and void.
- MOA of a company shall be drawn up in such form as is given in Tables A, B, C, D and E in Schedule I of the Companies Act, 2013 [Section 4].

Table A	Form for MOA of a company limited by shares.
Table B	Form for MOA of a company limited by guarantee and not having a share capital.
Table C	Form for MOA of a company limited by guarantee and having a share capital.

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Table D	Form for MOA of an unlimited company.
Table E	Form for MOA of an unlimited company and having share capital.

8.2 Contents of the memorandum

8.2.1 Name Clause

- The memorandum of the company shall state, in relation to the name clause, the name of the company with the last word
    - **'Limited'** in the case of a **public limited company**, or
    - **'Private Limited'** in case of a **private limited company.**
- **Section 8 company –**
    - **This clause is not applicable to Section 8 company.**
    - In case of **Section 8 company** formed in accordance with the **Electoral Trusts Scheme, 2013** notified by the Central Board of Direct Taxes (CBDT), the name including **phrase 'Electoral Trust' may be allowed.**
    - Also, for the Companies under section 8 of the Act, the **name shall include the words foundation, Forum, Association, Federation, Chambers, Confederation, council, Electoral trust, and the like etc.**
- **Government Company –** A Government company's name must **end with the word 'Limited'.**
- **One Person Company** – In the case of One Person Company, **the words 'One Person Company', should be included below its name.**

8.2.2 Registered Office clause

The **State** in which the registered office of the company is to be situated.

8.2.3 Object clause

- The **objects for which the company is proposed to be incorporated** and any matter considered necessary in furtherance thereof.
- **If Company has changed its activities which are not reflected in its name** – It shall **change its name in line with its activities** within a period of **6 months** from the change of activities after complying with all the provisions as applicable to change of name.

8.2.4 Liability clause

This clause covers details on liability of members of a company, whether limited or unlimited, and also state –

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- In the case of a **company limited by shares**, that the **liability of its members is limited to the amount unpaid, if any, on the shares** held by them; and
- In the case of a **company limited by guarantee**, that the **liability of its members is limited to the amount up to which each member undertakes to contribute –**
    - to the **assets of the company in the event of its being wound-up**, for payment of the debts and liabilities of the company
    - to the costs, charges, and expenses of winding-up and for adjustment of the rights of the contributories among themselves

8.2.5 Capital Clause

The **amount of authorized capital** divided into share of fixed amounts and the **number of shares which the subscribers to the memorandum have agreed to take**, indicated opposite their names, which shall not be less than one share.

A company not having share capital need not have the Capital Clause.

8.2.6 Association Clause

Every subscriber to the memorandum shall take at least one share and **shall write against his name the number of shares taken by him**.

8.2.7 Nomination Clause

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

The above clauses of the Memorandum are called **compulsory clauses**, or **'Conditions'**. In addition to these a memorandum may contain other provisions, for example rights attached to various classes of shares.

8.3 Signatories to the memorandum

- The memorandum must be printed, divided into paragraphs, numbered consecutively.
- It should be **signed by at least 7 persons** (two in the case of a private company and one in the case of One Person Company) in the presence of at least one witness, who will attest the signatures. The particulars about the signatories to the memorandum as well as the witness, as to their address, description, occupation etc., must also be entered.

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A company being a legal person can through its agent, subscribe to the memorandum. However, **a minor cannot be a signatory to the memorandum** as he is not competent to contract. The guardian of a minor, who subscribes to the memorandum on his behalf, will be deemed to have subscribed in his personal capacity.

9. Doctrine of Ultra Vires

- **The term ultra vires means 'beyond (their) powers'.** The legal phrase "*ultra vires*" is applicable only to acts done in excess of the legal powers of the doers.
- When an act is performed, which though legal in itself, is **not authorized by the object clause of the memorandum, or by the statute**, it is said to be ultra vires the company, and hence null and void.
- An act which is ultra vires (i.e., beyond the powers of) is **void and does not bind the company.** Neither the company nor the contracting party can sue on it.
- An act which is ultra vires the company being void, **cannot be ratified by the shareholders of the company.**

  Example : If you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent.

  - But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is ultra vires the company.
  - If the ultra vires loan has been utilised in meeting lawful debt of the company then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

An ultra vires contract can never be made binding on the company. It cannot become "Intra vires" by reasons of estoppel, acquiescence, lapse of time, delay, or ratification.

- Sometimes, act which is ultra vires can be regularised by ratifying it subsequently –
  - If the act is **ultra vires the power of the directors**, the **shareholders can ratify** it,
  - If the act is **ultra vires the articles** of the company, the **company can alter the articles**,
  - If the act is **within the power of the company but is done irregularly**, **shareholder can validate it.**

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Case Law: Ashbury Railway Carriage and Iron Company Limited v. Riche

Facts: The main objects of a company were:

a) To make, sell or lend on hire, railway carriages and wagons.
b) To carry on the business of mechanical engineers and general contractors.
c) To purchase, lease, sell and work mines.
d) To purchase and sell as merchants or agents, coal, timber, metals etc.

Directors of the company entered a contract with Riche, for financing the construction of a railway line in Belgium, and the company further ratified this act of the directors by passing a special resolution. The company however, repudiated the contract as being ultra-vires. And Riche brought an action for damages for breach of contract. His contention was that the contract was well within the meaning of the word general contractors and hence within its powers. Moreover, it had been ratified by a majority of share-holders.

Judgement: It was held that the contract was null and void. The Court held that the word 'general contractors' had to be given a restricted meaning. Only such contracts could be covered in the term 'general contractors' as are in some way related or connected with mechanical engineering. Therefore, the company could not finance the construction of a railway line by alleging that such a business falls under the business of general contractors.

10. Articles of Association

- The articles of association (AOA) of a company are its **rules and regulations**, which are **framed to manage its internal affairs**.
- Just as the memorandum contains the fundamental conditions upon which the company is allowed to be incorporated, so also the articles are the internal regulations of the company ***[Guiness vs. Land Corporation of Ireland].***
- It **regulates domestic management** of a company and creates certain rights and obligations between the members and the company [***S.S. Rajkumar vs. Perfect Castings (P) Ltd.].***
- AOA are the **bye-laws** of the company according to which director and other officers are required to perform their functions as regards the management of the company, its accounts and audit

10.1 Contents of the Articles [Section 5]

- The articles of a company shall **contain the regulations for management of the company.**
- The articles shall also **contain such matters, as are prescribed under the rules.**
- However, a company **may also include such additional matters** in its articles as may be considered necessary for its management.

10.2 Entrenchment Provision [Section 5]

- The articles **may contain provisions for entrenchment (to protect something).** It is such provision in AOA that **makes certain amendments either more difficult or impossible to pass,** making such amendments inadmissible.

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- The provision for entrenchment may be made –
    i) **at the time of formation of the company**; or
    ii) **by an amendment to the articles**,
        - with the **consent of all members**, in case of a **private company**
        - by passing a **special resolution,** in case of a **public company.**
- Where the articles contain provisions for entrenchment, the company shall give **notice to the Registrar** of such provisions in such form and manner as may be prescribed.

10.3 Forms of Articles [Section 5]

- The articles of a company shall be in **respective forms specified in Tables, F, G, H, I and J in Schedule I** as may be applicable to such company.
- A company may adopt all or any of the regulations contained in the model articles applicable to such company.
- Where the registered **articles of a compan**y registered after the commencement of this Act **do not exclude or modify the regulations contained in the model articles** applicable to such company, those regulations shall, so far as applicable, be the regulations of that company as if they were contained in the duly registered articles of the company.

Memorandum of Association vs. Articles of Association

Basis of Difference	Memorandum of Association (MOA)	Articles of Association (AOA)
Objectives	Defines and delimits the objectives of the company.	Lays down the rules and regulations for the internal management of the company. AOA determine how objectives of company are to be achieved.
Relationship	Defines relationship of company with outside world.	Define relationship between company and its members.
Alteration	Can be altered only under certain circumstances and in manner provided in the Act.	Can be altered simply by passing a special resolution.
Ultra Vires	Acts done by company beyond the scope of MOA are ultra-vires and void. These cannot be ratified even by unanimous consent of all shareholders.	Acts ultra-vires the articles can be ratified by a special resolution of the shareholders, provided they are not beyond provisions of MOA.

11. Doctrine of Indoor Management

11.1 Doctrine of Constructive Notice

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- **Section 399** of the Companies Act, 2013 provides that **any person can inspect by electronic means any document kept by the Registrar**, or make a record of the same, or get a copy or extracts of any document, including certificate of incorporation of any company, on payment of prescribed fees.
- The doctrine of Constructive Notice means that –
    - **Whether a person reads the documents or not, he is presumed to have knowledge of the contents of the documents.** He is not only presumed to have read the documents but also understood them in their true perspective, and
    - **Every person dealing with the company** not only has the constructive notice of the memorandum and articles, but also of all the other related documents, such as Special Resolutions etc., which are required to be registered with the Registrar.

  Thus, if a **person enters a contract which is beyond the powers of the company** as defined in the memorandum, or outside the authority of directors as per memorandum or articles, **he cannot acquire any rights under the contract against the company.**

It is duty of every person dealing with a company to inspect its documents and make sure that his contract is in conformity with their provisions.

11.2 Doctrine of Indoor Management

- The Doctrine of Indoor Management is the **exception to the doctrine of constructive notice.**
- It can be explained with the help of a landmark case: The Royal British Bank vs. Turquand**,** and thus, is popularly known as **Turquand Rule.**

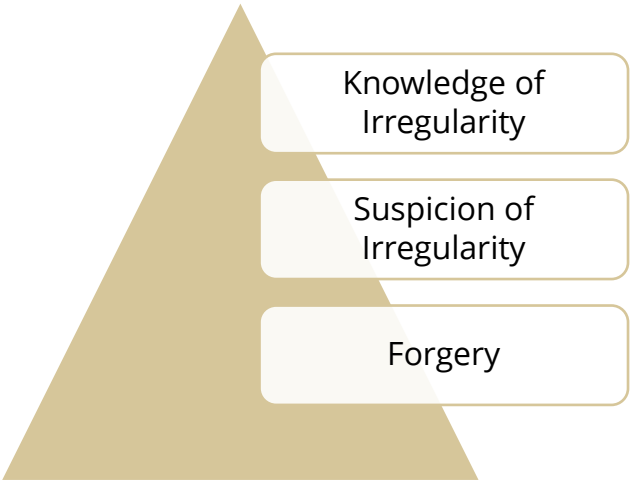
Case Law: Royal British Bank vs. Turquand

Facts: Mr. Turquand was the liquidator of the insolvent Cameron's Coalbrook Steam, Coal and Swansea and Loughor Railway Company. The company had given a bond for £2,000 to the Royal British Bank, which secured the company's drawings on its current account. The bond was under the company's seal, signed by two directors and the secretary. When the company was sued, it alleged that under its the articles of association, directors only had power to borrow up to an amount authorized by a company resolution. A resolution had been passed but not specifying how much the directors could borrow.

Judgement: It was decided that the bond was valid as the bank was deemed to be aware that the directors could borrow only up to the amount resolutions allowed. AOA were registered with Companies House, so there was constructive notice. But the bank could not be deemed to know which ordinary resolutions passed, because these were not registrable. The bond was valid because there was no requirement to look into the company's internal workings. This is the indoor management rule, that the company's indoor affairs are the company's problem.

11.3 Exceptions to the doctrine of Indoor Management

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11.3.1 Actual or constructive knowledge of irregularity

Where the **person dealing with the company has knowledge of irregularity within the company**, the benefit under the doctrine of indoor management would not be available.

Example : The directors cannot not defend the issue of debentures to themselves because they should have known that the extent to which they were lending money to the company required the assent of the general meeting which they had not obtained ***[Howard vs. Patent Ivory Manufacturing Co.].***

11.3.2 Suspicion of Irregularity

- If there are **suspicious grounds** surrounding a transaction, **but the person dealing with company fails to make reasonable inquiry**, the benefit of doctrine of indoor management will not be available.
- **The doctrine in no way, rewards those who behave negligently.** Where the person dealing with the company is put upon an inquiry, for example, where the transaction is unusual or not in the ordinary course of business, it is the duty of the outsider to make the necessary enquiry.

Example : A person accepted a transfer of a company's property from its accountant. The transfer was held void as such person could not have supposed, in absence of a power of attorney that the accountant had authority to effect transfer of the company's property ***[Anand Bihari Lal vs. Dinshaw & Co.].***

Case Law: Haughton & Co. v. Nothard, Lowe & Wills Ltd.

Facts: A person holding directorship in two companies agreed to apply the money of one company in payment of the debt to other.

Judgement: It was held that the situation was something so unusual that the plaintiff (company which filed the case and for whose debt, payment was applied), should have made an inquiry to ascertain whether the person (director who had ownership in both companies) making the contract had any authority in fact to make it.

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11.3.3 Forgery

- **The rule of indoor management does not extend to transactions involving forgery.**
- In case of forgery, it is not that there is absence of free consent but there is **no consent** at all. Since there is no consent at all there is no transaction. Consequently, it is not that the title of person is defective but there is no title at all.

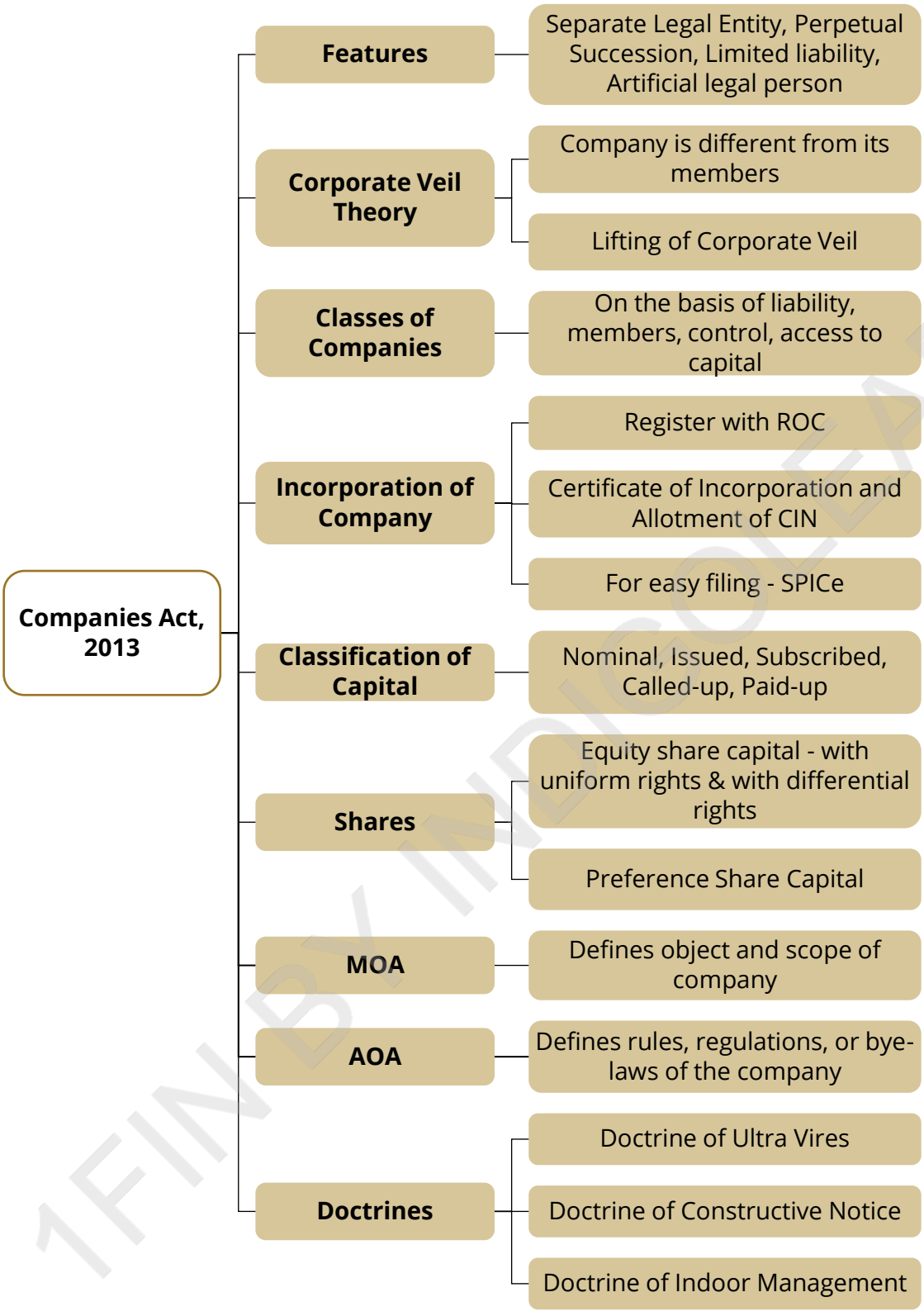
Case Law: Ruben v Great Fingall Consolidated

Facts: The plaintiff was the transferee of a share certificate issued under the seal of the defendant's company. The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate. The plaintiff contended that whether the signature were genuine or forged was part of the internal management, and therefore, the company should be estopped from denying genuineness of the document.

Judgement: The Court held, that the doctrine of Indoor Management has never been extended to cover such a complete forgery. Thus, the certificate was held to be invalid.

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12. Overview



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INCORPORATION OF THE COMPANY AND MATTERS INCIDENTAL THERETO

Learning Outcomes –

- Explain the formation & incorporation of a company (Private Limited/ Public Limited), One Person company (OPC) and the formation of not for profit organization (Section 8 company).
- Identify the need for Memorandum of Association (MOA) and Articles of Association (AOA) and changes incidental thereto.
- Know the effect of registration.
- Explain and identify the concept related to registered office of company.
- Know how the service of documents is effected.
- Know about Authentication of documents, proceedings and contracts and Excecution of bills of exchange, etc.

INTRODUCTION TO INCORPORATION OF COMPANIES

1.1 Incorporation

Incorporation of a company means the **process of registration of a company** to bring it to existence as a separate legal entity.

1.2 Promoter

The registration procedure is undertaken by 'Promoters' of the company. They are the founders of the company & they pitch the initial ideas for business.

Section 2(69) of the Companies Act, 2013 defines the term **"Promoter"** which 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

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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.

A person who is acting merely in professional capacity shall not be regarded as promoter, e.g., the solicitor, banker, accountant etc. are not regarded as promoters.

FORMATION OF COMPANY

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

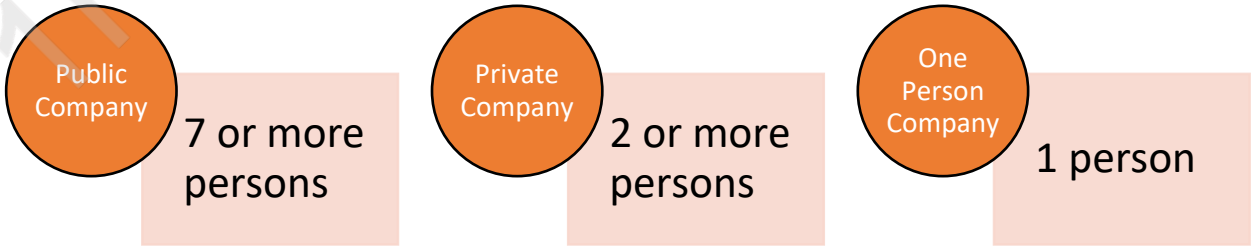
2.1 Minimum number of Members [Section 3(1)]

A company may be formed for any lawful purpose by-

a) **7 or more persons**, where the company to be formed is to be a **public company**;
b) **2 or more persons**, where the company to be formed is to be a **private company**; or
c) **1 person**, where the company to be formed is to be **One Person Company** that is to say, a private company,

by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.

Section 2(62) defines a **One Person Company** means a company which has only one person as a member.



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2.2 Types of companies based on Liability [Section 3(2)]

A company formed under sub-section (1) may be either-

a) A company **limited by shares**; or
b) A company **limited by guarantee**; or
c) An **unlimited** company

2.2.1 Company limited by Shares:

Section 2(22) defines a **"**company limited by shares**"** which 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.

2.2.2 Company limited by Guarantee:

Section 2(21) defines a "company limited by guarantee" which 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.**

2.2.3 Unlimited Company:

Section 2(92) defines an "unlimited company" which means a company **not having any limit on the liability of its members**.

Company limited by shares

- The Liability of the shareholders is limited to the amount which is unpaid on shares.

Company limited by guarantee

- Some of the shareholders agree to take up extra guarantee to pay an extra amount at the time of winding up.

Unlimited Company

- Shareholders who have agreed to take the unlimited liability will bring any amount of assets in order to satisfy the liabilities and the payment of the shareholders at the time of winding up.

2.3 Penalty if minimum members criteria not met [Section 3A]

If at any time the **number of members of a company is reduced**,

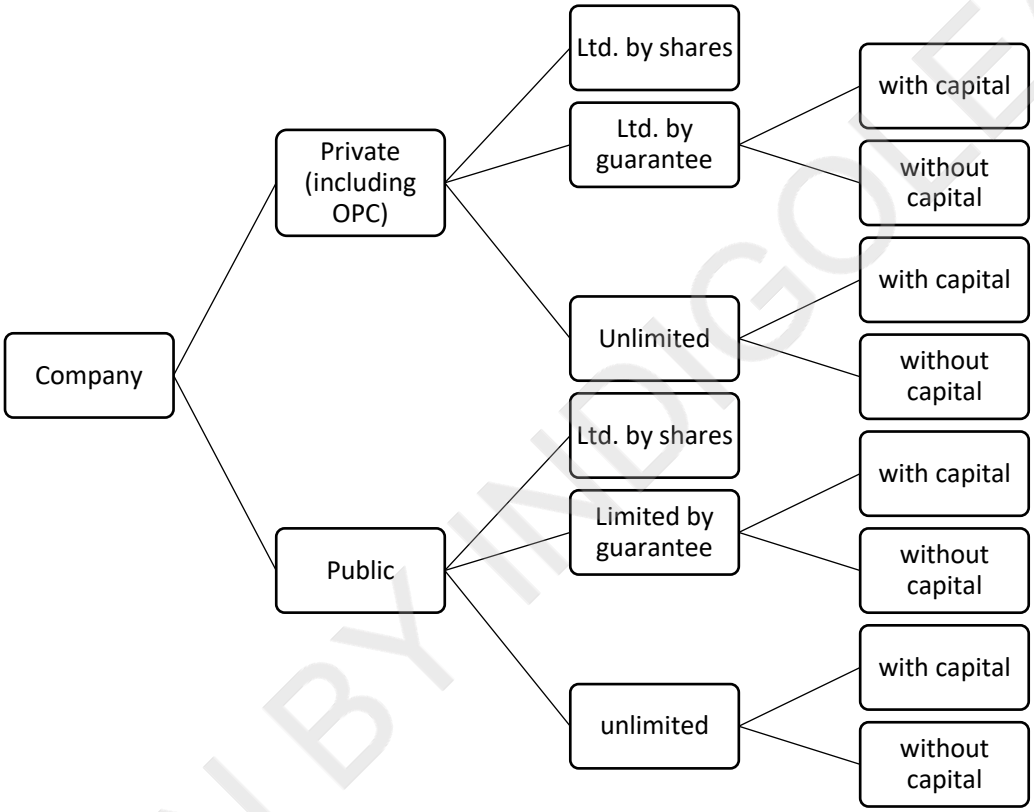
- ✓ In case of a public company, below 7,
- ✓ In case of a private company, below 2,

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And the **company carries on business for more than 6 months** while the number of members is so reduced, then,

→ **Every person**
- **who is a member of the company during the time** that it so carries on the business after those 6 months **and**
- **who is cognizant (i.e., aware) of the fact** that it is carrying on business with less than 7 members or 2 members, as the case may be

→ **shall be**
- **severally liable for the payment of the whole debts** of the company contracted during that time (i.e., after 6 months) **and**
- may be **severally sued** therefore.



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MEMORANDUM OF ASSOCIATION (MOA)

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

3.1 Memorandum

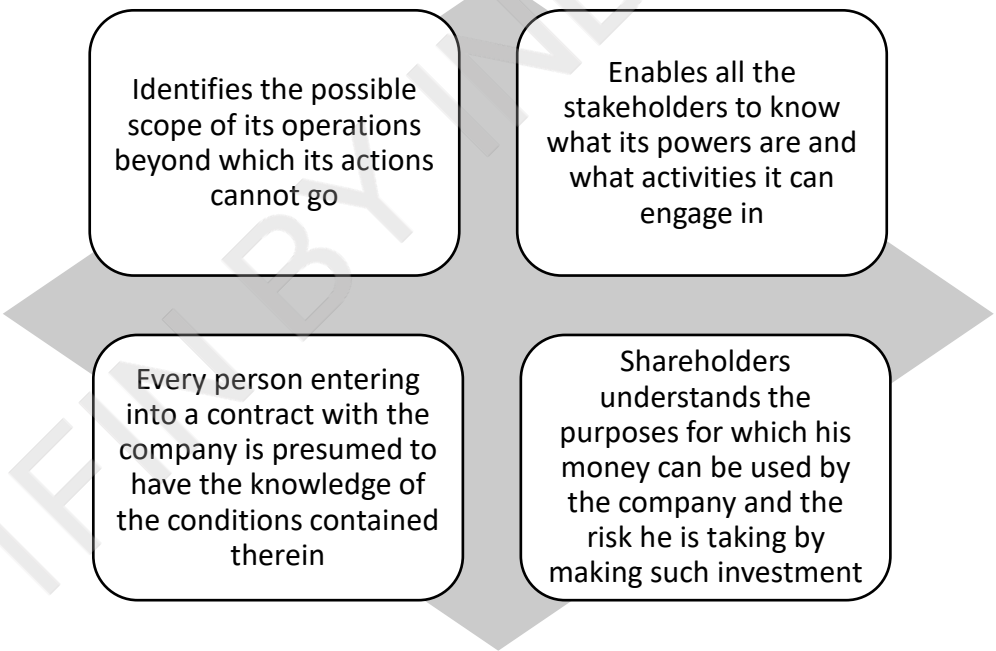
Section 2(56) defines "**Memorandum**" which means the memorandum of association (MOA) of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act.

The memorandum of a company shall be in respective forms as outlined below (Specified in Schedule I):

> Memorandum is the base document for the formation of the company and along with, the Articles of Association (AOA) is regarded as the Constitution of the Company.

Sl.No.	Table	Form
1.	Table A	MOA of a company limited by shares
2.	Table B	MOA of a company limited by guarantee and not having share capital
3.	Table C	MOA of a company limited by guarantee and having share capital
4.	Table D	MOA of an unlimited company and not having share capital
5.	Table E	MOA of an unlimited company and having share capital

3.2 Object of registering a memorandum of association



The **company cannot depart from the provisions contained in the memorandum** however imperative (i.e., utmost imperative) may be the necessity for the departure. **If it does so**, it would be **ultra-vires the company and void.**

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3.3 Content of Memorandum of Association

Memorandum of Association contains the following clauses:

- Name Clause
- Object Clause
- Liability Clause
- Capital Clause
- Domicile/ Situation Clause
- Subscription Clause
- Nomination Clause

3.4 Name Clause

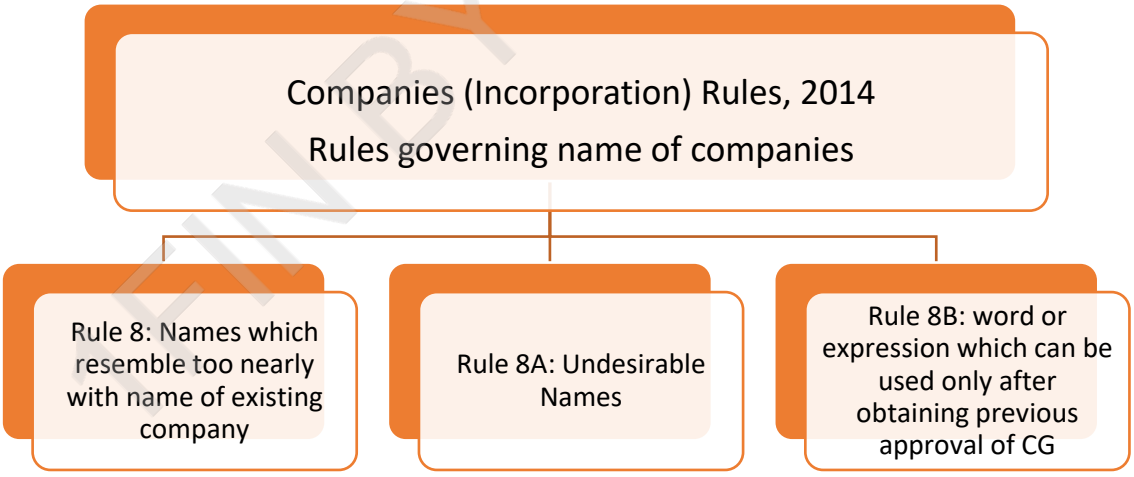
The memorandum of the company shall state, in relation to the name clause, the name of the company with the last word

- **"Limited"** in the case of a **public limited company**, or
- **"Private Limited"** in case of a **private limited company.**

3.4.1 Restrictions on Name of the company

Name of the company **should not be:**

- ✓ **Offensive**
- ✓ **Identical** to existing Name of another company
- ✓ **Similar** to existing Name of another company
- ✓ **Undesirable w.r.t. the objects** of the company
- ✓ **Indicating association with government of India** (unless approved by government)
- ✓ **Containing word "national"** unless specific permission obtained from central government
- ✓ **Containing word "bank"** unless it is involved in banking business.



3.4.2 Reservation of name

a) **Application for reserving a name** as
   - The name of the proposed company; or

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- The name to which the company proposes to change its name

Shall be **made to the Registrar** in the prescribed form and along with fee.

Application for reserving name for proposed company

A person may make an application in SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC-32) accompanied by fee, as provided in the Companies (Registration Offices and Fees) Rules, 2014, to the Registrar for reservation of a name set out in the application as name of the proposed company.

Resubmission shall be allowed within 15 days, for rectification of defect, if any.

A person may make an application, using web service RUN (Reserve Unique Name) along with fee as provided in the Companies (Registration Offices and Fees) Rules, 201

b) Upon receipt of the application, the **Registrar may, reserve the name** of the company **for a period of 20 days** from the date of approval or such other period as may be prescribed.

c) In case of an application for reservation of name or for change of its name by an **existing company**, the Registrar may **reserve the name for 60 days** from the date of approval.

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

- ✓ If the **company has not been incorporated:**
  - The **reserved name shall be cancelled**, and
  - Person who has made the application shall be liable to a **penalty which may extend to Rs. One Lakh.**
- ✓ If the **company has been incorporated:**
  - Direct the company to **change its name within a period of 3 months,** after passing an ordinary resolution;
  - Take action for **striking off the name** of the company from the register of companies; or
  - Make a **petition for winding up** of the company.

3.5 Object Clause

It contains the **objects for which the company is proposed to be incorporated** and any **matter necessary in furtherance** thereof.

Specified IFSC Public Company & IFSC Private company shall state its objects to do financial services activities as permitted under the Special Economic Zones Act, 2005 read with SEZ Rules, 2006 and any matter considered necessary in furtherance thereof in accordance with license to operate, from International Financial Services Centre located in an approved multi services Special Economic Zone, granted by the RBI, SEBI, or IRDA

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3.6 Liability Clause

This clause covers **details on liability of members** of a company, whether limited or unlimited

3.7 Capital Clause

In case of **company limited by shares**:

- the **amount of share capital** with which the company is to be registered,
- The **division of share capital into shares** of a fixed amount,
- The **number of shares which the subscribers to the memorandum agree to subscribe** which shall not be less than one share, and
- The **number of shares each subscriber to the memorandum intends to take**, indicated opposite his name.

In case of an OPC, this clause covers the name of the person (i.e., **nominee**) who in the event of death of subscriber, shall become the member of the company.

3.8 Domicile/ Situation Clause

This clause mentions the **name of the federal state** where the registered office of the company is to be situated.

3.9 Subscription Clause

It states the purpose of the subscribers to incorporate the company wherein they agree to take the shares in the company based on the number written in the Memorandum. It **contains signatures of such subscribers**.

ARTICLES OF ASSOCIATION (AOA)

Section 5 of the Companies Act, 2013 seeks to provide the contents and model of articles of association.

4.1 Articles

Section 2(5) defines "**Articles**" which 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.

The articles of a company shall be in respective forms as outlined below (Model Articles -specified in Schedule I)

Sl.No.	Table	Form
1.	Table F	AOA of a company limited by shares
2.	Table G	AOA of a company limited by guarantee and having share capital

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3.	Table H	AOA of a company limited by guarantee and not having share capital
4.	Table I	AOA of an unlimited company and having share capital
5.	Table J	AOA of an unlimited company and not having share capital

4.2 Content of Articles

- ✓ The AOA shall contain the **regulations for management** of the company.
- ✓ The AOA shall also contain such **matters, as are prescribed under the Rules**.
- ✓ However, a company may also include **such additional matters** in its AOA as may be **considered necessary for its management**.

4.3 Entrenchment Provision

- ✓ It is such provision in AOA that **makes certain amendments either more difficult or impossible to pass,** making such amendments inadmissible.
- ✓ **Time of Entrenchment:**
  - On **formation** of a company, or
  - **By an amendment** in the articles
    - agreed to by all the members of the company in case of a private company; and
    - by a special resolution in the case of a public company.
- ✓ **Notice to the registrar:**
  Where the AOA contains provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the ROC in such form and manner as may be prescribed.

The company shall give notice to the Registrar of entrenchment provisions included in article

a. In the SPICe+(Simplified Proforma for Incorporating company Electronically Plus: INC-32), along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014 at the time of incorporation of the company, and

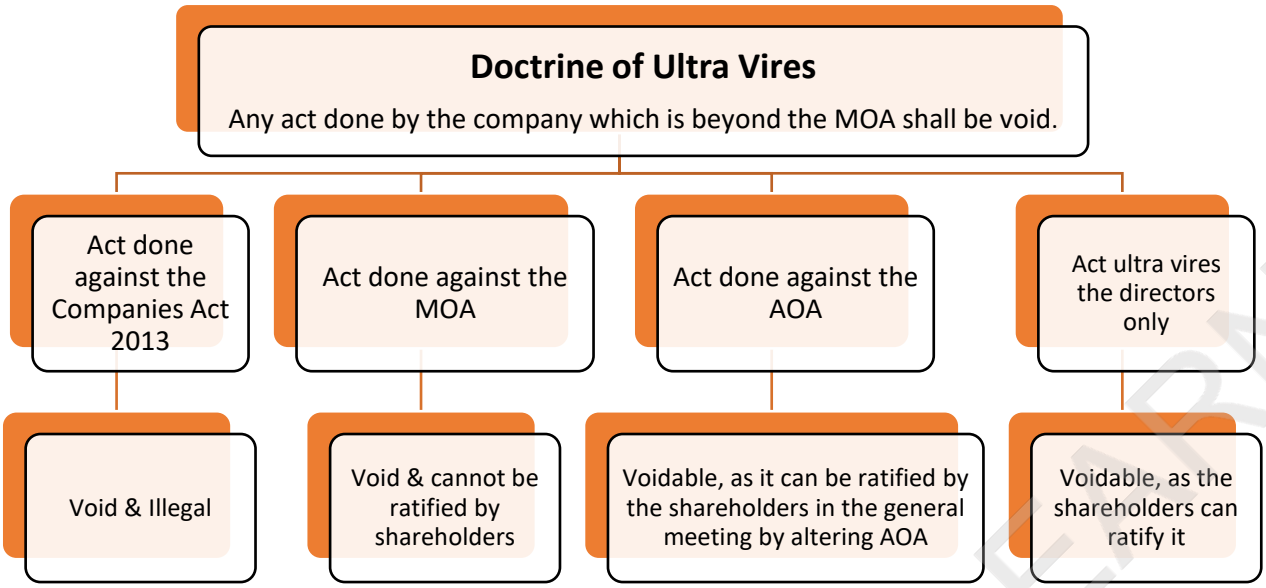
b. In case of existing companies, in Form No. MGT-14 within thirty days from the date of entrenchment of the articles, along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014

DOCTRINE OF ULTRA VIRES

- ✓ The doctrine of ultra-vires prohibits any action which is not stated in the memorandum as the objects or powers of the company.
- ✓ **An act which is ultra vires (i.e., beyond the powers of) is void** and does not bind the company. Neither the company nor the contracting party can sue on it.

The doctrine of ultra vires was first enunciated by the House of Lords in the classic case, **Ashbury Railway Carriage and Iron Co. Ltd v Riche (1878)**

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DOCTRINE OF CONSTRUCTIVE NOTICE

- ✓ The doctrine of constructive notice is a doctrine where **all persons dealing with a company are deemed (or "construed") to have knowledge of the company's articles of association and memorandum of association**.
- ✓ The **doctrine of indoor management is an exception** to this rule.

DOCTRINE OF INDOOR MANAGEMENT

- ✓ According to this doctrine, **persons dealing with the company cannot be assumed to have knowledge of internal problems of the company**. All stakeholders can simply assume that all the required things were get done properly in the company.
- ✓ This doctrine **helps protect external members from the company** and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

Enunciation of Doctrine of Indoor Management

The Doctrine of Indoor Management was first laid down in the case of **Royal British Bank v. Turquand**

The directors of a company were authorised by the articles to borrow on bonds such sums of money as should from time to time, by a resolution of the company in general meeting, be authorised to be borrowed. The directors gave a bond to Turquand without the authority of any such resolution. The question arose whether the company was liable on the bond. Held, the company was liable on the bond, as Turquand was entitled to assume that the resolution of the company in general meeting had been passed

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7.1 Exceptions to the Doctrine of Indoor Management

- **Knowledge of irregularity:** Where the outsider has knowledge of irregularity within the company, the benefit under the doctrine of indoor management would not be available.
- **Negligence:** If, with minimum effort, the irregularities within a company could be discovered by the outsider, the benefit of doctrine of indoor management would not apply.
- **Forgery:** Where a person relies upon a document that turns out to be forged, the benefit of doctrine of indoor management would not apply.

ACT TO OVERRIDE MEMORANDUM, ARTICLES, ETC.

Section 6 of the Companies Act, 2013 states that the provisions of this Act shall have an overriding effect.

Save as otherwise expressly provided in this Act –

(a) The **provisions of this Act shall have effect notwithstanding anything to the contrary contained** in
   - ✓ the **memorandum or articles** of a company, or
   - ✓ any **agreement executed** by it, or
   - ✓ any **resolution passed** by the company in general meeting or by its Board of directors,

   whether the same be registered, executed, or passed, as the case may be, before or after the commencement of this Act; and

The provision of this section starts with **"Save as otherwise…".** This means that if any other section says that article is superior, then we will treat it accordingly.

(b) any **provisions contained** in the memorandum, articles, agreement, or resolution shall, to the extent to **which it is repugnant (i.e., in conflict) to the provisions of this Act**, become or be **void**, as the case may be.

EFFECT OF MEMORANDUM AND ARTICLES

Section 10 of the Companies Act, 2013 covers the effects of registration of the memorandum and articles.

The effect of registration of MOA and AOA are as follows:

1) MOA and AOA shall **bind the company and the members** thereof and
2) All **monies which are payable by any member to the company** under the memorandum or articles **shall be a debt due from him** to the company.

Thus, based on MOA and AOA:

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- ✓ Company is liable to the members
- ✓ Members are liable to the company
- ✓ But normally members are not liable to each other.

Hence, a company can recover calls in arrear from a member as forcefully as it is recovering a loan.

INCORPORATION OF COMPANY

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

10.1 Steps for incorporation of company

10.1.1 Reservation of name

- ✓ An application for reservation of name can be made through the web service available at **www.mca.gov.in** by using the **form RUN (Reserve Unique Name)** along with prescribed fees.
- ✓ The **application may either be approved or rejected**, as the case may be, by the Registrar, Central Registration Centre **after allowing re-submission of such application within 15 days for rectification of defects, if any.**

10.1.2 Drafting and signing of MOA and AOA and its submission to ROC.

- ✓ **Predefined formats given in Schedule I** can be used for drafting the MOA and AOA.
- ✓ These documents have to be **e-filed and e-stamped.**

10.1.3 Consent of directors to be submitted

Consent of persons nominated as directors to act as directors to be submitted electronically.

10.1.4 Submission of statutory declaration

Statutory declaration of compliance and other declarations are to be submitted electronically.

10.1.5 Payment of fees and amount of stamp duty electronically

10.1.6 Obtain Certificate of Incorporation digitally signed by ROC

- ✓ The Registrar shall on the basis of documents and information filed, **register all the documents and information** in the register and **issue a certificate of incorporation** to the effect that the proposed company is incorporated under this Act.
- ✓ On and from the date mentioned in the Certificate of Incorporation, the Registrar shall **allot to the company a Corporate Identity Number**, which shall be a **distinct identity for the company** and shall also be included in the certificate.

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corporate identity number

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

CIN is a 21 alpha-numeric digit based unique identification number, comprising data sections/elements that reveals the basis aspects about company.

Example - Decode the CIN

CIN of Infosys Limited is L85110KA1981PLC013115

The first character – L (reveals listing status, L for listed and U for unlisted, for instance Infosys is Listed one)

The next five digits – 85110

The next two letters – KA (reveals the Indian state where the company is registered, for instance KA is for Karnataka)

The next four digits – 1981 (reveals the year of incorporation of a company)

The next three characters – PLC (reveals the company classification - PLC for public, PTC for private, FTC for foreign, and GOI for government)

The last six digits – 013115 (reveals registration number with concerned ROC

10.1.7 File declaration about address of Registered office.

10.2 Documents and information to be filed with the registrar

For the registration of the company, the following documents and information are to be filed with the registrar within whose jurisdiction the registered office of the company is proposed to be situated –

i. The **MOA and AOA duly signed** by all the subscribers to the memorandum.

ii. A **declaration that all the requirements** of this act and rules thereunder **in respect of registration and related matters have been complied with**. This declaration is to be made by:
- Person who is engaged in the formation of the company (i.e., an advocate, a CA, CS, or CWA in practice) and
- A person named in the articles (director, manager, or secretary of the company)

iii. A **declaration from each of the subscribers and from the persons named as first directors**, if any, in the articles, **stating that** –
- He is **not convicted of any offence** in connection with the promotion, formation, or management of the company, or
- He has **not been found guilty of any fraud** or misfeasance or of any breach of duty to any company **during the last 5 years**, and
- That **all the documents filed** with the registrar for registration of the company c**ontains information that is correct, complete, and true** to the best of his knowledge and belief.

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iv. The **address for correspondence** till its registered office is established.

v. The **particulars** (name, residential address, nationality) **of every subscriber to memorandum** along with proof of identity.

vi. The **particulars** (name, DIN, residential address, nationality) **of persons mentioned in the articles as the first directors** and such other particulars as may be prescribed.

vii. The **particulars of interests of the** persons mentioned in the AOA as **first directors in other firms or body corporates** along with **their consent to act as directors** in such form and manner as may be prescribed.

The duly signed memorandum of association and articles of association (Ch2a)

Note:

Form No. INC-8 is prescribed form for Declaration of Compliance by Professional & Director, Manager or Secretary of company
Form No. INC-9 is prescribed form for Declaration by subscribers to the memorandum and persons named as the first directors
Following particulars of every subscriber to the memorandum shall be filled;
a. Name (including surname or family name) and recent Photograph affixed
b. Father's/Mother's name
c. Nationality, Proof of nationality in case the subscriber is a foreign national
d. Date and Place of Birth (District and State)
e. Educational qualification and Occupation
f. Permanent Account Number
g. Email id and Phone number of Subscriber
h. Permanent residential address and also Present address
i. Residential proof such as Bank Statement, Electricity Bill, Telephone / Mobile Bill, provided that Bank statement Electricity bill, Telephone or Mobile bill shall not be more than two months old
j. Proof of Identity (For Indian Nationals - Voter's identity card, Passport copy, Driving License copy, Unique Identification Number (UIN) & for Foreign nationals and Non Resident Indians – Passport)
k. If the subscriber is already a director or promoter of a company(s), the particulars relating to name of the company; Corporate Identity Number; Whether interested as a director or promoter

Where the subscriber to the memorandum is a body corporate, then the following particulars shall be filed with the Registrar

a. The name of the body corporate and Corporate Identity Number of the Company or Registration number of the body corporate, if any
b. GLN, if any
c. The registered office address or principal place of business
d. E-mail Id

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e. If the body corporate is a company, certified true copy of the board resolution specifying inter-alia the authorization to subscribe to the MOA
f. If the body corporate is a limited liability partnership or partnership firm, certified true copy of the resolution agreed to by all the partners specifying inter alia the authorization to subscribe to the MOA
g. In case of foreign bodies corporate, the details relating to the copy of certificate of incorporation of the foreign body corporate; & the registered office address

An application for registration of a company shall be filed, with the Registrar within whose jurisdiction the registered office of the company is proposed to be situated, in SPICe+(Simplified Proforma for Incorporating company Electronically Plus: INC32) along with the fee as provided under the Companies (Registration offices and fees) Rules, 2014 accompanied by following documents and information;

SPICe+ is an integrated Web form offering 10 services by 3 Central Govt. Ministries & Departments. (Ministry of Corporate Affairs, Ministry of Labour & Department of Revenue in the Ministry of Finance) thereby saving as many procedures, time and cost for starting a business in India. SPICe+ is initiatives towards Ease of Doing Business. Students may refer to FAQs on SPICe+ form at MCAs' website for more details
https://www.mca.gov.in/MinistryV2/spicefaq.html

The duly signed memorandum of association and articles of association

The memorandum (e-MOA in Form No. INC-33) and article (e-AOA in Form No. INC-34) of company so furnished shall be duly signed by all the subscribers to the memorandum in the manner prescribed by rule 13 of the *Companies (Incorporation) Rules, 2014* as stated below:

a. Each subscriber shall add **his name, address, description & occupation**, if any, in the presence of **at least one witness** who shall attest the signature, shall sign and add his name, address, description and occupation, if any.

b. Where a subscriber is illiterate, he shall **affix his thumb impression** or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and **authenticate it by his own signature** and he shall also write against the name of the subscriber, the number of shares taken by him.

Note: The type written or printed particulars of the subscribers and witnesses shall be allowed as if it is written, so long as appends signature or thumb impression.

c. Where the subscriber is a **body corporate**, the memorandum and articles of association shall be signed by **director, officer or employee** of the body corporate **duly authorized** in this behalf by a resolution of the board of directors.

d. Where the subscriber is a **Limited Liability Partnership**, it shall be signed by a **partner** of the Limited Liability Partnership, **duly authorized** by a resolution approved by all the partners of the Limited Liability Partnership:

Note: In either case c or d stated above, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of Association.

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e. Where subscriber to the memorandum is a foreign national residing outside India his signatures and address on the memorandum and articles of association and proof of identity shall be **notarized by a Notary (Public)** with a certificate. Further, if such person residing in a country outside the Commonwealth or which is not a party to the Hague Apostille Convention, 1961, the certificate of the Notary (Public) shall be **authenticated by a Diplomatic or Consular Officer.**

f. Where subscriber to the memorandum is a foreign national residing outside India and visited in India and intended to incorporate a company, in such case the incorporation shall be allowed if, he/she is having a valid **Business Visa**. In case of Person is of Indian Origin or Overseas Citizen of India, requirement of business Visa shall not be applicable.

As per rule 12 of the Companies (Incorporation) Rules, 2014

In case any of the objects of a company requires registration or approval from sectoral regulators such as the RBI and SEBI, then such registration or approval shall be obtained by the proposed company before pursuing such objects and a declaration in this behalf shall be submitted at the stage of incorporation. In case of a Company being incorporated as a Nidhi, the declaration by the Central Government under Section 406 of the Act shall be obtained by the Nidhi before commencing the business and a declaration in this behalf shall be submitted at the stage of incorporation by the Company

10.3 Maintenance of copies of all documents and information

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

10.4 Furnishing of false or incorrect information or suppression of material fact at the time of incorporation

- ✓ If any person furnishes any false or incorrect information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to registration of company, he shall be **held liable for action for fraud u/s 447.**

- ✓ **If the company has already been incorporated by furnishing false or incorrect information or suppressing any material fact: -** the promoters, persons named as first directors, persons making declaration shall each be **held liable for fraud u/s 447.**

- ✓ **Order of the Tribunal:** The Tribunal may, on an application made to it, on being satisfied that the situation so warrants –
    - Pass such orders as it thinks fit for regulation of management of the company including **changes, if any, in its MOA and AOA**; or
    - Direct that **liability of the members shall be unlimited**; or
    - Direct the **removal of name of company** from the Register of companies; or
    - Pass an **order for winding up of the company**; or
    - Pass **such orders as it thinks fit**.

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Before making such order, the company shall be given a **reasonable opportunity of being heard** and consider such transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

EFFECT OF REGISTRATION

Section 9 of the Companies Act, 2013 provides the effect of registration of a company.

From the date of incorporation, the subscribers to the memorandum and all other persons, who may from time to time become members of the company,

- → **shall be a body corporate** by the name contained in the memorandum.
- → **Capable of exercising all the functions of an incorporated company** under this act and
- → Having **perpetual succession** with power
  - ✓ to **acquire, hold and dispose of property**,
  - ✓ to **contract**, and
  - ✓ to **sue and be sued**,

  by the said name.

COMMENCEMENT OF BUSINESS ETC.

Section 10A of the Companies Act, 2013 covers the provisions relating to commencement of business after incorporation of a company.

12.1 Declaration to be filed before commencement of business [Sec 10A(1)]

A company incorporated after the commencement of the Companies (Amendment) Ordinance, 2019 and having a share capital shall not commence any business or exercise any borrowing power unless –

(a) A declaration is **filed by a director within a period of 180 days** of the date of incorporation of the company with the Registrar that **every subscriber to the memorandum has paid the value of the shares agreed** to be taken by him on the date of making such declaration: and

(b) The company has filed with the Registrar a **verification of its registered office**.

12.2 Penalty on defaultssss

Rule 23A of the Companies (Incorporation) Rules, 2014 states that the **declaration u/s 10A** by the director shall be in the prescribed form with prescribed fees and the contents of the form **shall be verified by a CS/CA/CWA, in practice.**

If any default is made in complying with these provisions,

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→ the **company** shall be liable to a penalty of **Rs 50,000/-**, and
→ every **officer in default** shall be liable to penalty of **Rs 1,000/- for each day** during which default continues subject to a **maximum penalty of Rs 1,00,000/-.**

Where **no declaration has been filed** with the registrar u/s 10A(1)(a) within 180 days and

→ the Registrar has reasonable cause to believe that the **company is not carrying on any business or operations**,
→ he may **initiate action for removal of name of Company** from the register of Companies.

AUTHENTICATION OF DOCUMENTS, PROCEEDINGS AND CONTRACTS

Section 21 of the Companies Act, 2013 covers the provisions relating to authentication of documents or proceedings or contracts made by or on behalf of a company.

13.1 Authentication

A document or proceeding requiring authentication by a company or contracts made by or on behalf of a company **may be signed by** –

i. Any **key managerial personnel**, or

ii. An **officer or employee of the company duly authorized** by the Board in this behalf.

13.2 Key managerial personnel

Section 2(51) defines "**Key managerial personnel**", (KMP) in relation to a company, which means-

(a) the CEO or the MD or the manager.
(b) the company secretary.
(c) the whole-time director.
(d) the CFO.
(e) such other officer not more than one level below the directors who is in whole time employment, designated as KMP by the Board: and
(f) such other officer as may be prescribed.

EXECUTION OF BILLS OF EXCHANGE, ETC.

Section 22 of Companies Act, 2013 covers provisions relating to execution of Bills of exchange, hundi and promissory note and other deeds.

(1) A bill of exchange, hundi, or promissory note shall be **deemed to have been made, accepted, drawn or endorsed on behalf of a company**, if –

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→ Made, accepted, drawn, or endorsed in the name of, or on behalf of, or on account of the company, by **any person authorised by the company in this behalf.**

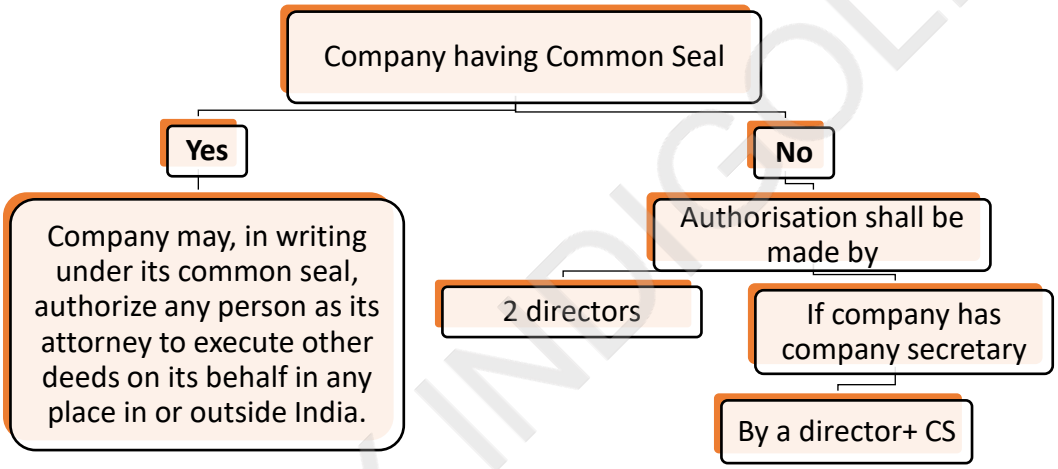
(2) **Authorisation of a person by the company:**

→ **If the company has common seal:** Company may, by writing under its common seal, authorize any person, either generally or for specified matters, as its attorney to execute other deeds on its behalf in any place in or outside India.

→ **If the company does not have a common seal:**

- **Company has appointed a company secretary:** The authorization shall be made by a director and the CS.
- **Company does not have Company Secretary**: The authorization shall be made by 2 directors.

(3) A **deed signed by such an attorney** on behalf of the company and under his seal **shall bind the company**.



SERVICE OF DOCUMENTS

Section 20 of the Companies Act, 2013 provides the mode in which documents may be served on the company, on the members and on the registrars.

15.1 Serving of document to the Company

A document may be served on a company or an officer thereof by **sending it to the company or the officer at the registered office of the company by**-

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- ✓ Registered post, or
- ✓ Speed post, or
- ✓ Courier service, or
- ✓ Leaving it at its registered office, or
- ✓ Means of such electronic or other mode as may be prescribed.

Electronic mode means any mode using electronic media that is capable of retention, including:

- Fax or email
- Posting of an electronic message board or network designated by the registrar.
- Other means of electronic communication

15.2 Serving of document to Registrar/ Member

→ A document may be served on registrar/ any member by **sending it to him by-**

- ✓ Post, or
- ✓ Registered post, or
- ✓ Speed post, or
- ✓ Courier service, or
- ✓ Leaving it at its registered office, or
- ✓ Means of such electronic or other mode as may be prescribed.

→ A **member may request for delivery of any document through a particular mode**, for which he shall pay such fees as may be determined by the company in its AGM.

→ Where the **Act or Rules made thereof provided for filing of documents with the Registrar in electronic mode**, it shall only be filed in electronic mode.

15.3 Time when service is effected

In case of delivery by post, such service shall be deemed to have been effected-

→ In case of notice of meeting : at the expiration of 48 hours after the notice is posted; and
→ In other case: at the time at which the letter would be delivered in the ordinary course of post.

SUBSIDIARY COMPANY NOT TO HOLD SHARES IN ITS HOLDING COMPANY

Section 19 of the Companies Act, 2013 provides the provisions relating to holding of shares by subsidiary company in its holding company.

16.1 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.

16.2 Subsidiary Company [Section 2(87)]

Subsidiary company or subsidiary, in relation to any other company, means a company in which the holding company –

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a) Controls the composition of the Board of Directors; or
b) Exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies.

16.3 Subsidiary company not to hold shares in the Holding Company [Section 19]

No company shall, either by itself, or through its nominees,

→ **hold any shares in its holding company**
→ and **no holding company shall allot or transfer its shares** to any of its subsidiary companies
→ and **any such allotment or transfer of shares** of a company to its subsidiary company **shall be void**.

Exceptions:

a) Subsidiary company holds such shares as **legal representative** of a deceased member of the holding company.
b) Subsidiary company holds such shares as **trustee.**
c) Subsidiary company is a **shareholder even before it became a subsidiary** of the holding company. However, the subsidiary company shall have a right to vote at a meeting of the holding company only in respect of the shares held by it as a legal representative or as a trustee.

RECTIFICATION OF NAME OF THE COMPANY

Example:

→ RPIP Ltd. has invested 51% in the shares of SSP Pvt. Ltd. on 31st March 2019.
→ SSP Pvt. Ltd. have been holding 2% equity of RPIP Ltd. since 2013.
→ SSP Pvt. Ltd. cannot increase its equity beyond that 2% on or after 31st March 2019.
→ However, it could continue to hold or reduce its initial 2% stake.

17.1 Rectification based on opinion of Central Government [Section 16(1)(a)]

If a company on its first registration, or on its registration by a new name, is registered by a name which, **in the opinion of the Central Government** (CG),

→ **is identical with or too nearly resembles** the name by which a company in existence had been previously registered,

Section 16 of the Companies Act, 2013 provides the provisions relating to rectification of the name of a company.

Note: Rectification is different from voluntary change of name.

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→ it may **direct the company to change its name**
→ and the **company shall change its name** or new name
→ **within a period of 3 months** from the issue of such direction by passing an ordinary resolution.

17.2 Rectification based on an application by a registered proprietor of a trademark [Section 16(1)(b)]

If a company on its first registration, or on its registration by a new name, is registered by a name which, **on an application by a registered proprietor of a trademark,**

→ is **identical with or too nearly resembles** to a registered trademark of such proprietor,
→ **made to the CG within 3 years** of incorporation or registration or change of name of the company,
→ the CG may **direct the company to change its name** or new name
→ **within a period of ~~6~~ 3 months** from the issue of such direction by passing an ordinary resolution.

17.3 Notice of change to registrar [Section 16(2)]

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

17.4 Default

- Central Government shall allot new name to company in such manner as may be prescribed and
- Registrar shall enter new name in register of companies in place of old name and issue a fresh certificate of incorporation with new name, which the company shall use thereafter
- Provided that it shall NOT prevent a company from subsequently changing its name in accordance with the provisions of section 13

REGISTERED OFFICE OF THE COMPANY

Section 12 of the Companies Act, 2013 seeks to provide for the registered office of the companies for the communication and serving of necessary documents, notices, letters etc.

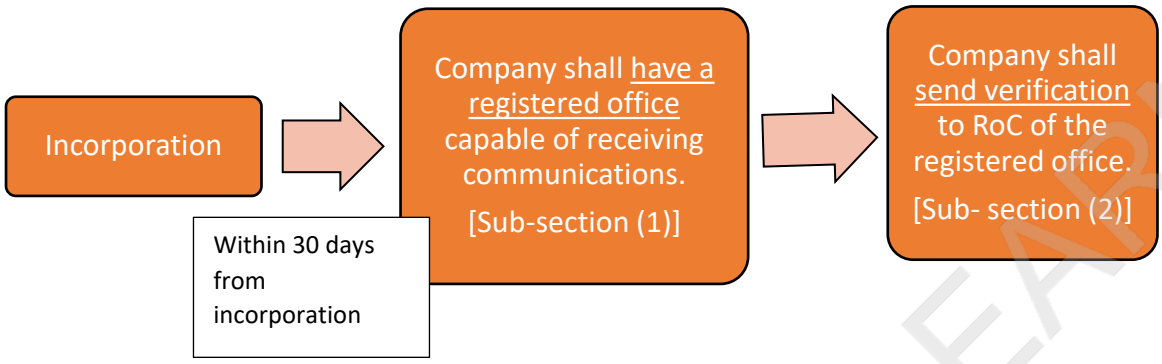
The registered office of a company should be a **physical office** where the corporation will receive service of legal documents from ROC or in case of lawsuit, etc. This address **cannot be a P.O. box** but must be a physical location where someone is present, to receive service of legal documents during normal business hours.

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18.1 Need for Registered office

- ✓ For **communication** and serving of necessary documents, notices, letters etc.
- ✓ To determine the **domicile and nationality** of a company.
- ✓ To determine the **jurisdiction** of the court.

18.2 Verification of registered office



18.3 Labelling of Company

Every company shall –

- ✓ **Paint, or affix its name and the address of its registered office**, and keep the same painted and affixed, **on the outside of every office or place in which its business is carried on**, in a conspicuous position, in legible letters, and
  - → If the characters employed are not those of the language in general use in that locality, then also in the characters of that language.
- ✓ Have its **name engraved in legible characters on its seal**, if any.
- ✓ Get its **name, registered office address, CIN, telephone number**, fax number, email, and website address, if any, printed in all its **business letters, bill heads, letter papers and in all its notices** and other official publications.
- ✓ Have its **name printed on hundis, promissory notes, bills of exchange** and such other documents as may be prescribed.

18.3.1 Name change by the company

Where a company has **changed its name(s) during the last 2 years**, it shall **paint or affix or print, along with its name, the former name(s) so changed** during the last 2 years.

18.3.2 In case of OPC

The **words "One Person Company" shall be mentioned in the brackets** below the name of such company, wherever its name is printed, affixed, or engraved.

18.4 Change of Registered Office

18.4.1 Notice of change to the Registrar

- → Verified in the manner prescribed,
- → Shall be **given to the Registrar within 30 days of the change**, who shall record the same.

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18.4.2 Change outside the local limits of any city

The registered office of a company shall be changed to outside the local limits of any city, town, or village where such office is situated **by passing a special resolution.**

18.4.3 Change outside the jurisdiction of the Registrar

Where a company changes the place of its registered office from the jurisdiction of one Registrar to the jurisdiction of another Registrar **within the same State**,

- → Such change is **to be confirmed by the Regional Director** on an application made by the company.
- → The **confirmation of such change shall be communicated within 30 days** from the date of receipt of application by the regional director to the company.
- → The company shall **file the confirmation with the Registrar within 60 days** of the date of confirmation.
- → The **Registrar shall** register the same and **certify the registration within 30 days** from the date of filing such confirmation.
- → The certificate shall be conclusive evidence of compliance of requirements of this Act.

The alteration of the memorandum relating to the place of the registered office from one State to another shall not have any effect unless it is approved by the Central Government (power delegated to Regional Director by Central Government) 30 on an application in Form No. INC-23 along with the fee and shall be accompanied by the following documents, namely;

a. Copy of Memorandum of Association, with proposed alterations;

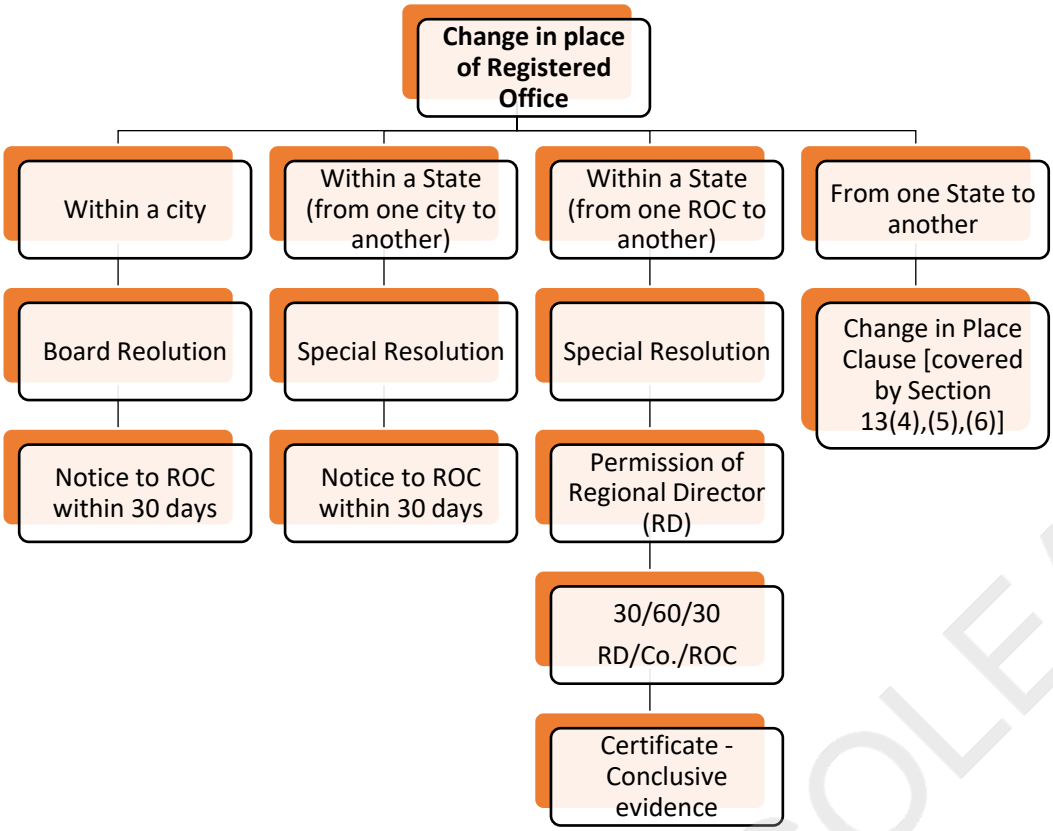
b. Copy of the minutes of the general meeting at which the resolution authorising such alteration was passed, giving details of the number of votes cast in favour or against the resolution;

c. Copy of Board Resolution or Power of Attorney or the executed vakalatnama, as the case may be.

d. List of creditors and debenture holders

e. Acknowledgment of service of a copy of the application with complete annexures to the Registrar and Chief Secretary of the State Government or Union territory where the registered office is situated at the time of filing the application.

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18.5 Penalty on default

- ✓ If any default is made in complying with the requirements of this section, the **company and every officer in default** shall be punishable with a penalty of
  - → **Rs. 1,000/- for each day** during which the default continues
  - → but **not exceeding Rs. 1,00,000/-. [Sub-section (8)]**

- ✓ If the ROC has reasonable cause to believe that **company is not carrying on any business or operations**,
  - → He may cause a **physical verification** of the registered office of the company in prescribed manner and
  - → If any **default is found to be made** in complying with the requirements of sub-section (1),
  - → He may without prejudice to the provisions of sub-section (8), **initiate action for the removal of the name of the company** from the register of companies.

CONVERSION OF COMPANIES ALREADY REGISTERED

Section 18 of the Companies Act, 2013 provides the provisions relating to conversion of a company to some other class of company.

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A registered company of any class may convert itself as a company of any other class **by alteration of memorandum and articles of the company.**

Where such conversion is required to be done, the company shall **file an application to the Registrar.**

The **Registrar shall,** after satisfying himself that the provisions applicable for registration of companies have been complied with, **close the former registration of the company.**

After registering the required documents, the **Registrar shall issue a certificate of incorporation.**

The conversion of companies shall not affect any debts, liablities, obligations or contracts incurred or enterd into, by or on behalf of the company before the conversion. Such debts etc may be enforced in the manner as if such registration had not been done.

ALTERATION OF ARTICLES

Section 14 of the Companies Act, 2013 vests companies with power to alter or add to its articles.

a) Subject to the provisions of the Act and the conditions contained in the MOA, a company may, **by a special resolution**, alter its Articles.

b) Alteration of Articles include the alterations having the effect of conversion of-

- ✓ A private company to a public company; or
- ✓ A public company to a private company.

c) An alteration having the effect of **conversion of a public company into a private company shall be valid only if it is approved by the Central Government**, on an application made by the company.

d) **Every alteration of AOA and a copy of the order of the Central Government** approving the order, shall be **filed with the Registrar**, together with a copy of the altered AOA, **within 15 days**, who shall register the same.

e) Every alteration made in the AOA shall be **noted in every copy of the AOA.**

f) **ALTERATION BY SPECIAL RESOLUTION**
Any alteration having the effect of conversion of a public company into a private company shall not be valid unless it is approved by an order of the Central Government on an application made within sixty days from the date of passing of special resolution, be filed with Regional Director in e-Form No. RD-1 along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 and shall be accompanied by the following documents, namely;

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a. Draft copy of Memorandum of Association and Articles of Association, with proposed alterations;
b. Copy of the minutes of the general meeting at which the special resolution authorising such alteration was passed together with details of votes cast in favour and or against with names of dissenters;
c. Copy of Board resolution or Power of Attorney dated not earlier than thirty days, as the case may be, authorising to file application for such conversion;
d. Declaration by a key managerial personnel regarding the compliance under difference section of the Act and rules made there under;

g) **Penalty on default**: The company and every officer in default shall be liable to a penalty of **Rs. 1,000/- for every copy of AOA issued without such alterations**.

ALTERATION OF MEMORANDUM

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

Section 15 of the Companies Act, 2013 provides that the alteration of MOA/AOA shall be noted in every copy of the MOA/AOA.

Company may alter the provisions of its MOA with the approval of the members by a Special resolution.

21.1 Name change of the company

- ✓ Name change shall be **effected only with the approval of the CG** in writing.
  - → However, such **approval of CG is not necessary** where the change in the name is related only to **addition/ deletion of the word "Private"** upon conversion of any class of company into another.
- ✓ **Name change is not allowed to a company** which has not filed annual returns or financial statements with the Registrar or failed to pay or repay matured deposits or debentures or interest thereon.
- ✓ **On change of name, the ROC shall**
  - → **enter the new name in the Register of companies**, in the place of the old name and
  - → shall **issue a fresh certificate of incorporation** with the new name, and
  - → the change in name shall be complete and effective only on the issue of such a certificate.

21.2 Change in the registered office

- ✓ The alteration of the MOA with respect to place of registered office from one State to another shall not have any effect unless it is **approved by the Central Government on an application filed to it.**

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- ✓ The **Central Government shall verify that**
  - → The alteration has the **consent of the creditors, debenture holders**, and other persons concerned with the company, **or**
  - → **Sufficient provision** has been made by the company **for due discharge of all its debts and obligations**, **or**
  - → **Adequate security** has been provided for such discharge.

- ✓ Once the Central Government is satisfied upon these verifications, it shall **dispose off the application within 60 days.**

- ✓ The company shall **file with the Registrar-**
  - → The **special resolution** passed by the company, and
  - → The **approval of the Central Government** for change in name of the company, if the alteration involves any such change.
- ✓ The company shall **file a certified copy of the order of the Central government approving the alteration with the Registrar of each of the States**, who shall register the same.

- ✓ The Registrar of the State to which the registered office is being shifted to, shall **issue a fresh certificate of incorporation indicating the alteration**.

21.3 Change in liability clause

The change in liability which results in **increase in liability of any shareholder** shall not be valid without the **consent of such shareholder**.

21.4 Change in capital clause

Every alteration of MOA should be approved by the company by passing a **Special resolution u/s 13.** Apart from this, **Section 61** of the Companies Act, 2013 **deals with the power of limited company to alter its capital clause**.

- → A limited company having a share capital may, **if so authorized by its Articles**, **alter its share capital by passing an ordinary resolution.**

- → The **notice of such alteration** must be **given to the registrar within 30 days** of such alteration in **Form SH-7** with the certified true copy of ordinary resolution along with the explanatory statement and altered copy of the MOA.

21.5 Change in the object of the company

- → **A company, which has raised money from the public through prospectus and still has any unutilized amount** out of the money so raised, **shall not change its objects** for which it raised the money **unless a special resolution through postal ballot is passed** by the company.

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→ The **details of such resolution** shall be **published in the newspapers** (one in English and one in vernacular language) which is in circulation at the place where registered office of the company is situated.

→ Also, the details of such resolution shall be **placed on the website** of the company, if any, indicating therein the reason for such change.

→ The **dissenting shareholders** shall be given an **opportunity to exit**.

→ The **registrar shall register any alteration of the MOA** with respect to the objects of the company and certify the registration **within 30 days** from the date of filing the special resolution.

21.6 Alteration to be noted in every copy [Section 15]

✓ Every alteration made in the MOA /AOA of a company shall be noted in **every copy** of the memorandum or articles, as the case may be.

✓ **If the company defaults**: The company and every officer in default shall be liable to a **penalty of Rs. 1,000/- for every copy of the MOA/AOA issued without alteration.**

COPIES OF MEMORANDUM, ARTICLES, ETC., TO BE GIVEN TO MEMBERS

Where any member of a company requests for the copies of

(a) The memorandum,

Section 17 of the Companies Act, 2013 provides the provisions that deal with providing the members of the company with the copies of MOA/AOA.

(b) The Articles; and

(c) Every document and every resolution referred in section 117 (i.e., Resolutions and agreements to be filed), if and in so far as they have not been embodied (i.e., incorporated) in the MOA and AOA,

the company shall, **within 7 days of the request** on the payment of fees, send copies of these documents.

In case of default: The company and every officer in default shall be liable for each default, to a **penalty of Rs. 1,000/- for each day** during which the default continues, subject to a **maximum of Rs. 1,00,000/-**

ONE PERSON COMPANY (OPC) [Section 3]

23.1 Nominee of OPC

✓ The MOA of a One Person company shall **indicate the name of the other person (i.e., Nominee),** with his prior consent in the prescribed form, who shall, **in the event of death of the subscriber or his incapacity to contract become the member of the company**, and

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- ✓ The **written consent of such person shall be filed with the registrar** at the time of incorporation of the company along with its MOA and AOA.
- ✓ Such **nominee may, at any time, withdraw his consent** in such manner as may be prescribed.
- ✓ The **member of OPC may, at any time, change the name of the Nominee** by giving a notice in such manner as may be prescribed.
- ✓ It shall be the **duty of the member of OPC to intimate the company the change**, if any, in the name of the Nominee by indicating in the MOA or otherwise within such time and in such manner as may be prescribed. However, any change in the name of Nominee **shall not be deemed to be an alteration of the MOA.**

23.2 Qualifications of Member/ Nominee of OPC

i. A **natural person**,
ii. An **Indian citizen**, whether **resident in India or otherwise**
(***Resident in India*** *means a person who has stayed in India* ***for a period of not less than 120 days*** *during the immediately preceding financial year*).
iii. **Not a minor**.

Can a minor start a OPC for his benefit through his guardian?

Ans: No. A minor cannot hold shares of OPC with beneficial interest.

23.3 Member/ Nominee of not more than one OPC

- ✓ A natural person shall not be a member of more than one OPC at any point of time and the said person shall not be a nominee of more than one OPC.

This means that a person can be the member of one OPC and nominee of another one OPC at the same time. However, no person can be the member/nominee of more than one OPC at the same time.

- ✓ Where a natural person being a member in OPC,
  - → Becomes member in another OPC by virtue of his being nominee in that OPC,
  - → Such person shall **meet the eligibility criteria within a period of 180 days.**

23.4 Restrictions upon OPC

i. OPC **cannot be incorporated or converted into a Section 8 company** though it can be converted into private or public companies anytime after its incorporation.

ii. OPC **cannot carry out Non-Banking Financial Investment activities** including investment in securities of any body corporate.

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Section 8 of the Companies Act, 2013 deals with the formation of not-for-profit companies.

24.1 Object of formation of Section 8 Company

- ✓ **To promote the charitable objects** of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.
- ✓ Such company intends to **apply its profit in promoting its objects**.
- ✓ Section 8 company **prohibits the payment of any dividend** to its members.

24.2 Power of Central Government to issue the license

The Central Government shall register such person or association of person **as a company with limited liability without the addition of the words 'Limited' or 'Private Limited' to its name**, by issuing license on such conditions as it deems fit.

The **Registrar shall on application register** such person or association of persons as a company under this Section.

REGISTRATION OF COMPANY USING LICENSE

After granting licence, an application shall be made to registrar under section 8(1) itself for registration of company in the manner specified in rule 19 of *the Companies (Incorporation) Rules 2014.*

Application for registration

A person or an association of persons desirous of incorporating a company with limited liability under section 8(1), shall make an application to registrar in **Form SPICe+** (Simplified Proforma for Incorporating company Electronically Plus: INC- 32) along with the fee as provided in *the Companies (Registration offices and fees) Rules, 2014.*

Supporting document along with Application

The application furnished as specified above shall be accompanied by the following documents;

a. The memorandum and articles of association of the proposed company in the Form No. INC-13 and Form No. INC-31, respectively;

b. An estimate of the future annual income and expenditure of the company for next three years, specifying the sources of the income and the objects of the expenditure;

c. The declaration in by an Advocate, a Chartered Accountant, cost accountant or Company Secretary in practice Form No. INC-14 and by each of the persons making the application in Form No. INC-15, that;

- ♦ the memorandum and articles of association have been drawn up in conformity with the provisions of section 8 and rules made thereunder and
- ♦ all the requirements of the Act and the rules made thereunder relating to registration of the company under section 8 and matters incidental or supplemental thereto have

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been complied with;

24.3 Special provisions relating to Section 8 company

i. On registration, the Section 8 company shall enjoy **same privileges and obligations as of a limited company**.

ii. A **firm can be a member** of a Section 8 company.

iii. **Shall not alter the provisions of its MOA/AOA** except with the **previous approval of the Central Government**.

iv. Section 8 company which intends to **convert itself into a company of any other kind** shall pass a **special resolution** at a general meeting for approving such conversion.

v. Can call its general meeting by giving a clear 14 days notice instead of 21 days.

vi. Requirement of minimum number of directors, independent directors does not apply.

vii. Need not constitute Nomination and Remuneration Committee and Shareholders Relationship Committee.

24.4 Revocation of license

24.4.1 Reasons for revocation of license

(a) Company **contravenes any of the requirements or conditions** of this section subject to which a license is issued, or
(b) The **affairs of the company are conducted fraudulently**, or in violation to its objects, or prejudicial to public interest.

Before such revocation the Central Government must give it a written notice of its intention to revoke the license and opportunity of being heard.

24.4.2 Effect of revocation of license

✓ The **Registrar shall put the words 'Limited' or 'Private Limited'** against the companies name in the register.

✓ The **Central Government may**, by order, if it is satisfied that it is essential in the public interest, **direct that the company be wound up** under this Act **or amalgamated** with another company registered under this Section and having similar objects, after giving the company an opportunity of being heard.

✓ If upon winding up or dissolution, **there remains**, after the satisfaction of its debts and liabilities, **any asset**,
→ **they may be transferred to another company registered under this Section** and having similar objects, subject to such conditions as Tribunal may impose, **or**
→ **may be sold** and proceeds thereof credited to the Insolvency and Bankruptcy Fund.

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CONVERSION INTO ANY OTHER KIND OF COMPANY

A company registered under this section may convert itself into company of any other kind only after complying with such conditions as may be prescribed in rule 21 and 22 of the Companies (Incorporation) Rule 2014 as described below;

a. A company shall pass a **special resolution** at a general meeting for approving such conversion

b. An **explanatory statement** to notice of such general meeting must set-out the details on reason of such conversion.

c. The company shall file an application in Form No. INC-18 with the **Regional Director** with the fee along with a certified true copy of the special resolution and a copy of the Notice convening the meeting including the explanatory statement for approval for conversion.

Also attach the proof of serving of the notice served by **registered post or hand delivery**, to:

1. the Chief Commissioner of Income Tax having jurisdiction over the company,
2. Income Tax Officer who has jurisdiction over the company,
3. the Charity Commissioner,
4. the Chief Secretary of the State in which the registered office of the company is situated,
5. any organisation or Department of the Central Government or State Government or other authority under whose jurisdiction the company has been operating.

Note: If any of these authorities wish to make any representation to Regional Director, it shall do so within sixty days of the receipt of the notice, after giving an opportunity to the Company.

d. A **copy** of the application with annexures as filed with the Regional Director shall also be **filed with the Registrar**.

The company shall, within a week from the date of submitting the application to the Regional Director, **publish a notice** at its own expense, and a copy of the notice, as published, shall be sent forthwith to the Regional Director and the said notice shall be in Form No. INC-19 and shall be published;

1. 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 having a wide circulation in that district, and **at least once in English language** in an English newspaper having a wide circulation in that district; and
2. on the **website of the company**, if any, and as may be notified or directed by the Central Government.

e. The company should have filed all its **financial statements** and **Annual Returns** upto the financial year preceding the submission of the application to the Regional Director and all other returns required to be filed under the Act up to the date of submitting the application to the Regional Director

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Note: In the event the application is made after the expiry of three months from the date of preceding financial year to which the financial statement has been filed, a statement of the financial position duly certified by chartered accountant made up to a date not preceding thirty days of filing the application shall be attached.

f. On receipt of the application, and on being satisfied , the Regional Director shall issue an **order approving the conversion** of the company into a company of any other kind subject to **such terms and conditions** as may be imposed in the facts and circumstances of each case.

g. Before imposing the conditions or rejecting the application, the company shall be given a reasonable **opportunity of being heard** by the Regional Director

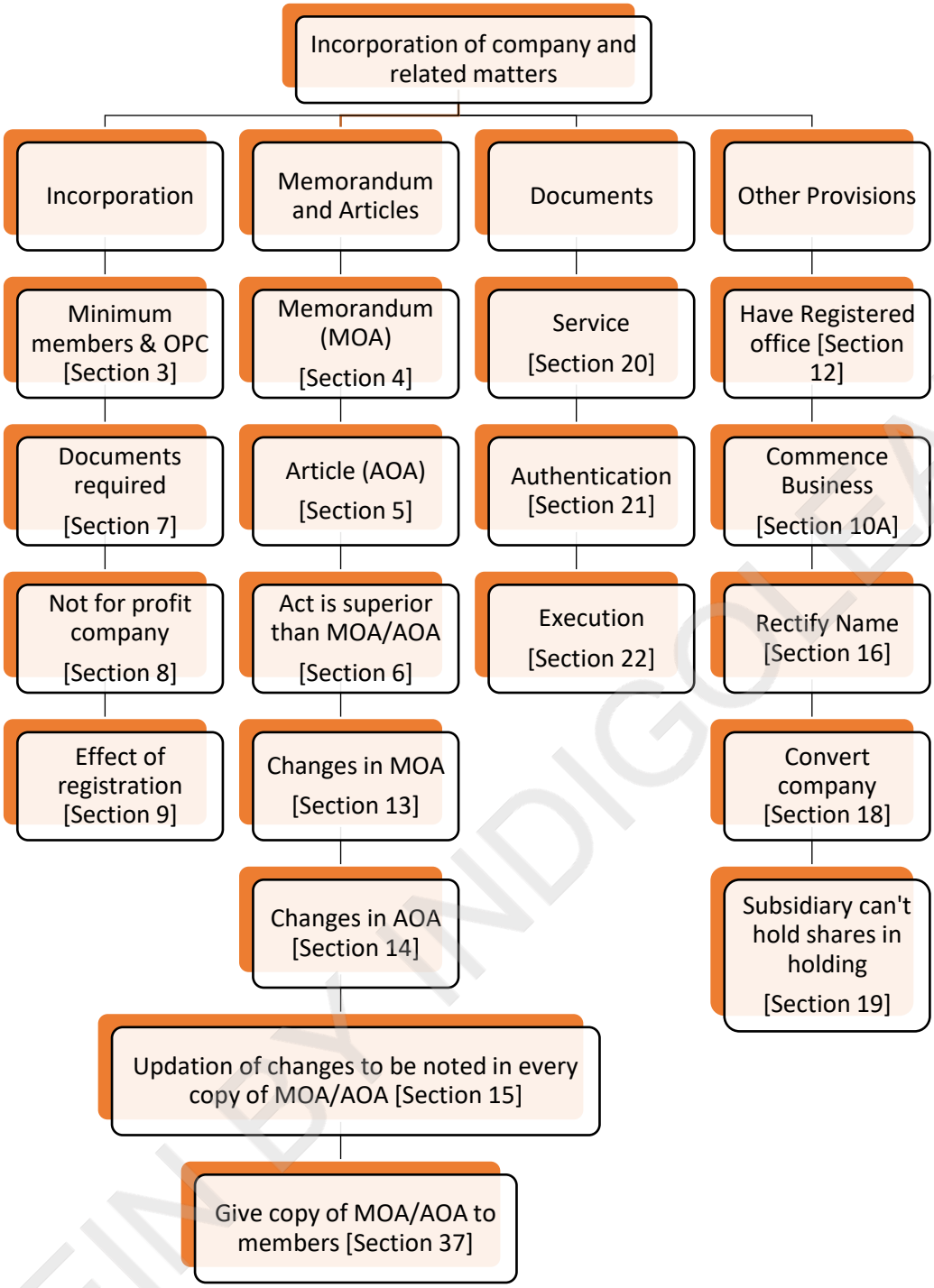
h. On **receipt of the approval** of the Regional Director, the company shall convene a **general meeting** of its members to pass a **special resolution** for amending its **memorandum of association and articles of association** and the Company shall thereafter **file these with the Registrar** (with declaration to adhere conditions if any, imposed by Regional Director)

i. On receipt of the documents referred above, the Registrar shall register the documents and **issue the fresh Certificate of Incorporation**.

24.5 Penalty/ punishment in contravention

- **Company:**
  - → **Fine:** varying from Rs. 10 lakhs to Rs. 1 Crore.
- **Director and every officer in default**:
  - → **Fine**: varying from Rs. 25,000/- to Rs. 25 lakhs,
  - → Where the affairs of the company were conducted **fraudulently, every officer in default shall be liable for action u/s 447.**

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PROSPECTUS AND ALLOTMENT OF SECURITIES

Learning Outcomes –

- Define prospectus
- Understand various types of prospectus
- Explain the procedure for issue of prospectus and other related concepts
- Know abot the criminal and civil liability for mis-statements in prospectus and punishment fr fraudulently inducing persons to invest money
- Understand the procedre for allotment of securities by companies
- Know the procedure of private placement of securities.

INTRODUCTION

The provisions relating to raising of capital such as issue of prospectus, allotment of securities etc., and other matters incidental thereto are contained in **Chapter III of the Companies Act, 2013**. This Chapter is **divided into two parts:**

- ✓ **Part I** relates to '**Public offer'** (Section 23 to 41); and
- ✓ **Part II** relates to '**Private Placement**' (Section 42).

The provisions contained in Part I and II are supplemented by the **Companies (Prospectus and Allotment of Securities) Rules, 2014**.

PUBLIC OFFER AND PRIVATE PLACEMENT

2.1 Issue of securities by Public company

Section 23 of the Companies Act, 2013 provides the provisions relating to public offer, private placement, right issue and bonus shares issue.

As per **Section 23(1)**, a public company may issue securities-

a) To public through **prospectus** (i.e., public offer); or
b) Through **private placement**; or
c) Through a **rights issue** or a **bonus issue.**

2.2 Issue of securities by Private Company

As per **Section 23(2)**, a private company may issue securities-

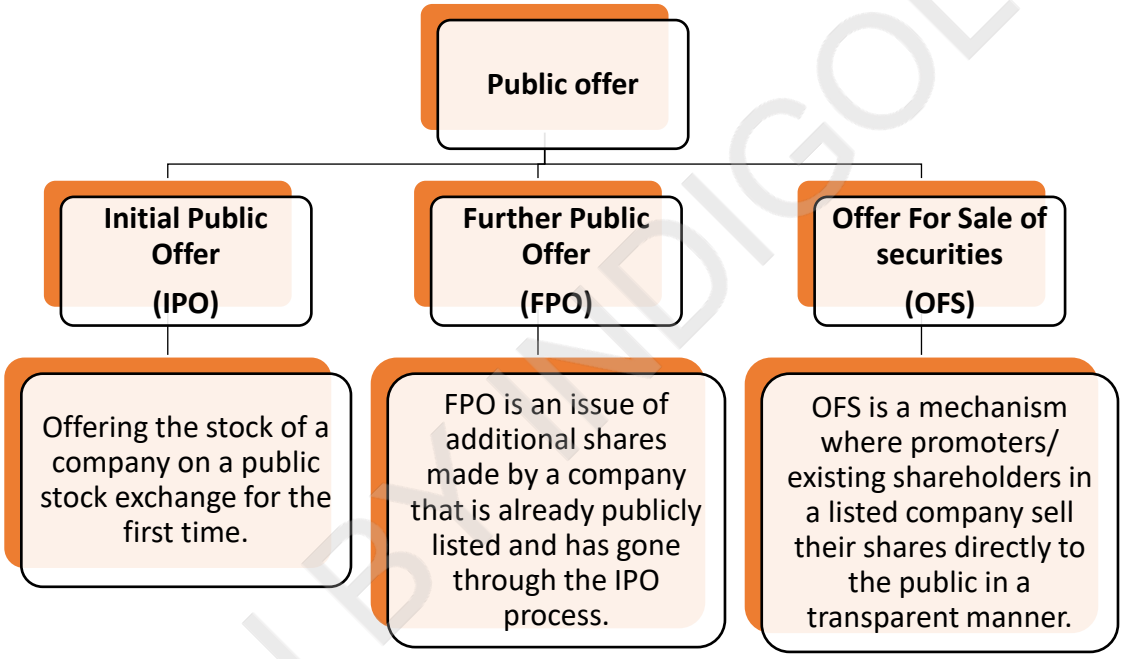
a) By way of **rights issue** or **bonus issue**; or
b) Through **private placement**.

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	Private Company	Public Company
	✓	✓
	✓	✓
	✓	✓
	×	Allowed to 'Eligible Companies'

Note:

i. **Rights issue**: It is a group of rights offered to existing shareholders to purchase additional stock shares in proportion to their existing holdings.
ii. **Bonus shares**: It is an offer of free additional shares to existing shareholders in proportion to their existing holdings. (also known as 'capitalization of profits').
iii. **Private Placement**: It means the sale of securities to a relatively small number of selected investors.
iv. **Public offer**: It is the offering of securities of a company or a similar corporation to the public. In order to do that the securities are to be listed on a stock exchange.



Note:

To bring ease to doing business for corporates, Sub-section 3 and 4 to section 23 of the Act inserted vide, the Companies (Amendment) Act, 2020 (enforced w.e.f 28th September 2020) Prior to Amendments of 2020

Indian companies can access the overseas equity markets only through depository receipts (e.g. American Depository Receipts (ADRs) or Global Depository Receipts (GDRs) or by listing their debt securities (such as, foreign currency convertible bonds, masala bonds, etc.) on foreign markets.

Since more and more businesses are going global & capital raised from across the border is cost effective, hence section 23(3) is inserted to open ways of overseas direct listing for notified class of

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public companies by allowing them to issue notified securities for the purpose of listing on permitted stock exchanges in permissible foreign jurisdictions or such other jurisdictions as may be prescribed.

How overseas direct listing is different from ADRs/GRDs?

In a direct listing, a domestic company can enlist itself with the stock exchanges of other countries without an intermediary. Unlike American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs), the Indian company can directly offer their shares in foreign markets instead of giving them to a foreign depository bank. Direct listing excludes intermediaries, decreases the overall transaction cost, and increases transparency.

Section 23(4) of the Act empowers the Central Government to exempt any class or classes of public companies from complying with the provisions of Chapter III (Prospectus and Allotment of Securities), Chapter IV (Share Capital and Debentures), section 89 (Declaration in respect of a beneficial interest in any share), section 90 (Register of significant beneficial owners in a company) or section 127 (Punishment for failure to distribute dividends) of the Act, by issuing notification.

REGULATION OF ISSUE AND TRANSFER OF SECURITIES ETC. [SECTION 24]

Securities and Exchange Board of India is empower to administer those provisions under chapter III and IV of the Act, which pertains to issue & transfer of securities and non-payment of dividend; by listed companies or those companies which intend to get their securities listed on any recognised stock exchange in India, by making regulations in this behalf.

All other matters (including matters relating to prospectus, return of allotment, redemption of preference shares) specifically provided in this Act, shall be administered by the Central Government, Tribunal or the Registrar, as the case may be.

SECURITIES

Section 2 (81) of the Companies Act, 2013 defines the term **Securities** which means the securities as **defined in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 [SCRA].**

List of securities as per Securities Contracts (Regulation) Act, 1956 –

- ✓ Shares, stocks, debentures, bonds
- ✓ Derivatives
- ✓ Units- Collective Investment Scheme
- ✓ Mutual Fund Scheme
- ✓ Government securities
- ✓ Security receipts
- ✓ Central Government may declare other securities under this definition
- ✓ Rights and interests related to securities.

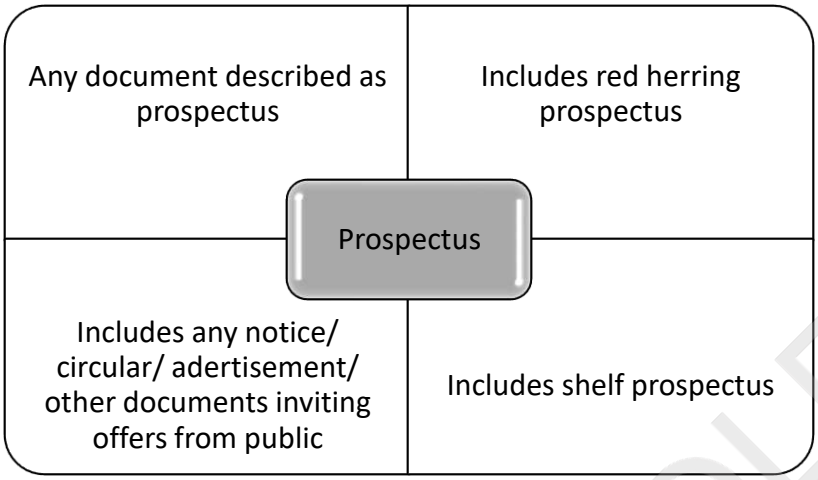
PROSPECTUS

4.1 Meaning of Prospectus

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Section 2(70) defines '**prospectus**' which means **any document described or issued as a prospectus** and **includes**

→ a **red herring prospectus** referred to in section 32 or
→ a **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.



4.2 Matters to be stated in the prospectus

Section 26 of the Companies Act, 2013 mentions the various matters which are to be stated in a prospectus.

4.2.1 *Prospectus to be dated and signed and to state specified information, etc.*

Every prospectus issued by or on behalf of

→ A public company either with reference to its formation or subsequently, or
→ Any person who is or who has been engaged or interested in the formation of a public company,
→ Shall be **dated and signed** and
→ shall **state such information and set out such reports on financial information** as may be specified by the Securities and Exchange Board of India [SEBI].

The prospectus shall **make a declaration about**

→ the **compliance of the provisions of the Act** and
→ a statement to te effect that **nothing in the prospectus is contrary to the provisions** of this Act, the Securities Contracts (Regulation) Act, 1956 and the SEBI Act, 1992 and the rues and regulations made thereunder.

Exceptions:

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a) Where the securities are being **issued to the existing members or debenture holders** of a company, whether an applicant has the right to renounce the shares or not in favor of any other person.
b) Where the shares or debentures issued or to be issued are **uniform with the shares or debentures previously issued** and are being dealt in or quoted on a **recognised stock exchange**.

4.2.2 *Prospectus to be issued after delivery to Registrar for filing*

→ No prospectus shall be issued unless **on or before the date of its publication**,
→ a **copy thereof has been delivered** to the Registrar for filing.
→ Such copy shall be **signed by** every person who is named therein as a director or proposed director of the company or by his duly authorised attorney.

> The date indicated in the prospectus shall be deemed to be the **date of its publication.**

4.2.3 *Prospectus not to include Expert's statement under certain circumstances*

A prospectus issued shall not include a statement purporting to be made by an expert unless **2 conditions** are satisfied:

i) The expert is a **person who is <u>not</u>**, and who has not been, **engaged or interested in the formation or promotion or management** of the company, and
ii) He has given his **written consent to the issue** of the prospectus and
→ **has not withdrawn such consent** before the delivery of a copy of the prospectus to the Registrar and
→ a statement to that effect has been included in the prospectus.

4.2.4 *Cover page of Prospectus*

Every prospectus issued shall, on the face of it, **state the following matters**:

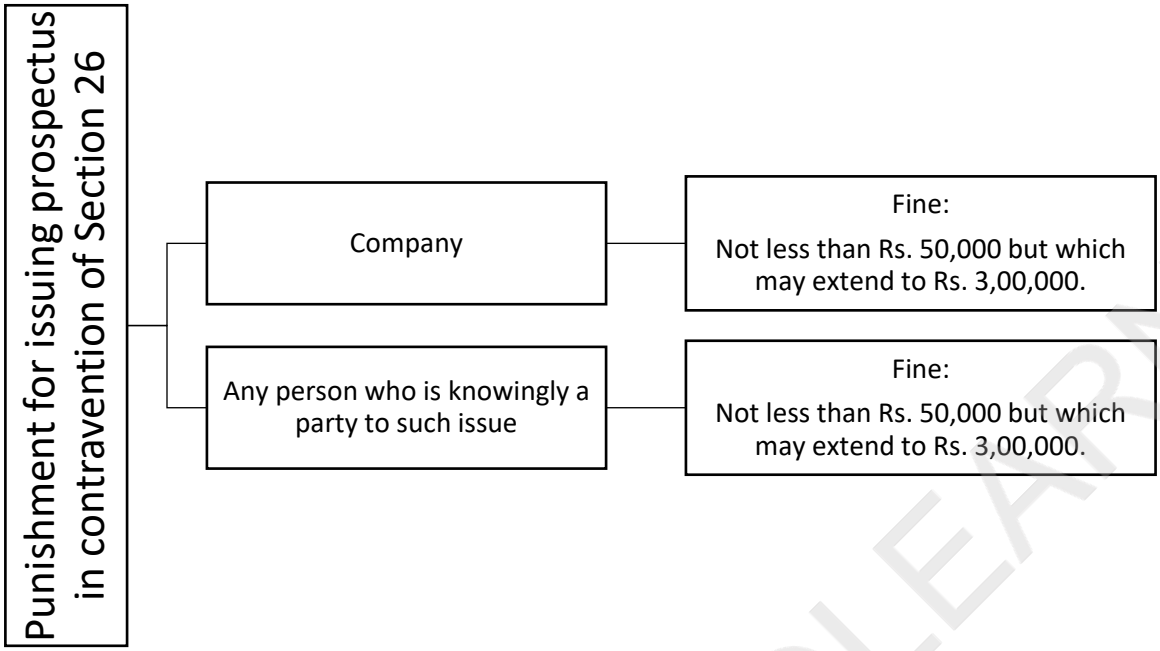
→ State that a **copy has been delivered** for filing to the ROC
→ **Specify any documents required to be attached** to the copy delivered or refer to the statements included in the prospectus which specify these documents.

4.2.5 *Prospectus to be issued within specified time*

No prospectus shall be valid if it is issued more than **90 days** after the date on which a copy thereof is delivered to the ROC

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4.2.6 *Punishment for contravention*



4.3 Public offer of Securities to be in Dematerialised Form

Section 29 of the Companies Act, 2013 along with the Companies (Prospectus and Allotment of Securities) Rules, 2014 [PAS Rules] contain provisions which require public offer of securities to be in dematerialised form.

→ Following companies shall issue securities only in dematerialised form by complying with the provisions of Depositories Act, 1996:

- **Every company making public offer**, and
- Such **other class/ classes of companies as may be prescribed**.

→ In case of such class or classes of unlisted companies as may be prescribed, the securities shall be held or transferred only in dematerialised form in the manner laid down in the Depositories Act, 1996 and the regulations made thereunder [**Sub-section (1A)**].

→ Any **company, other than a company mentioned above, may convert its securities into dematerialised form or issue its securities in physical form** in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 and the regulations made thereunder [**Sub-section (2)**].

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4.4 Advertisement of Prospectus

Section 30 of the Companies Act, 2013 provides the rules relating advertisement of the prospectus.

Wherever there is advertisement of prospectus published, **it must contain following details**:

- Objects,
- The liability of members and amount of share capital of the company,
- The names of subscribers to the MOA,
- The number of subscribers,
- The number of shares subscribed by each subscriber to the memorandum,
- The capital structure of the company.

4.5 Shelf prospectus

Section 31 of the Companies Act, 2013 contains provisions relating to Shelf Prospectus.

4.5.1 *Meaning of Shelf prospectus*

It is the **prospectus with the shelf life**, i.e., a validity period. In this type of public offering, company is allowed to offer and sell securities to the public **without a separate prospectus for each act of offering**.

4.5.2 *Maximum period of validity*

→ Any class or classes of companies as provided may file a shelf prospectus with the ROC at the stage of the first offer of securities which shall indicate a **period not exceeding 1 year** as the period of validity and,

→ in respect of subsequent offer within that validity period, not further prospectus is required.

The period of validity shall **commence from the date of opening of the first offer of securities** under that prospectus.

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4.5.3 *Information memorandum*

Every **subsequent offer requires issuing an 'information memorandum'** containing the **details of changes** that took place from the previous issue, i.e.

- Financial changed
- New charges created
- Other material facts

If **Advance is received for further shares before the issue of Information memorandum**: then,

→ Company must **intimate the investor** of all changes using Information Memorandum and
→ **Give an 'Exit Option'** (Investor may withdraw his money. The refund shall be processed in 15 days).

Information Memorandum shall be prepared in **Form PAS-2** and **filed with the ROC within 1 month prior to the issue of a second or subsequent offer** of securities under the shelf prospectus. [**Rule 10** of PAS Rules, 2014]

4.6 Red Herring prospectus

Section 32 of the Companies Act, 2013 contains provisions relating to Red-herring Prospectus.

4.6.1 *Meaning of Red Herring prospectus*

In this kind of public offering, the **Price and quantity of shares to be allotted are not included in prospectus**. Thus the prospectus is incomplete.

Need of Red Herring Prospectus:

Developments taking place in the financial markets from time to time allow innovative methods of raising funds so as to avail the most of favourable market conditions. Timing the issue and book building of issue are facilitated by the concept of red herring prospectus whereby the price per security and number of securities are left open to be decided post closure of the issue.

4.6.2 *Issuing and filing Red herring prospectus*

→ A company proposing to make an offer of securities may issue a red-herring prospectus **prior to the issue of the prospectus**.
→ It shall be **filed with the ROC at least 3 days prior to the opening of the subscription list** and the offer.

4.6.3 *Filing of the prospectus upon closing of the offer*

Upon closing of the offer, the prospectus **stating the total capital raised** (by debt/share capital) **and closing price of securities** along with other prescribed details, shall be **filed with the ROC and SEBI.**

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Note: Book Building is a price discovery method. In this method, the company doesn't fix up a particular price for the shares, but instead gives a **price range.** An underwriter builds a book by accepting orders from fund managers, indicating the number of shares they desire and the price they are willing to pay.

4.7 Abridged prospectus

As per **Section 2(1)**, 'Abridged Prospectus' means **a memorandum containing such salient features of a prospectus** as may be specified by the SEBI.

Abridged prospectus is a **summarised form of actual prospectus**.

4.7.1 Meaning of 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.

4.7.2 Need of Abridged Prospectus

In fact, 'Abridged Prospectus' is a summarized form of actual prospectus, containing the salient features of a prospectus to **cut the cost involved in the publication** of large number of prospectus which has to accompany the application forms for shares or debentures in case of public offer.

4.7.3 Abridged Prospectus accompany the application form [Sub-section 1]

Section 33(1) provides that every application form for shares or debentures has to be accompanied with the abridged prospectus.

Proviso to sub-section 1 provides exceptions, when the requirement of abridged prospectus does not apply;

a. When application form is issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to shares or debentures:
b. In relation to shares or debentures which were not offered to the public; or
c. Where offer is made to existing members of the company.

4.7.4 Right to receive prospectus [Sub-section 2]

Sub-section 2 provides that a prospectus (full prospectus) is to be made available to any person who request for it before the closing of the subscription list and the offer.

4.7.5 Penalty [Sub-section 3]

A company who makes any default in complying with the provisions of section 33, shall be liable to a penalty of **fifty thousand rupees for each default**.

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4.8 Deemed prospectus

Section 25 of the Companies Act, 2013 provides that a document by which offer of securities to the public is made, shall be a deemed prospectus.

- → Where a **company allots or agrees to allot any securities** of the company (i.e., private placement)
- → **with a view to all or any of those securities being offered for sale to the public**,
- → **any document by which the offer** for sale to the public is made shall be deemed to be a prospectus issued by the company.
- → All the enactments and rules of law as to the contents of prospectus shall apply to the deemed prospectus.

4.8.1 *Offer for sale to the public*

Any private placement of securities made by a company shall be considered as securities offered for sale to the public, if it is shown that –

a) An offer of the securities or any of them for sale to the public was **made within 6 months of allotment or agreement to allot**; **OR**
b) At the date when the offer was made, the **whole consideration to be received** by the company in respect of the securities **has not been received by it**.

CASE LAW

Above Sub-section of section 25 are not exhaustive in nature, there may be certain other situations when issuing document may construe as deemed prospectus.

SEBI v Kunnamkulam Paper Mills Ltd Where a rights issue is made to existing members with a right to renounce in favour of others, if the number of such others exceeds fifty, it also becomes a deemed prospectus

4.8.2 *Additional matters to be stated in the prospectus in an offer for sale to the public*

a) The **net amount of consideration** received or to be received by the company in respect of the securities to which the offer relates.
b) The **time and place at which the contract** where under the said securities have been or are to be allotted **may be inspected.**

4.8.3 *Signing of document in case of a company or a firm*

Where a person making the OFS to the public is a company / firm, the deemed prospectus shall be signed by:

- → 2 directors of the company, or
- → Not less than one-half of the partners in the firm, as the case may be.

Since the provisions of the Act relating to prospectus and the penal provisions are attracted only when

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the prospectus (including deemed prospectus) has been **issued.** "Issued" means issued to the **public.**

Hence In context of 'Invitation to Public' 'Inviting offer from the Public' or 'Offer of securities for sale to Public' two valid questions arise here:

1. **What constitute as 'Public'? Does only 'Public at large' constitute as Public?**

The term public is not restricted to the public at large. It includes any section of the public, it is immaterial howsoever such section is selected.

Public connotes persons not personally known to the promoter as distinguished from his own friends, relatives, connections and acquaintances.

Re, South of England Natural Gas and Petroleum Co. Ltd

Facts – 3000 copies of a document which was offered for subscription of shares in a company and which was headed "For Private Circulation only," circulated to the members of certain number of gas companies only.

Legal Question – Was this a prospectus? Should it contain the particulars required by the Act?

– It was decided that though the offer was only to limited class, it was not less than an offer to the public in any sense, because **those persons from limited class were nonetheless the public**. Hence, the distribution of a document entitled, "For Private Circulation only" offering the company shares was an offer to the public and their document was a prospectus. Therefore, it must contain the particulars required by the Act.

2. **Whether a single private communication tantamount to issue; can it be construe to a prospectus to attract the provisions of the Act?**

The term "issue" is **not satisfied by a single private communication**. There must be some measure of publicity, however modest. A **private communication** is not thus open and **does not construe to be a prospectus**, hence not attracting the provisions of the Act.

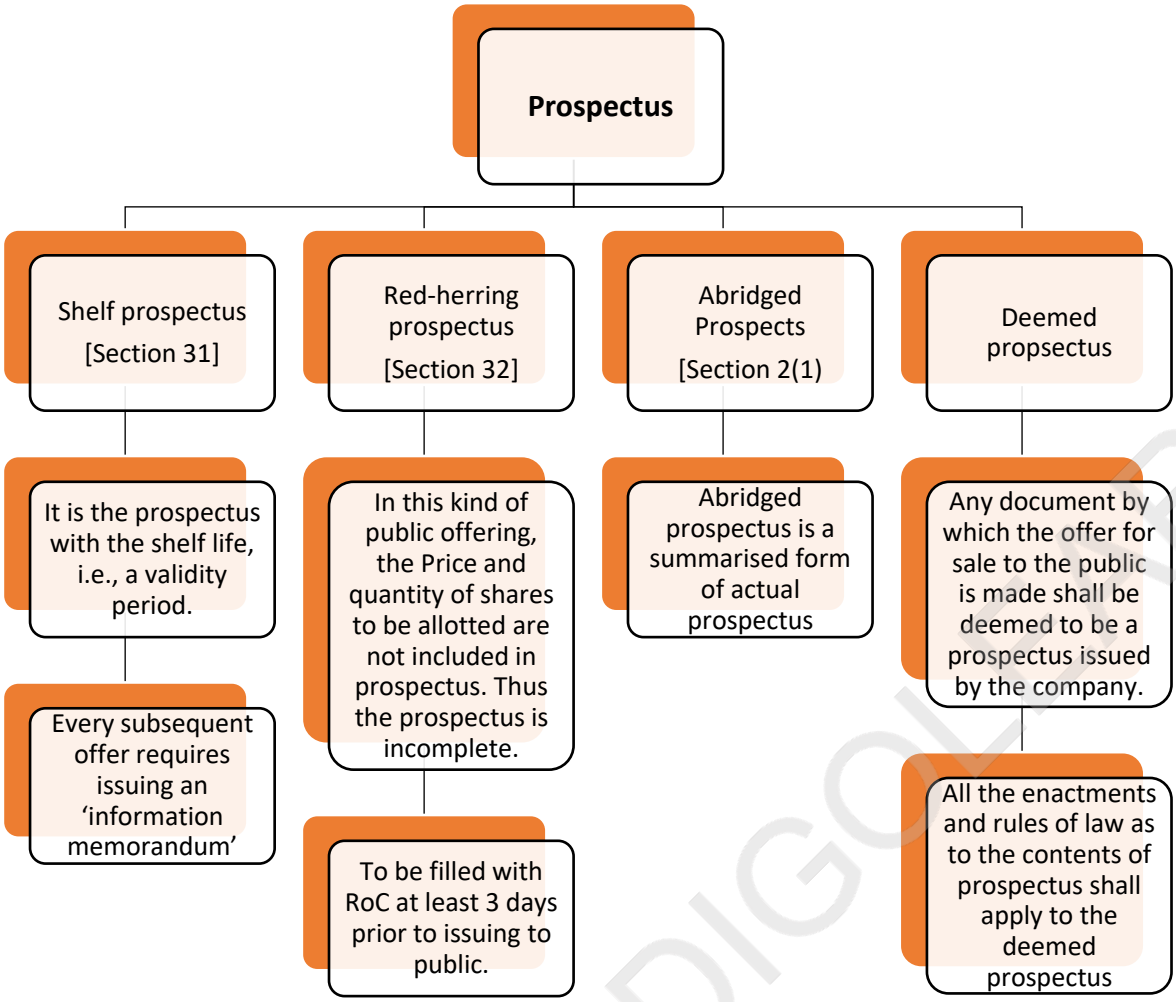
Nash Vs Lynde

Facts – Nash applied for certain shares in a company on the basis of a document sent to him by Lynde, the managing director of the company. The document was marked 'strictly private and confidential'. The document did not contain all the material facts required by the Act to be disclosed. Nash filed a suit for compensation for loss suffered by him by reason of the Omissions.

Decision – Suit was dismissed.

Viscount Summer's landmark dictum in this case is worth to consider here as basis of above answer. "The public in the definition is of course a general word, no particular number are prescribed. Anything from two to infinity may serve, perhaps even one if he is intended to be the first of a series of subscribers but made further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be opened to anyone who brings his money and applies in due from, whether the prospectus was addressed to him on behalf of the company or not. A private communication is not thus open and does not construe to be a prospectus."

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4.9 Offer for sale by certain members of the company

Section 28 of the Companies Act, 2013 contains provisions which regulate the offer for sale of securities by certain members of company.

→ Members may offer whole or part of their shareholding for sale to public **provided BOD approves**.

→ **Document offered to public inviting subscription shall be Deemed Prospectus**. All provisions applicable to normal prospectus shall apply.

→ Individuals/Body corporates whose shares are being OFS, shall

- **authorize company** whose shares are being offered for sale to the public, to take all the actions in respect of OFS on their behalf and
- **reimburse** the company of **all related expenses**.

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4.9.1 *Rule 8 of PAS Rules –*

(1) The provisions of Prospectus and Allotment of Securities and rules made thereunder shall be applicable to an offer of sale referred to in Section 28 except for the following: -

a) Provisions relating to **minimum subscription**,
b) Provisions for **minimum applicable value**,
c) Provisions requiring any statement to be made by the BOD in respect of **utilization of money**,
d) **Any other provision or information** which cannot be compiled or gathered by the offeror, with detailed justification for non-compliance.

(2) The prospectus issued u/s 28 shall **disclose the name of the person** or persons or entity **bearing the cost of making the offer of sale** along with reasons.

4.10 Variation of terms of contract or objects in prospects

Section 27 of the Companies Act, 2013 contains provisions relating to variation in terms of contract or objects in prospectus.

4.10.1 *Variation on approval in general meeting by passing SR*

Company may vary terms in the prospectus **only by**

- **passing SR in general Meeting**
- **Details of the notice** in respect of such resolution to the shareholders **shall be published in 2 Newspapers** (English and vernacular) in the city where registered office of the company is situated, and it shall clearly indicate the justification for such variation.

4.10.2 *Rule 7 of PAS Rules*

(1) Where the company has raised money from public through prospectus and has any unutilised amount out of the money so raised, it **shall not vary the terms of contracts referred to in the prospectus or objects for which the prospectus was issued except by passing a SR through postal ballot.**

The company shall **not use** any amount raised by it through prospectus **for buying, trading or otherwise dealing in equity shares** of any other listed company.

The notice of the proposed SR shall contain the following particulars –

i) The original purpose/ object of the issue,
ii) The total money raised,
iii) The money utilised for the objects sated in the prospectus,
iv) The extent of achievement of the proposed objects,

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v) The unutilised amount,
vi) The particulars of proposed variation,
vii) The reason and justification for seeking variation,
viii) The proposed time limit within which the proposed varied object would be achieved,
ix) Clause-wise details
x) The risk factors relating to new objects,
xi) Other relevant information.

(2) The **advertisement of the notice** for getting the SR passed shall be in **Form PAS – 1**. It shall be published simultaneously with dispatch of Postal Ballot notices to the shareholders.

(3) The notice shall **also be placed on the website of the company**, if any.

4.10.3 *Exit offer to dissenting shareholders*

Those **shareholders who have not agreed to the variation** shall be given an exit offer by promoters or controlling shareholders **at such exit price** as may be specified by the SEBI [Section 27 (2)].

DEMATERIALISATION OF SECURITIES OF UNLISTED PUBLIC COMPANIES

5.1 Issue of securities in dematerialised form [Rule 9A(1)]

Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules, 2014 mentions about securities in dematerialised form by unlisted public companies.

Every unlisted public company (*excluding Nidhi Company, Government Company, and a wholly owned subsidiary*) shall **issue the securities only in dematerialised form** and also facilitate dematerialisation of all existing securities.

5.2 Conversion of securities in dematerialised form [Rule 9A(2)]

Also, **before making an offer** for

a) issue of any securities or
b) buyback of securities or
c) issue of bonus shares or rights offer,

every unlisted company shall **ensure that entire holding of securities of its promoters, directors, key managerial personnel has been dematerialised.**

5.3 Responsibility of every holder of securities of an unlisted public company [Rule 9A(3)]

Every **holder of securities of an unlisted public company**:

→ Who **intends to transfer such securities** shall get the securities dematerialised before the transfer or

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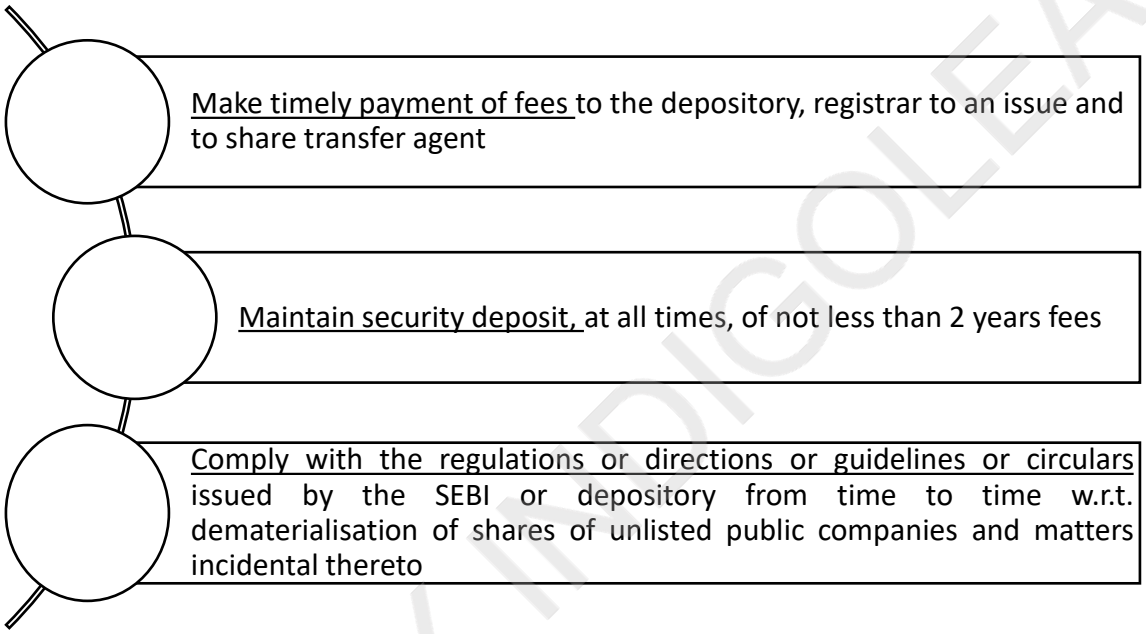
→ Who **subscribes to any securities of an unlisted public company** shall ensure that all his existing securities are held in dematerialized form.

5.4 Application to the depository [Rule 9A(4)]

Every unlisted public companies shall

→ **facilitate dematerialisation** of all its existing securities **by making necessary application to a depository**,
→ **secure International Security Identification Number (ISIN)** for each type of security and
→ **inform all its existing security holders** about such facility.

5.5 Obligations of every unlisted public company [Rule 9A(5 & 6)]



No unlisted public company which has **failed to comply with above obligations** shall make an offer of any securities or buyback its securities or issue any bonus or right shares till the payments to depositories or registrar or share transfer agent are made. [Sub-rule 6]

5.6 Application of certain provisions [Rule 9A(7)]

The provisions of –

d) The **Depositories Act, 1996**,
e) The **Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018**, and
f) The **Securities and Exchange Board of India (Registrars to an issue and Share Transfer Agents) Regulations, 1993**

shall apply mutatis mutandis to dematerialisation of securities of unlisted public companies.

5.7 Filing with the Registrar [Rule 9A(8 & 8A)]

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- ✓ Every unlisted public company governed by Rule 9A shall **submit Form PAS-6 to the Registrar within 60 days** from the conclusion of each year **duly certified** by a CS/CA in practice.
- ✓ The company shall immediately bring to the notice of the depositories any **difference observed in its issued capital and the capital held** in dematerialised form [**Sub-rule (8A)**].

5.8 Grievances redressal mechanism [Rule 9A(9 & 10)]

- ✓ **Grievances** of the security holders of unlisted public companies under Rule 9A shall be **filed before the Investor Education and Protection Fund (IEPF).**
- ✓ The IEPF authority shall initiate any **action against a depository or participant or registrar to an issue and share transfer agent** after prior consultation with the SEBI.

SECURITIES TO BE DEALT WITH IN STOCK EXCHANGES

Section 40 of the Companies Act, 2013 contains provisions in respect of securities which are to be dealt with in recognised stock exchanges.

6.1 Listing of Securities

→ Every company, making public offer, shall **before making such offer**, make an application to one or more recognised stock exchange and obtain permission for the securities to be dealt with in such stock exchanges.

→ The **prospectus shall state the names of the stock exchange** in which securities shall be dealt with.

→ All **monies received** on application shall be **kept in a separate bank account in a scheduled bank** and shall be used only for adjustment against allotment and for repayment in case unable to allot.

→ Nothing can be written in the prospectus to waive this section.

→ **Default in compliance:**

- ➢ **Company:** Fine- minimum Rs. 5 lakh and
  Maximum Rs. 50 lakhs.
- ➢ **Defaulting officer:**
  - o Fine of minimum Rs. 50,000/- and maximum Rs. 3 lakh, or

6.2 Payment of Commission

A company my pay commission to any person in connection with the subscription to its securities.

The **conditions** for payment of commission are:

→ Authorized by AOA.
→ May be paid out of proceeds of issue or out of profits of the company or both.

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→ **Rate of commission**:

For shares	For Debentures
✓ Rate mentioned in AOA or ✓ 5 % of price at which shares are issued **Whichever is less**	✓ Rate mentioned in AOA or ✓ 2.5 % of price at which debentures are issued **Whichever is less**

→ **Disclosure in prospectus**:

- The **name of underwriters**,
- The **rate and amount of commission** payable to the underwriters,
- The **number of securities which is to be underwritten** or subscribed by the underwriter absolutely or conditionally.

→ No commission shall be paid to any underwriter on securities which are not offered to the public for subscription.

Underwriting is the process through which an individual or institution takes on financial risk for a fee. In this case, such institutions agree to take over the un-subscribed portion of securities offered to public to meet minimum subscription.

→ A **copy of the contract** for payment of commission is **delivered to the ROC** at the time of delivery of prospectus for registration.

ALLOTMENT OF SECURITIES BY COMPANY

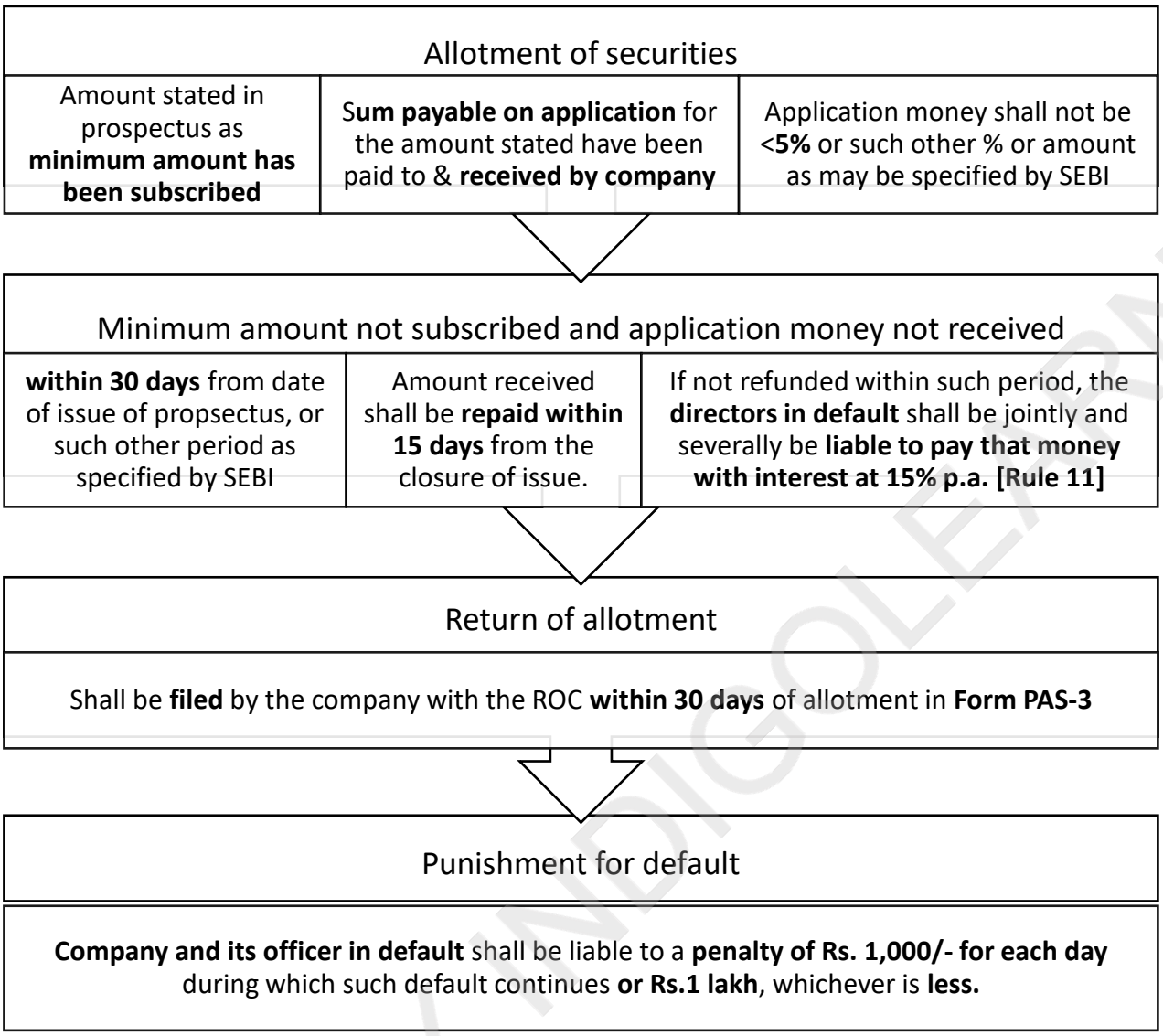
7.1 Meaning of Allotment

Section 39 of the Companies Act, 2013 contains provisions in respect of allotment of securities when there is a public offer.

Allotment means the **appropriation out of previously un-appropriated capital** of a company, of a certain number of shares to a person. Allotment is when the **ownership of shares is given** in the name of shareholder **and entry is made in the register of members**. It brings shares into existence.

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7.2 Allotment of Securities



7.3 Rule 12 of PAS Rules

Note:

- As per the regulation 45(1) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 201827, the minimum subscription is 90% of the entire issue.
- As per the regulation 47(4) of the 28Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, the minimum sum payable on application per specified security shall be at least twenty five percent of the issue price.
- Further, proviso to regulation 47(4) provides that in case of an offer for sale, the full issue price for each specified security shall be payable at the time of application

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7.3.1 *Time limit for filing Return of Allotment [Rule 12(1)]*

Whenever a company having a share capital makes any allotment of its securities, the company shall, **within 30 days**, file with the ROC a return of allotment in **Form PAS – 3**, along with the specified fees.

7.3.2 *Details to be attached with PAS - 3*

a) A **list of allottees** stating their names, address, occupation, and number of securities allotted and shall be **certified by the signatory** as being complete and correct as per records of the company [Sub-rule (2)]

b) Where the **securities are issued for consideration other than cash**:
   → A **copy of the contract duly stamped**, pursuant to which the securities have been allotted [Sub-rule (3)].

   → If such contract for issue of securities for consideration other than cash is not reduced in writing, the company shall furnish complete particulars of contract stamped with the same stamp duty as would have been payable if the contract had been reduced in writing [Sub-rule (4)].

   → A **report of a registered valuer** in respect of valuation of the consideration [Sub-rule (5)].

c) In case of **issue of bonus shares**, a **copy of the resolution passed in the GM** authorizing the issue of such shares [Sub-rule (6)].

d) In case **shares have been issued in pursuance of section 62(1)(c)** (i.e., Preferential issue of shares) by a company **other than listed company whose equity shares or convertible preference shares are listed** on any recognized stock exchange,
   → the **valuation report** of registered valuer shall be attached along with PAS – 3 [Sub-rule (7)].

MISSTATEMENT IN PROSPECTUS

A contract of shares in a company is a contract of **Uberrimae fides (Latin**), which means **'utmost good faith**'. The legal doctrine of Uberrimae fides provides that all parties to contract must deal in good faith, making a full declaration of all material facts. The intending purchasers of shares are entitled to true and correct disclosures of all the facts in the prospectus.

Sections 34 and 35 of the Companies Act, 2013 contains provisions relating to punishment in case of misstatement in prospectus.

Some of landmark judicial pronouncements –

Mislead through false Statement (prima-facie of facts) - Henderson v. Lacon

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It was stated in the prospectus, 'the directors and their friends have subscribed a large portion of the capital and they now offer to the public the remaining shares.' Whereas, in actually each of director had subscribed only 10 shares. It was held that such a statement is misleading one.

Misled by hiding truth through superficial statement - Rex v. Kylsant

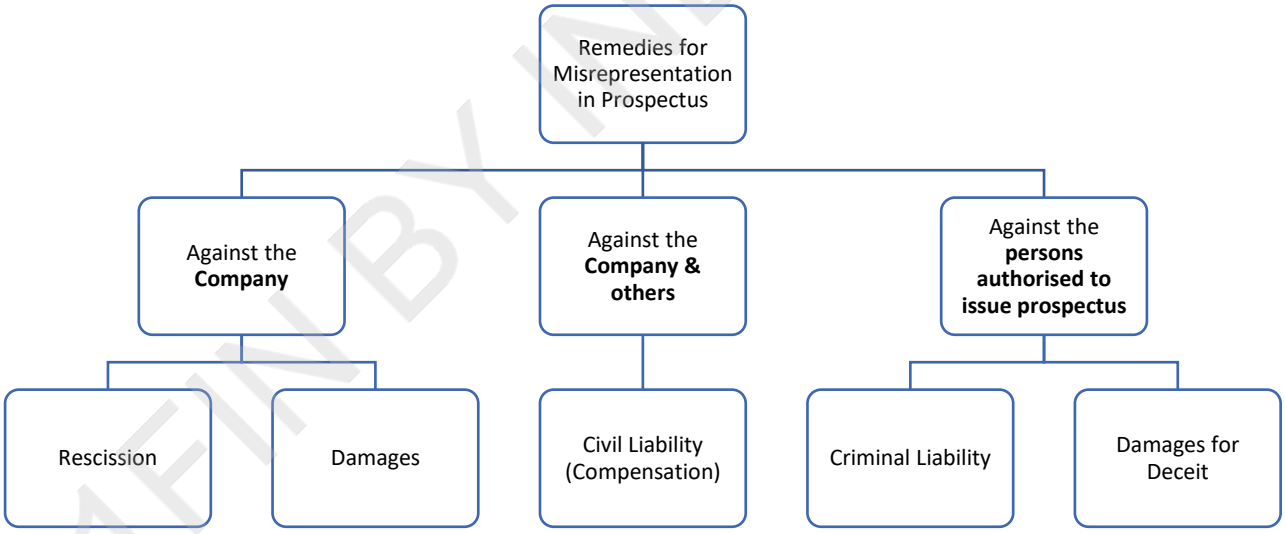
In the prospectus, it is stated that the company had regularly paid dividends, in actual, company has been incurring substantial losses during all those years. Company used to write back some of the past provisions to the credit of the profit and loss account. It was held that the prospectus did not disclose the true picture of the company.

Misled through ambiguous statement - Smith v. Chadwick

The prospectus of a manufacturing company contain, 'the present value of turnover is £1million sterling per annum,' the statement was true only if production capacity is considered but untrue if it meant the present production level (capacity in utilisation). It was held that, such a statement which director knew may bear multiple meaning out of which any can be false to their knowledge, considered to be furnishing of misleading statement

EFFECT OF MISLEADING PROSPECTUS – REMEDIES OF MISREPRESENTATION

The fear of heavy liability and criminal sanctions have controlled the directors' tendency of "using extravagant terms and flattering description". But if the prospectus contains a misleading or false statement or omits to disclose a material fact which amounts to misrepresentation, the aggrieved shareholder has the remedies. The law allows the following remedies for misrepresentation



RIGHT OF RESCISSION

When to seek rescission? A person who has purchased shares from the company on the basis of the prospectus containing untrue and misleading statement of material facts is entitled to apply to the

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court for the rescission of the contract, under the relevant provisions of the Indian Contract Act 187225.

Effect of rescission

The agreement to take up shares is voidable at the option of the subscriber to the shares, it will remain valid unless he actually rescinds it. If the court accepts his application for the repudiation of the contract, company will remove his name from the register of members and return his money with interest and other incidental cost.

Entitlement to compensation for any damages which he sustained through the nonfulfilment of the contract arises under section 75 of the Indian Contract Act 1872.

Exceptions – When right of rescission is not available?

a. Right to rescind allotment of shares will not be available to the subsequent purchasers of shares from the market.

b. A subscriber to the Memorandum of Association cannot also seek any relief, as the company cannot be considered to be in existence at the time when he appended his signatures to the Memorandum of Association. He cannot be said to have been influenced by any statement in the prospectus.

RIGHT OF ACTION FOR DAMAGES

When to evoke?

In the cases where mis- statement amounts to fraud, aggrieved investor also gets a right of action for damages against the company. This right is available even after the company has gone into liquidation.

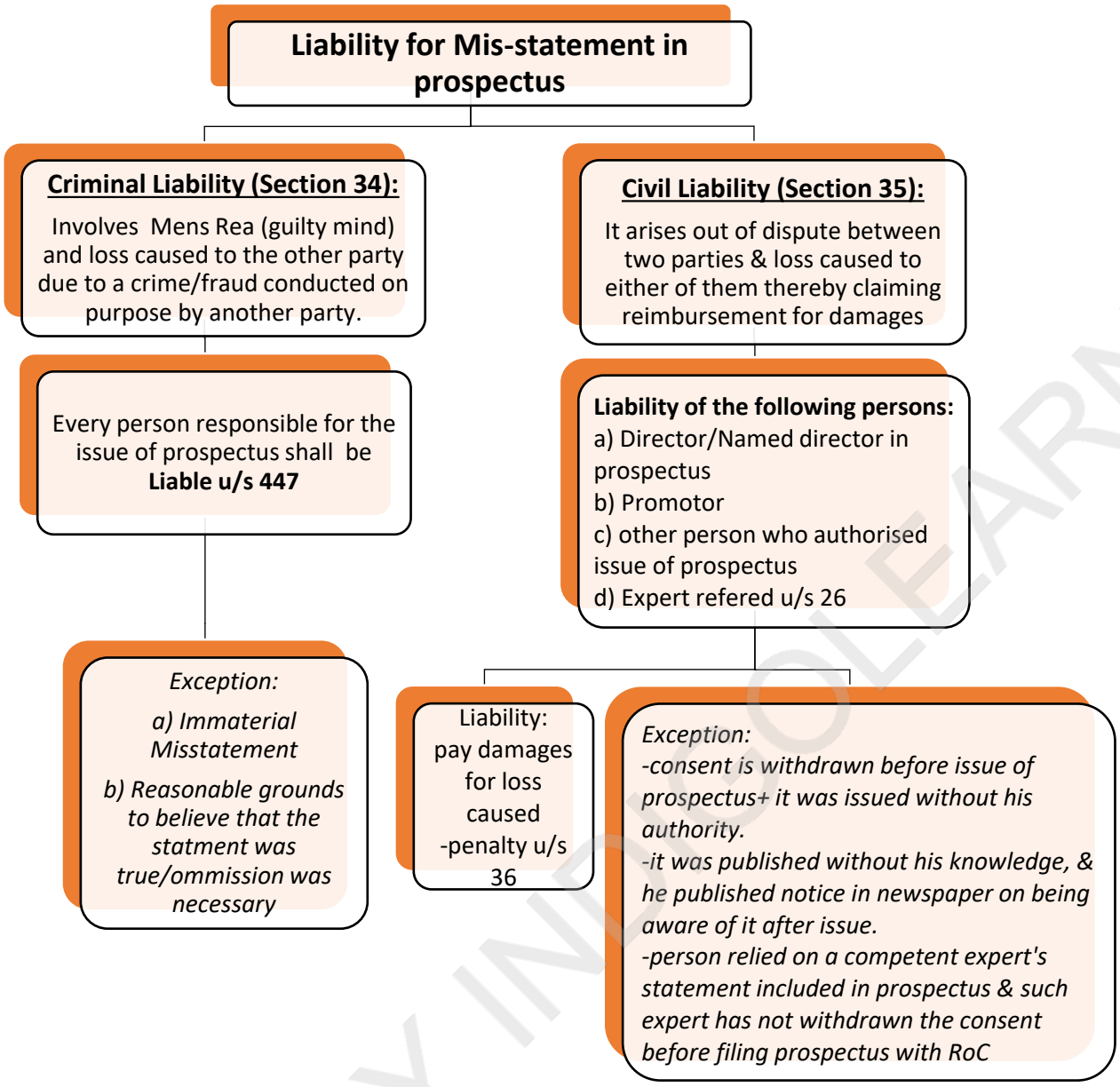
Pre-requisite to claim for damages

a. Misrepresentation (fraudulent) was there in the prospectus and it is of material fact

b. Person is intended to act upon it

c. Person suffered the damages as consequences of acting upon such fraudulent misrepresentation.

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Note

a. Loss from mis-statement is not essential, to held a person guilty under section 34.

b. Liability for offence under section 34, is strict liability, hence it is immaterial where the omission is intentional or unintentional, in both case person will be held guilty under section 34 and liable for punishment under section 447 of this Act.

DAMAGES FOR DECEIT

When remedy of damages for deceit is available?

Persons responsible for the issue of prospectus can also be held liable in an action for deceit, under general law as provided by section 19 of the Indian Contract Act. This remedy shall be available even where the remedy by way of rescission as against the company is lost either through latches or negligence or even if the company goes into liquidation.

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Prerequisite to claim damages for deceit is available

a. There was a fraudulent mis-statement related to some existing material facts.

b. He is original allottee and had seen the prospectus.

c. He has been actually deceived.

Peek v. Gurney Gurney

issued a fraudulent prospectus on behalf of a company. No shares were purchased by Peek at that time. Several months afterwards, Peek purchased 2,000 shares of the company from the stock exchange. He brought an action against the directors for deceit (on the basis of prospectus). Court held, the directors were not liable as the shares were not purchased on the basis of prospectus.

PUNISHMENT FOR FRAUDULENTLY INDUCING PERSONS TO INVEST MONEY

→ Any person who,
→ **knowingly or recklessly**,
→ makes any statement, promise or forecast,

Section 36 of the Companies Act, 2013 prescribes punishment for fraudulently inducing persons to invest money.

- which is **false, deceptive or misleading**, or

→ deliberately conceals any material facts,
→ **to induce another person** to enter into, or to offer to enter into,

- any agreement for **acquiring, disposing of, subscribing for, or underwriting securities**, or
- any agreement for the purpose of **securing any profit** to any parties from the yield of securities, or
- any agreement for **obtaining credit facilities** from any bank/ financial institution

shall be **liable u/s 447.**

ACTION BY AFFECTED PARTIES

Any person aggrieved u/s 34, 35, 36 may file a

Section 37 of the Companies Act, 2013 has paved way for class action.

✓ **Normal suit** or
✓ **Class action suit** [A group of parties having common grievance against another party, may file a single case together. In such case, representative of such group may attend the hearings and follow up with legal proceedings].

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PUNISHMENT FOR PERSONATION FOR ACQUISITION, ETC., OF SECURITIES [SECTION 38]

The purpose of the section is to prevent allotment of shares in fictitious names.

Sub-section 1 provides, any person shall be liable for punishment under section 447, if:

a. He makes or abets the making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or

b. He makes or abets the making of multiple applications in different names or different combinations of his name or surname for acquiring or subscribing for its securities; or

c. otherwise induces, directly or indirectly a company to allot or register any transfer of any securities to him or to any other person in a fictitious name.

Sub-section 2, provides that every company which issues a prospectus is required to reproduce prominently the provisions of the sub- section (1) in the prospectus and every form of application for securities.

Note:

A person who gets shares allotted in a fictitious name becomes liable as a shareholder. Thus, where a person carried on business under an assumed name and took shares in that name, his trustee in bankruptcy of the said person, could not avoid liability.

Sub-section 3 provides, where a person has been convicted under the section, the court may order disgorgement of any gain made by such person. The order may also include seizure and disposal of securities which may be found in his possession.

The amount received through disgorgement or disposal of securities under sub- section (3), is to be credited to the Investor Education and Protection Fund. [Sub section (4)]

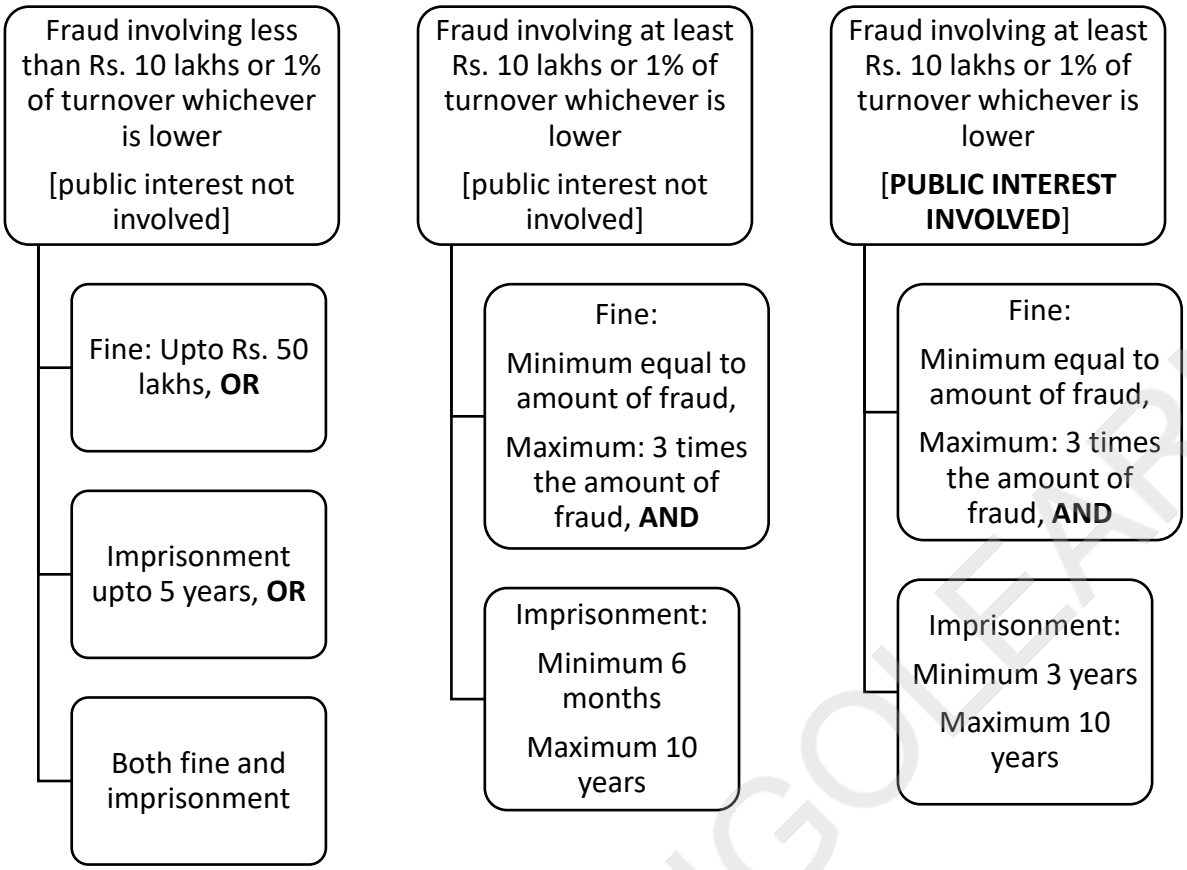
PUNISHMENT FOR FRAUD

Section 447 of the Companies Act, 2013 describes the punishment for fraud.

Meaning of fraud: The term fraud in relation to affairs of a company or a body corporate **includes**

→ any act, omission, concealment of fact, or abuse of position
→ committed by any person, or any other person with the connivance (i.e., involvement) in any manner,
→ with the intent to deceive, to gain undue advantage from, or to injure the interests of the company or its shareholders or its creditors, or any other person,
→ whether or not there is any wrongful gain or wrongful loss.

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13. GLOBAL DEPOSITORY RECEIPT [SECTION 41]

1. A global depository receipt is a general name for a depository receipt where a certificate issued by a depository bank, which purchases shares of foreign companies, creates a security on a local exchange backed by those shares.
2. GDR as per section 2(44) of this Act means any instrument in the form of a depository receipt, by whatever name called , created by a foreign depository outside India & authorized by a company making an issue of such depository receipts.
3. Section 41 provides, company may issue depository receipts in any foreign country after passing a **special resolution** in its general meeting and subject to such conditions as may be prescribed in the Companies (Issue of Global Depository Receipts) Rules, 2014 (as further amended in 2020).

MANNER AND FORM OF DEPOSITORY RECEIPTS

1. The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent in the concerned jurisdiction and may be listed or traded on the listing or trading platform in the concerned jurisdiction.
2. The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.

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3. The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank.

VOTING RIGHT

1. A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.
2. Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

PRIVATE PLACEMENT

13.1 Meaning of private placement

Section 42 of the Companies Act, 2013 and **Rule 14** of Companies (PAS) Rules, 2014 provides the provisions which are applicable when shares are issued on private placement basis.

Private placement means any **offer or invitation** to subscribe or issue of securities **to a select group of persons** by a company (other than by way of public offer) through private placement offer-cum-application.

13.2 Conditions for private placement

a) Offer made only to a **select group of persons** identified by the **BOD**.

b) Number of such identified persons shall not exceed **200 in a financial year**. [**Rule 14(2)** of PAS Rules, 2014]

c) This limit **excludes**:

→ Employees offered securities under **ESOP** (Employee stock option plan)
→ Securities issued to **Qualified Institutional Buyers**

d) Above limit of 200 Private placement in a FY **does not apply to**

→ **NBFC** registered with RBI
→ **Housing Finance Companies** registered with National Housing Bank
if they comply with the regulations made by RBI/National Housing bank in respect of private placement.

e) As per **Explanation** given in Rule, it is clarified that the restriction of 200 shall apply individually for each kind of security that is equity share, preference share or debenture.

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f) **Requirement of Special Resolution:** Prior approval of company by **special resolution in the general meeting** for each of the offers/ invitations in a FY is required. **[Rule 14(1)]**

→ In the explanatory statement annexed to the notice for shareholders' approval, following disclosure shall be made:-

✓ **particulars of the offer** including date of passing of Board resolution;
✓ **kinds of securities** offered and the price at which security is being offered;
✓ **basis** or justification **for the price** (including premium, if any) at which the offer or invitation is being made;
✓ name and address of **valuer** who performed valuation;
✓ **amount** which the company intends to raise by way of such securities;
✓ **material terms** of raising such securities, proposed time schedule, purposes or objects of offer, contribution being made by the promoters or directors either as part of the offer or separately.

→ **Other Provisos to Rule [14(1)]**
✓ Rule 14(1) shall not apply: In case of offer or invitation for non-convertible debentures, where the proposed amount to be raised < limit as specified in Sec 180(1)(c) - Relevant Board resolution under Section 179(3)(c) would be adequate
✓ Previous **special resolution** only **once in a year** sufficient:
- In case of offer or invitation for non-convertible debentures, where the proposed amount to be raised > limit as specified in Sec 180(1)(c)
- In case of offer or invitation of any securities to qualified institutional buyers

✓ No offer or invitation of any securities under this rule shall be made to a **body corporate** incorporated in, or a **national of**, a **country which shares a land border with India**,
- unless such body corporate or the national, as the case may be,
- have obtained Government approval under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 and
- attached same with private placement offer cum application letter

g) The **private placement offer-cum-application letter** shall be in **Form PAS-4** serially numbered and addressed specifically to the person to whom the offer is made. **[Rule 14(4)].** It shall be issued only after resolution has been filed in the Registry. **[Rule 14(8)]**

h) A **complete record** of private placement offers shall be maintained by the company in **Form PAS-5**. **[Rule 14(3)]**

i) **No public advertisement** shall be made to inform the public about such an issue.

12.1 Subscribing to the Private Placement Issue

→ Every identified person willing to subscribe to the private placement issue shall apply in the private placement and application issued.

→ Along with the subscription money paid either by cheque, or DD, or other banking channel (**not by cash**).

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→ The monies raised **shall not be utilised until allotment is made and return of allotment is filed** with the ROC.

→ The **payment shall be made from the bank account of the person subscribing** and the company shall keep the **record of the bank account** from where such payment for subscription has been received.

→ In case of **joint holders**, the money shall be paid from the bank account of the person whose name appears first in the subscription.

→ The monies received on an application shall be kept in a **separate bank account in a scheduled bank** and shall be used only for adjustment against allotment or for repayment of money where it is unable to allot the securities.

12.2 Limit on fresh offer

No fresh offer or invitation shall be made unless –

✓ the **allotment w.r.t any offer/ invitation made earlier have been completed, or**
✓ that offer or invitation has been **withdrawn or abandoned** by the company.

12.3 Time limit for allotment of securities

→ Within **60 days** of receipt of application money.

→ If the **company is unable** to allot the securities within that period, it shall **repay the money within 15 days** from the expiry of 60 days, and

→ If the company **fails to repay the money** within that period, it shall be liable for **interest at 12% p.a.** from the expiry of 60 days.

12.4 Return of allotment

A return of allotment in **Form PAS-3** shall be filed by the company with the ROC **within 15 days** from the date of allotment including a complete list of allottees, their address, number of securities allotted, date of allotment, nominal value and amount paid on such securities, particulars of consideration, etc.

If the **company defaults** in filing the return of allotment within the above period, the **company, its promoters and directors shall be liable to a penalty** of

→ **Rs. 1,000 for each default for each day** during which the default continues
→ Subject to a **maximum of Rs. 25 lakhs.**

Note
Proviso to Rule 4(1) states that when a company makes an offer or invitation to subscribe to securities, no offer or invitation of any securities shall be made to a body corporate incorporated in, or a national of, a country which shares a land border with India, unless such body corporate or the national, as the case may be, have obtained Government approval under the FEMA29 Rules, 2019 and attached the same with the private placement offer cum application letter.

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This means that companies will now have to obtain government approval under the FEMA Rules before inviting subscription to securities or offering securities to any entity from a country that shares a land border with India i.e. China, Bhutan, Nepal, Pakistan, Bangladesh, and Myanmar

12.5 Punishment for contravention of private placement provisions

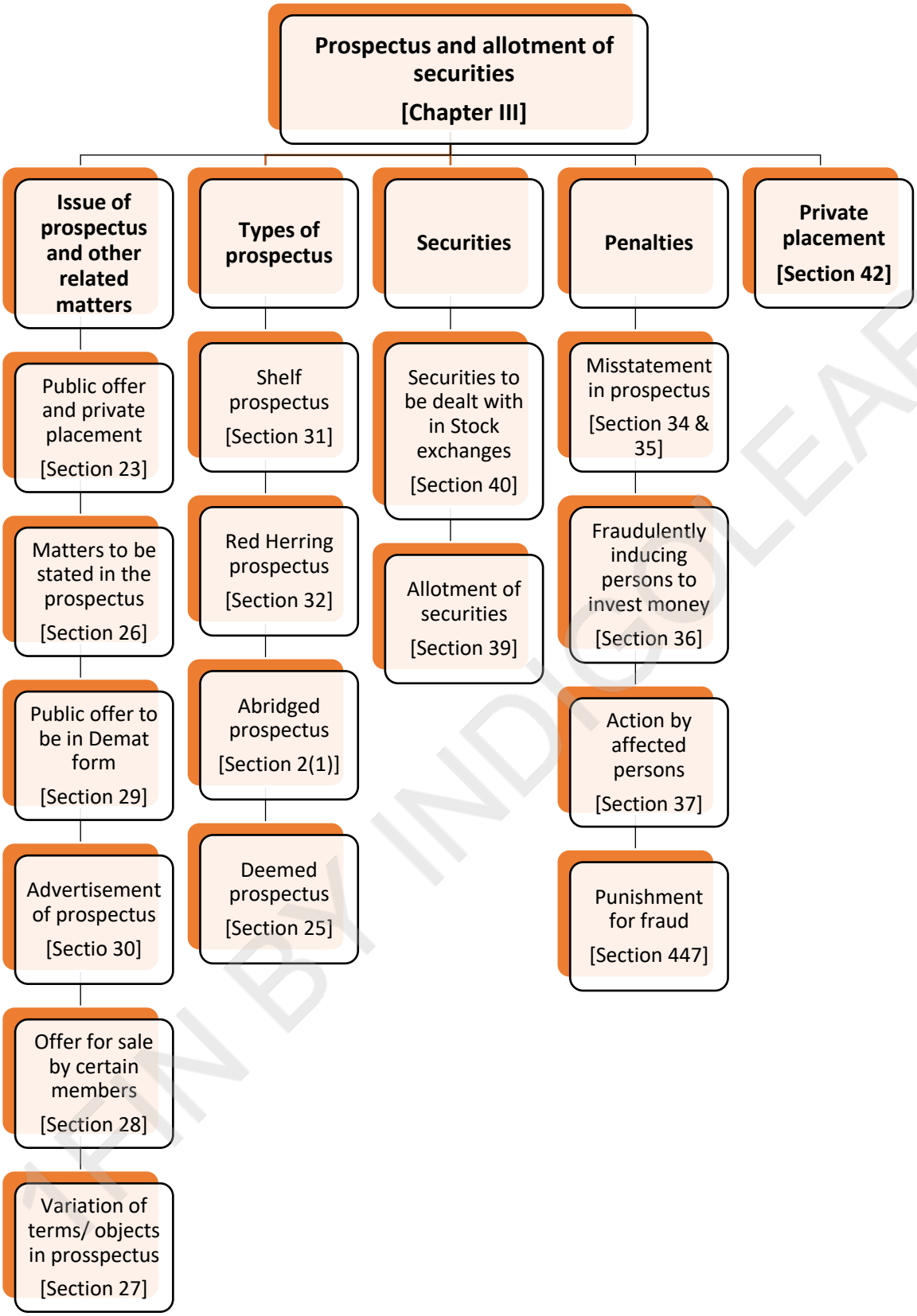
→ The company, its promoters and directors shall be liable for **penalty**
→ Which **may extend to**:
- **amount raised** through the private placement **or**
- Rs. **2 crores**, **whichever is lower**

→ And the **company shall also refund all monies with interest at 12%** to the subscribers **within 30 days** of order imposing the penalty.

Any **offer made without complying this section** shall be '**deemed public offer**' and relevant provisions of this Act, SEBI Act, 1992 and SCRA 1956 shall apply.

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OVERVIEW



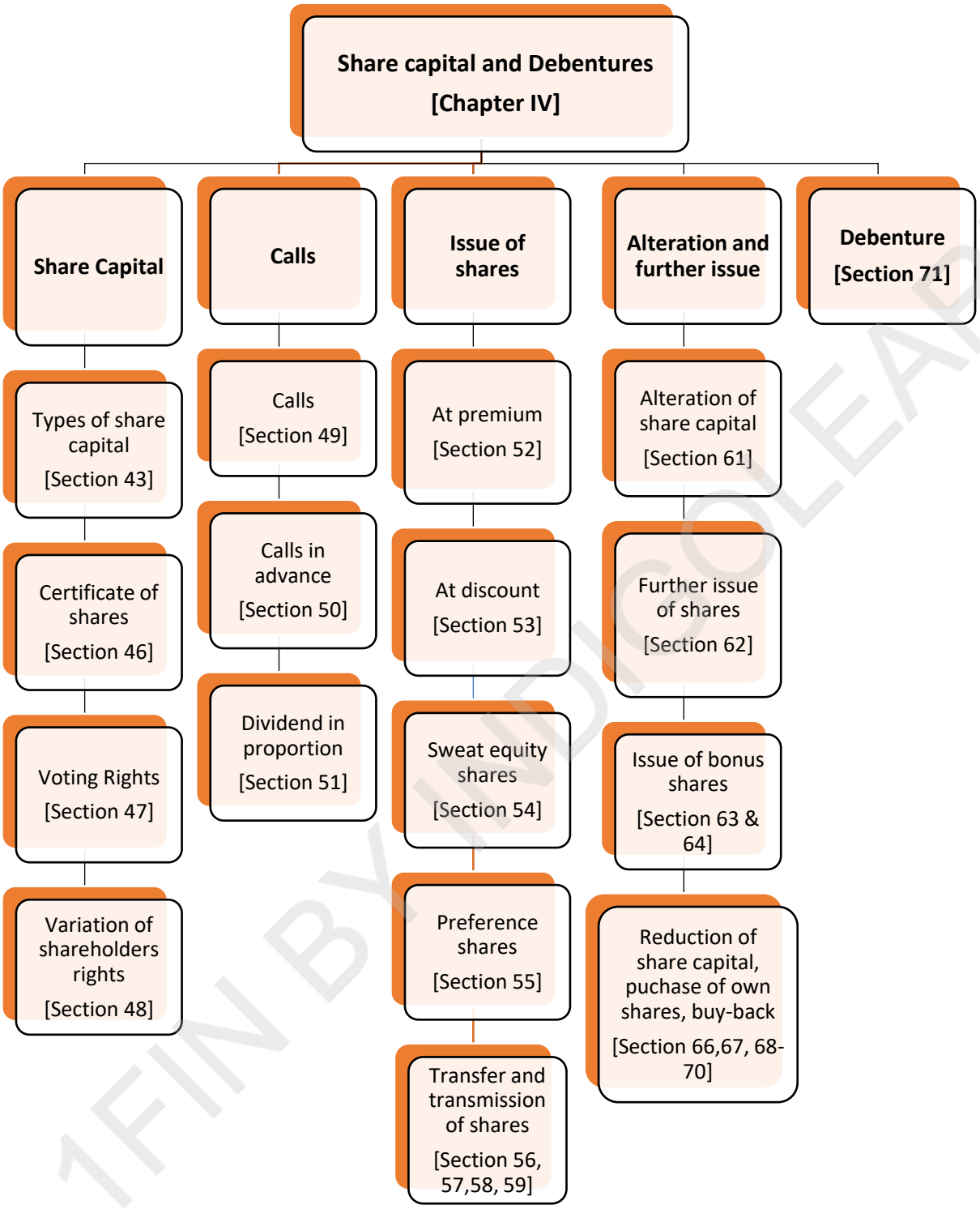
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SHARE CAPITAL AND DEBENTURES

Learning Outcomes –

- Know about the kinds of Share Capital
- Explain the basic requirements of issue of share certificates, voting rights and variation of shareholder's rights
- Explain calls on unpaid shares
- Know abou the time period permitted for delivery of Certificate of securities
- Understand the application of Securities Premium Account
- Identify prohibition on issue of shares at a discount
- Understand the issue of Sweat Equity Shares, Issue and Redemption of Preference Shares and creation of Capital Redemption Reserve Account
- Know about the transfer and transmission of securities, refusal to register and appeal against refusal
- Explain the concepts relating to the alteration of share capital and notice to the Registrar thereof
- Understand the concept relating to further issue of Share capital
- Know about the issue of bonus shares, reduction of share capital, Buy-back of shares and applicable restrictions thereon
- Know about the issue of debentures and creation of Debenture Redemption Reserve Account
- Identify the punishments and penalties for various offences including impersonation

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INTRODUCTION

Shares represent **ownership interest** in a company whereas **debentures** represent the **lenders' interest** in the company.

Shares and Debentures are financial instruments which help in arranging funds for the company. The legal provisions relating to Shares and Debentures are covered under **Chapter IV** of the Companies Act, 2013 (comprising **Sections 43 to 72**) and the **Companies (Share Capital & Debentures) Rules, 2014** as amended from time to time.

SHARE CAPITAL- TYPES

Section 43 of the Companies Act, 2013 provides the provisions relating to the kinds of share capital.

2.1 Share

Section 2(84) defines 'share' as a **share in the share capital** of a company and **includes a stock**.

- ✓ The share capital of a company is divided into **small units having a certain face value**. Each such unit is called a share.
- ✓ The definition of 'share' states that the term **share includes 'stock'**.
- ✓ If a company undertakes to **aggregate fully paid-up shares of various members** as per their requests and merge those shares into one fund, then such fund is called 'stock'. Stock is not issued originally but it is obtained by conversion of fully paid-up shares.

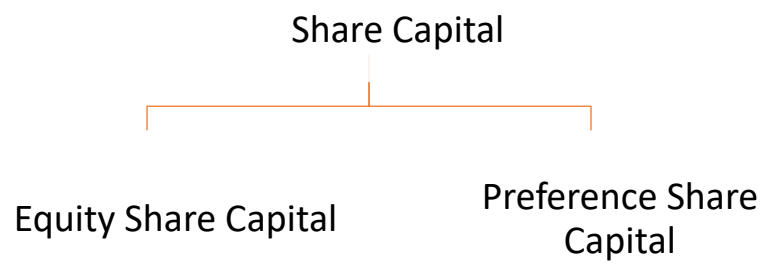
Case:

New London & Brazilian Bank v. Brockle Bank
A share is not a sum of money..., but is an interest measured in a sum of money, and made up of various rights, contained in the contract, including the right to a sum of money of a more or less amount.

Around two decade later, J. Farwell in landmark case of Borland's Trustee v Steel Brothers & Co Ltd2 place his trust in the opinion stated above, and observe that share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place and of interest in the second, and also consists of a series of mutual covenants entered into by all the shareholders inter se in accordance with the provisions of the Companies Act and the Articles of Association.

2.2 Two kinds of Share Capital

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Section 43 states that, the share capital of a company limited by shares shall be of two kinds, namely:-

a) Equity share capital –
   (i) With **voting rights**; or
   (ii) With **differential rights** as to dividend, voting or otherwise in accordance with such rules as may be prescribed [prescribed in Rule 4 of Companies (Share Capital & Debentures) Rules, 2014]; and
b) Preference share capital.

2.3 Equity Share Capital

Equity share capital means all share capital which is **not preference share capital.**

2.4 Preference Share Capital

Preference share capital means that part of the issued share capital of the company which carries or would **carry a preferential right with respect to**-

a) Payment of **dividend**, **and**
b) **Repayment** in case of a winding up or repayment of capital.

2.5 Equity Shares with Differential Rights

Rule 4 of the Companies (Share Capital & Debentures) Rules, 2014 contains provisions which need to be followed while issuing equity shares with differential voting rights.

2.5.1 *Conditions for issue of equity shares with differential rights*

(i) Authorised by the **AOA**,

(ii) Authorised by an **Ordinary Resolution** passed at a general meeting of the shareholders, In case of listed company, such issue shall be approved by the shareholders through postal ballot.

(iii) The **voting power** of shares with differential rights **shall not exceed 74% of the total voting power**, at any point of time,

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(iv) Company has **not defaulted** in filing the financial statements and annual returns **for immediately preceding 3 FYs**.

(v) Company has **no subsisting default** in
- → payment of a declared dividend to its shareholders or
- → repayment of its matured deposits or
- → redemption of its preference shares or debentures,

(vi) In the **preceding 5 FYs**, company has **not defaulted in**
- → payment of the dividend on preference shares or
- → repayment of any term loan from a public financial institution/Scheduled bank or interest payable thereon or
- → dues w.r.t statutory payments relating to employees to any authority or
- → crediting the amount in Investor Education and Protection Fund,

(vii) Company has **not been penalized by Court/Tribunal** during the **last 3 years** of any offence under the
- → RBI Act, 1934
- → SEBI Act, 1992
- → SCRA, 1956
- → FEMA, 1999 or
- → Any other Special Act, under which such company is regulated.

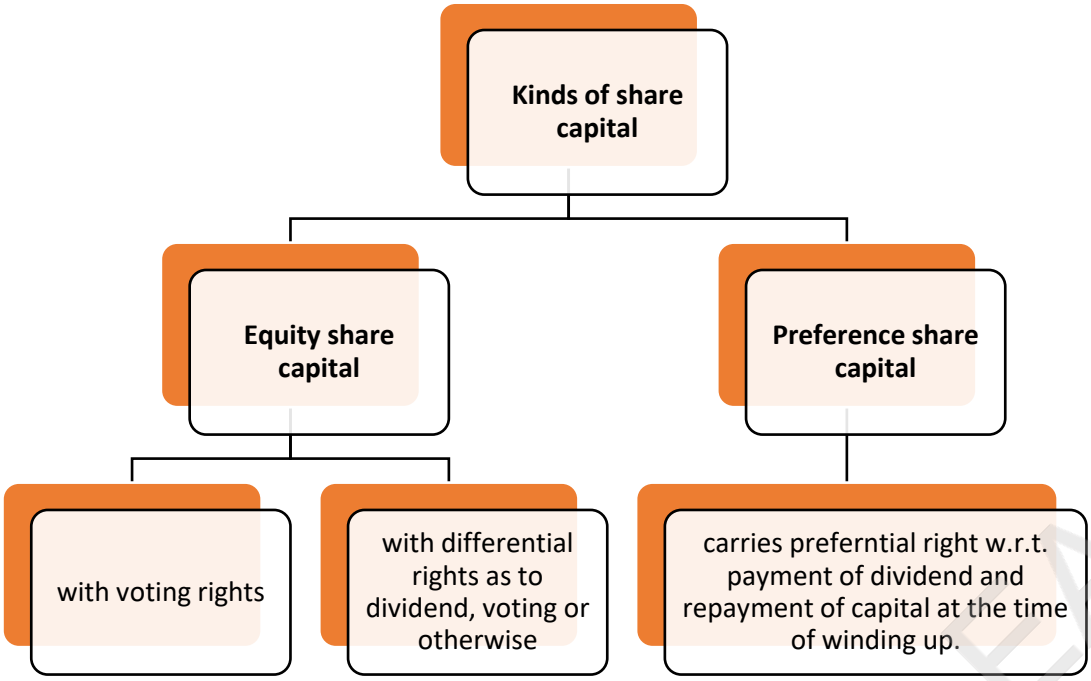
2.5.2 *Other Provisions for issue of equity shares with differential rights*

- ✓ **Rule 4(2)** – The **explanatory statement to be annexed** to the notice of the general meeting or of a postal ballot shall contain various matters like particulars of the issue including its size, details of differential rights etc.
- ✓ **Rule 4(3)** – Company **shall not convert its existing equity share capital** with voting rights into equity share capital carrying differential voting rights.
- ✓ **Rule 4(4)** – The BOD shall, *inter-alia*, **disclose the specified particulars in the Board's Report** for the F.Y. in which issue of equity shares with differential rights was completed.

> ***Inter-alia*** is a Latin phrase which means "among other things".

- ✓ **Rule 4(5)** – Holders of equity shares with differential rights shall **enjoy all other rights such as bonus shares, right shares, etc.,** which the holders of equity shares are entitled to.
- ✓ **Rule 4(6)** – The **Register of Members** shall contain all the relevant particulars of the shares issued with differential voting rights.

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CERTIFICATE OF SHARES

Section 46 of the Companies Act, 2013 contain provisions which regulate the certificate of shares.

A certificate issued under the common seal, if any, of the company or signed by two directors or by a director and the CS, if any, specifying the shares held by a person, shall be **prima facie evidence of the title** of the person to such shares.

A share certificate must be **distinctively numbered**.

Where shares are held in depository form, **the record of the depository** shall be the prima facie evidence of the interest of the beneficial owner.

Section 43 does not apply to:

a) **Private company** where the MOA or AOA so provides, provided such company has not defaulted in filing its FS u/s 137 or Annual Return u/s 92 with the ROC.
b) **Specified IFSC Company** where MOA or AOA so provides.

Note:

1. Since *w.e.f. 29-05-2015 though* Companies Amendment Act 2015, requirement to have common seal is optional for companies, hence physical share certificate issued under sign of two director or of one director along with company secretary is valid.
2. If the composition of the Board permits of it, at least one of the aforesaid two directors shall be a person other than the managing or whole-time director

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3. A director shall be deemed to have signed the share certificate if his signatureis printed thereon as a facsimile signature by means of any machine, equipment or other mechanical means such as engraving in metal or lithography, or digitally signed, but not by means of a rubber stamp, provided that the director shall be personally responsible for permitting the affixationof his signature thus and the safe custody of any machine, equipment or other material used for the purpose.

3.1 Duplicate Certificate

3.1.1 *Circumstance for issue of duplicate certificate*

Original certificate -

- Is proved to have been **lost or destroyed lost or destroyed**, or
- Has been **defaced, mutilated, or torn and is surrendered** to the company.

ISSUE OF RENEWED/DUPLICATE SHARE CERTIFICATE [SUB-SECTION 2 READ WITH RULE 6 OF THE COMPANIES (SHARES AND DEBENTURES) RULES, 2014]

Issue of renewed certificate

A case wherein originally issued share certificate has been defaced, mutilated or torn, a renewed share certificate in replacement shall be issued, in lieu of surrenderof such original certificate, to the company.

Note:

1. A company may replace all the existing certificates by new certificates upon sub-division or consolidation of shares or merger or demerger or any reconstitution without requiring old certificates to be surrendered
2. On renewed certificate it shall be stated that it is "Issued in lieu of share certificate No sub-divided/replaced/on consolidation"
3. Company may charge such a fee as board may think fit, but not exceeding ` 50 per certificate; and no fee shall be payable pursuant to scheme of arrangement sanctioned by the High Court or Central Government.

Issue of duplicate certificate

A case wherein share certificate originally issue has been lost or destroyed, a share certificate in duplicate may be issued if board is consented for the same basedupon evidences produced.

Record of renewed and duplicate certificate to be maintained

Particulars of every renewed and duplicate share certificates maintained in FormSH 2 with cross reference to register of members, in shape of register.

Such register shall be kept at **registered officer or any other place where register of members in custody** of company secretary or such other person as may be authorised by the Board.

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All entries made in such register shall be **authenticated by the company secretary** or such other person as may be authorised by the Board.

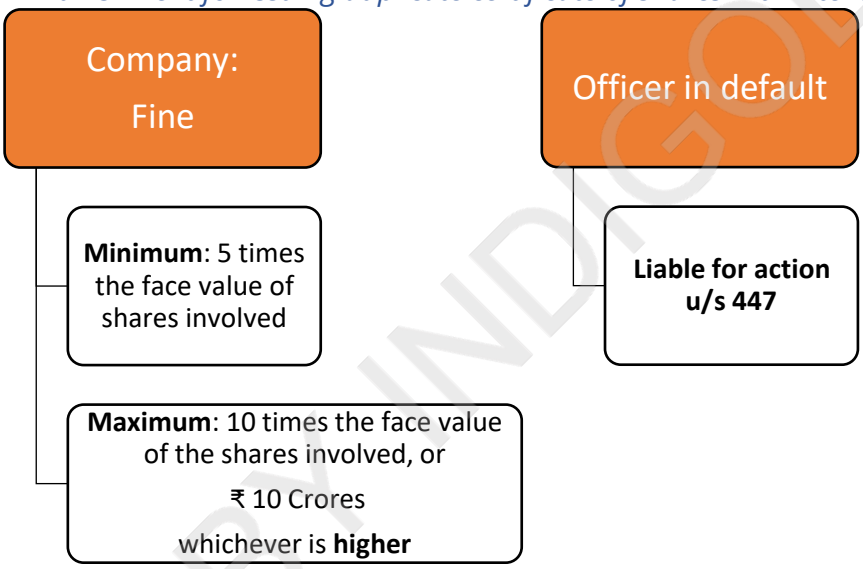
MANNER OF ISSUE OF CERTIFICATES/DUPLICATE CERTIFICATES

Sub-section 3 overrule the articles of a company, and say the issue of a certificateof shares or the duplicate thereof, the particulars to be entered in the register of members and other matters shall be in manner and form as prescribed in rule 5, 6, and 7 of the Companies (Shares and Debentures) Rules, 2014.

Rule 5 of the *Companies (Shares and Debentures) Rules, 2014* applies, where shares are not in demat form

Share certificate is in vogue in case of shares which are **held in the physical form**, not in the demat form (under the depository mode). Hence provisions contained in *rule 5* of the Companies (Shares and Debentures) Rules, 2014 pertaining to share certificate applicable where shares are not in demat form.

3.1.2 *Punishment for issuing duplicate certificate of shares with intent to defraud*



3.2 Dematerialisation of shares

- ✓ **Listed shares** are required to be held in electronic form (i.e., dematerialised form)
- ✓ **Rule 9A** of the Companies (Prospectus and Allotment of Securities) Rules, 2014, requires every **unlisted public company** to issue the securities in dematerialised form and facilitate the dematerialisation of all its existing securities.

At present, there are two depositories in India, i.e.,

- National Securities Depository Ltd. (**NSDL**) , and
- Central Securities Depository (India) Ltd. (**CSDL**)

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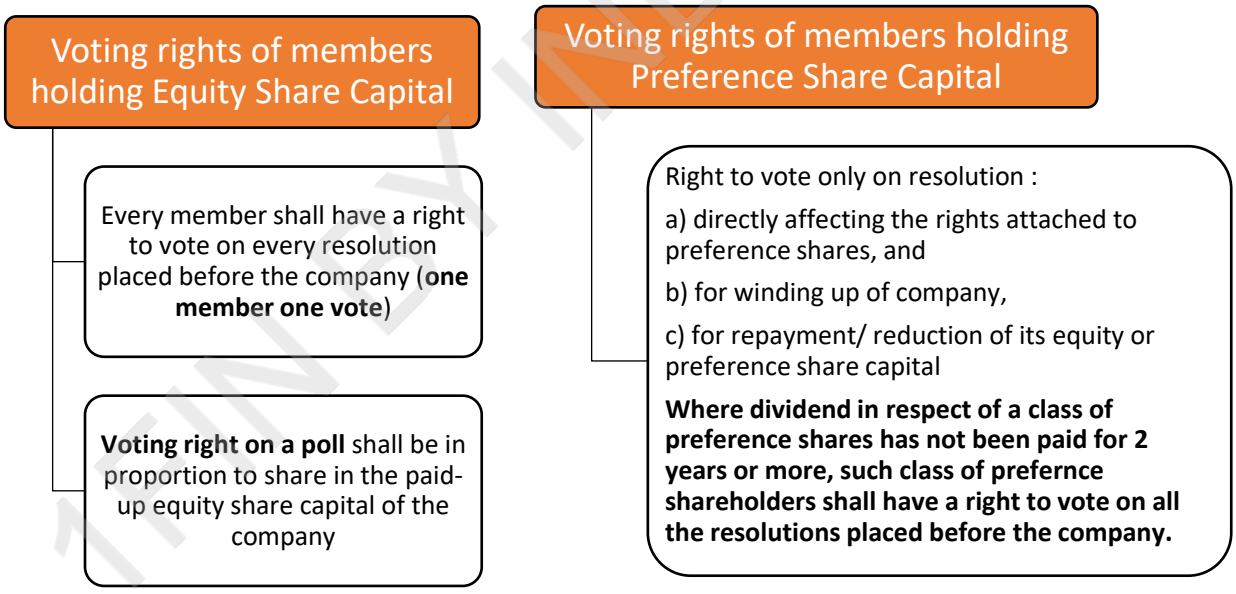
Rule 9A shall not apply to an unlisted public company which is:

a) A Nidhi
b) A government company
c) A wholly owned subsidiary

[Rule 9A has been covered in detail in Chapter 3 'Propsectus and allotment of securities]

VOTING RIGHTS

Section 47 of the Companies Act, 2013 governs the voting rights of the members of a company.



The **proportion of the voting rights of equity shareholders to the voting rights of preference shareholders** shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

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VARIATION OF SHAREHOLDERS' RIGHTS

Where a share capital of the company is divided into **different classes of shares**, the rights attached to the shares of any class may be varied.

Section 47 shall not apply to a private company, where MOA or AOA of the private company so provides and which has not defaulted in filing its financial statements or annual return with the Registrar.

Section 48 of the Companies Act, 2013 deals with the variation of shareholder's rights.

5.1 Consent for variation

Such variation requires the consent –

- **In writing** of the holders of **not less than 3/4th** of the issued shares of that class, *OR*
- By means of a **SR** passed at a separate meeting of the holders of shares of that class.
- If the variation affects the rights of any other class of shareholders, the consent of 3/4th of such other class of shareholders is also to be obtained.

5.2 Conditions for variation in rights of shareholders

- Provision w.r.t such variation must be **contained in the MOA/AOA**, *OR*
- In the absence of such provision in the MOA/AOA, variation should **not be prohibited by the terms of issue of the shares of that class**.

5.3 No consent given for variation

- Where holders of **not less than 10% of the issued shares of a class** did not consent to the variation, they may **apply to the Tribunal** to have the variation cancelled.
- The application shall be made **within 21 days** after the date on which consent was given or resolution was passed.
- The **application may be made on behalf of all shareholders** entitled to make an application **by any one or more person** as they may appoint in writing for this purpose
- Where such application has been made, the **variation shall not have effect unless and until it is confirmed by the Tribunal**.
- The decision of the Tribunal shall be binding on the shareholders.
- **Within 30 days** of order of the Tribunal, company shall **file a copy thereof with the Registrar**.

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CALLS, CALLS-IN-ADVANCE AND MATTERS INCIDENTAL THERETO

Section 49, 50 & 51 of the Companies Act, 2013 deals with making calls in respect of partly paid-up shares, call-in-advance and all the matters incidental thereto.

When the shares are partly paid up, the company issuing them can make calls asking the shareholders to pay the amount 'called up' in respect of such partly paid-up shares.

6.1 Calls [Section 49]

- ✓ Calls have to be **uniformly made**.
- ✓ There should be **no/ differentiation** for a given class of shareholders.
- ✓ However, where **different amounts are paid for shares of the same nominal value** by the shareholders, such shares shall be deemed to be different class of shares (i.e., this section shall not be applicable).

6.2 Calls-in-advance [Section 50]

- ✓ Company may accept from a member, the whole or a part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up (i.e., calls in advance)
- ✓ However, this should be **authorised by the AOA**.
- ✓ However, such **member shall not have voting right in respect such advance amount** paid by him till the amount is duly called up by the company.

Advance payment will not lead to increased voting rights.
However, **delayed payment of call money could lead to decreased voting rights.**

6.3 Dividend in proportion [Section 51]

The company is permitted to pay dividends in proportion **to the amount paid-up on each share**, if *authorised by the AOA*.

ISSUE OF SHARES AT PREMIUM

Section 52 of the Companies Act, 2013 deals with the provisions relating to issue of shares at a premium and the application of such premium.

7.1 Premium

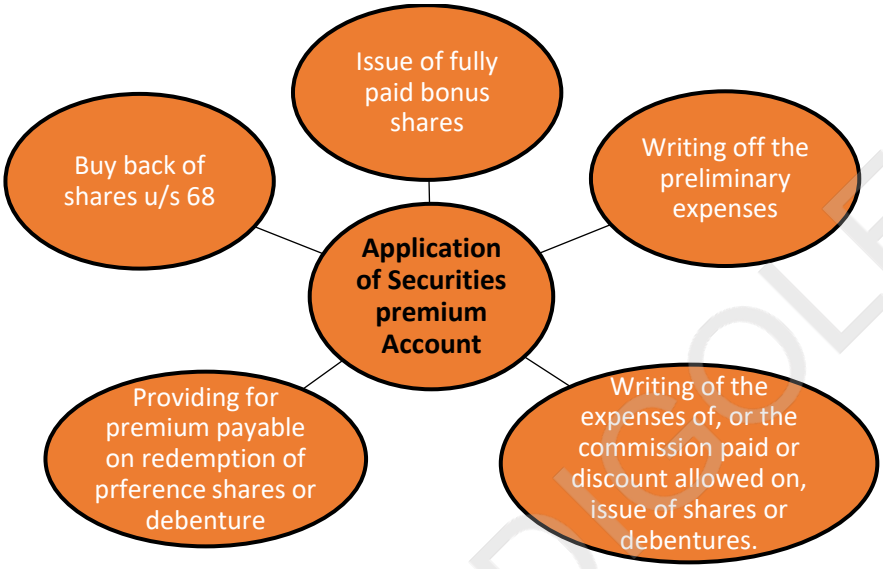
When a company **issues shares at a price higher than their face value**, the shares are said to be **issued at premium**, and the differential amount is termed as **premium**

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7.2 Application of Premiums

The aggregate amount of premium received shall be transferred to an account called **"Securities premium Account".**

Example: A share having face value of ₹10 is issued at ₹14. The amount over and above ₹ 10 is called premium (i.e., ₹4).



The Securities premium Account may be applied by such class of companies as may be prescribed and whose FS comply with the accounting standards u/s 133 for such class of companies, **for the following purposes**:

No such cos. have been prescribed so far.

a) For **paying up unissued equity shares** of the company to be issued to members of the company **as fully paid bonus shares**, or
b) For **writing off expenses** of or commission paid or discount allowed on any issue of equity shares of the company, or
c) For the **purchase of its own shares** or other securities u/s 68.

Transfer of premium to Securities Premium Account [Sub-section1]

Sub-section 1 lay-down following principles that shall be observed in regards to premium;

a. Premium may be received in cash or in kind.

b. The amount of premium so received, whether in cash or kind, shall be carried to a separate account to be known as the Securities Premium Account.

c. The amount to the credit of share premium account has to be maintained with the same sanctity as paid-up share capital

d. It can be reduced only in the manner of paid-up share capital can be reduced under this act.

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ISSUE OF SHARES AT DISCOUNT

Section 53 of the Companies Act, 2013 prohibits the issue of shares at discount.

8.1 Discount

Where the **issue price is lower than the face value** of shares, such issue of shares is regarded as being at discount and the differential amount is known as **discount**.

8.2 Prohibition on issue of shares at discount

Example: A share having face value of ₹5 is issued at a lower price of ₹4. The differential amount of ₹1 is known as discount.

- ✓ **A company shall not issue shares at a discount, except as provided in Section 54** (i.e., Sweat equity Shares).
- ✓ Any share issued by a company at a discount shall be **void**.
- ✓ **Exception**: A company may issue shares at a discount to its **creditors** when its debt is **converted into shares** under any *statutory resolution plan/ debt restructuring scheme as per RBI*.

8.3 Punishment for default

1) **Fine:** Company and every officer in default shall be liable to penalty which may extend to

   - Amount raised through issue of shares at discount, or
   - ₹ 5 lakhs

   } Whichever is less

2) Company shall also **refund all monies received with interest at 12% p.a**. from the date of issue of such shares to the persons to whom such shares have been issued

Restrictions mentioned in Section 52 & 53 apply only in respect of issue of shares but not to the issue of debt related products like bonds/ debentures.

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9.1 Sweat Equity Shares [Section 2(88)]

Section 54 of the Companies Act, 2013 mention the provisions to be adhered to by a company issuing sweat equity shares

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.

Employee means –

a) A **permanent employee** working in/outside India,
b) A **director** of the company, or
c) An **employee or director** as defined in sub-clauses (a) or (b) above **in a subsidiary**, in/outside India, **or of a holding company** of the company [Rule 8]

9.2 Conditions for issue of sweat equity shares

✓ Authorised by a **SR passed by the company.**
✓ The resolution shall **specify**:
→ number of shares,
→ current market price,
→ consideration, if any,
→ class or classes of directors or employees to whom such equity shares are to be issued.
✓ **Listed companies** shall follow the regulations made by SEBI in this behalf.
✓ **Unlisted company** shall comply with the provisions of Rule 8 of the Companies (Share and Debentures) Rules, 2014.

9.3 Important provisions contained in Rule 8 of the Companies (Share and Debentures) Rules, 2014

✓ The **SR** authorising the issue of Sweat Equity shares shall be **valid only for 12 months** from the date of passing [Rule 8 (3)].

Limit on issue of Sweat equity share [Rule 8(4)]	
Maximum issue of sweat equity shares shall be - ○15% of existing paid-up share capital in a year OR ○Shares of issue value of Rs. 5 crores, whichever is higher	The issuance of sweat equity shares in a company **shall not exceed 25% of paid-up capital** of the company *at any time*. •**Exception**: A **start-up company** may issue sweat equity shares not exceeding 50% of its paid-up capital up to 10 years.

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- ✓ **Lock-in-period:** Sweat equity shares issued shall be non-transferable for **3 years** from the date of allotment [Rule 8(5)].

- ✓ **Valuation of Sweat Equity shares**: Shall be at a **price determined by a registered valuer as the fair price** giving justification for such valuation [Rule 8(6)].

- ✓ The **valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued** shall be carried out by a registered valuer. A proper report giving justification for such valuation shall also be given to the BOD by such valuer [Rule 8(7)].

- ✓ **Treatment of non-cash consideration**: Where the sweat equity shares are issued for non-cash consideration, the treatment of such non-cash consideration shall be as follows:
  - → **Where non-cash consideration is a depreciable asset** – presented in the Balance sheet in accordance with the Accounting standards.
  - → **Other items** – expensed as provided in the Accounting standards. [Rule 8(9)].

- ✓ **Disclosure in the Director's Report**: The BOD shall, inter-alia, disclose in the Director's Report for the year in which such shares are issued, the **specified details of issue of sweat equity shares** [Rule 8(13)].

- ✓ **Maintenance of Register**: Company shall maintain a register of sweat equity shares in **Form SH 3** at the registered office of the company or such other place as BOD may decide in this behalf [Rule 8(14)].

Value additions means actual or anticipated **economic benefits** derived or to be derived by company from an expert or a professional for providing **know-how** or making available rights **intellectual property** rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

9.4 Sweat Equity shares to rank *pari passu [Sec 54(2)]*

- ✓ The rights, limitations, restrictions, and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares.
- ✓ The holders of sweat equity shares shall be ranked *pari passu* **with other equity shareholders**.

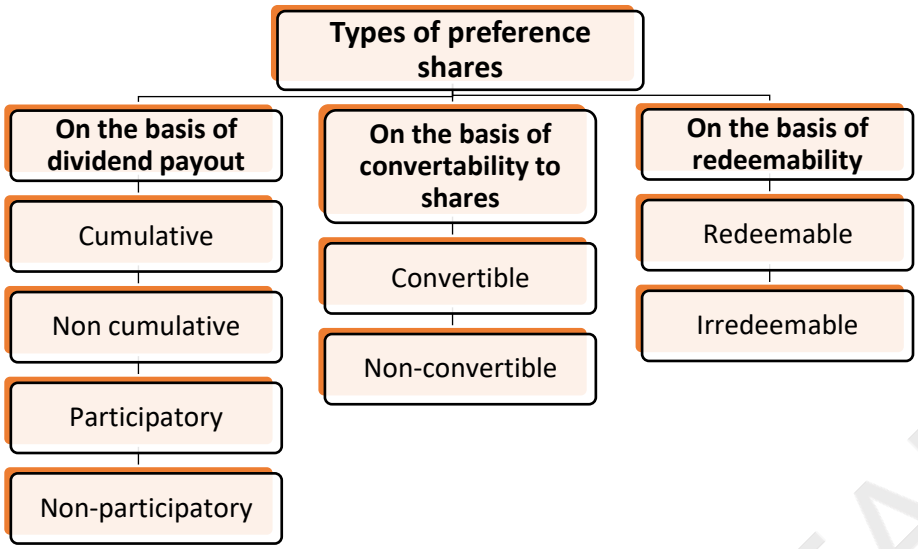
Expression **pari passu mean** 'to be in equal footing'.

PREFERENCE SHARES - ISSUE AND REDEMPTION

Section 55 of the Companies Act, 2013 along with **Rule 9** of the Companies (Share Capital and Debentures) Rules, 2014. contains the provisions for regulation of issue & redemption of preference shares.

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10.1 Types of Preference shares



A Company limited by shares shall issue only Redeemable Preference Shares.

10.2 Conditions for issuing preference shares

(i) Authorised by passing a **SR in the general meeting** of the company [Rule 9(1)].

(ii) Company should **not have subsisting default in the redemption of preference shares** issued earlier or in payment of dividend thereof [Rule 9(1)].

(iii) **Register of members** shall contain the particulars in respect of such preference shareholders [Rule 9(4)].

10.3 Redemption of Preference Shares

Only fully paid preference shares are to be redeemed.

10.3.1 *Time period within which Preference shares are to be redeemed*

- ✓ 20 years, or
- ✓ Time specified in AOA

} whichever is less

Exception: For **Infrastructure projects** as specified in Schedule VI, preference shares can be issued for a period **exceeding 20 years but not exceeding 30 years** *subject to the redemption of 10% of such preference shares beginning in 21st year onwards or earlier*, on a proportionate basis, at the option of such preference shareholders.

10.3.2 *Source of redemption of Preference shares*

Preference shares shall be redeemed only out of

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→ **profits** of the company which would otherwise be available for dividend, *or*
→ **proceeds of fresh issue** of shares made for the purpose of such redemption.

10.3.3 *Transfer to CRR Account*

Where the preference shares are proposed to be redeemed out of profits of the company,

→ out of such profits, a **sum equal to the nominal amount** of the shares to be redeemed, shall be **transferred to** a reserve called the **Capital Redemption Reserve (CRR) Account.**

CRR may be applied for **issue of fully paid bonus shares [Sec 55(4)].**

There is no need to transfer to the CRR account any amount paid towards premium.

10.3.4 *Payment of Premium on redemption*

In case of such class of companies, as may be prescribed and whose FS comply with the Accounting standards prescribed u/s 133,

- Premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.

In case of redemption of preference shares issued on or before the commencement of this Act,

- premium shall be provided for out of the profits of the company or out of the company's security premium account, before such shares are redeemed.

In a case not meeting above criteria,

- Premium payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

10.3.5 *Deemed Redemption*

Where a company is not in a position to redeem any preference shares or to pay dividend on such shares (*called unredeemed preference shares*),

→ It may **issue further redeemable preference shares** equal to the amount due, including dividend thereon and
→ On such issue of further redeemable preference shares, such *unredeemed preference shares* shall be deemed to have been redeemed.
→ **Conditions:**
  - **Consent of holders of 3/4th in value** of such preference shares
  - **Approval of Tribunal**.
  - Tribunal may pass order to **redeem shares of dissenting shareholders.**

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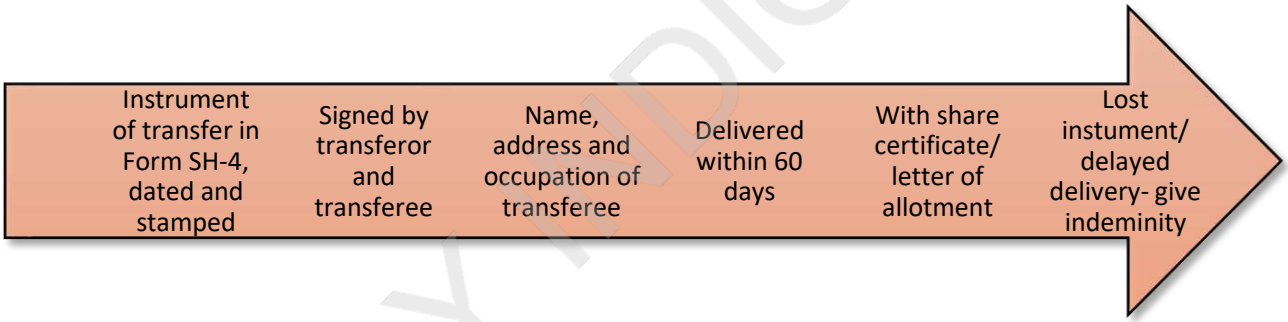
Section 56 of the Companies Act, 2013 deals with the transfer and transmission of securities or interest of a member of the company.

11.1 Transfer of Securities

- ✓ A company shall not register the transfer of securities of the company, unless a **proper instrument of transfer in Form SH-4**,
  - → duly stamped, dated, and executed by or on behalf of the **transferor and the transferee**,
  - → specifying the name, address, and occupation of the transferee
  - → has been **delivered to the company by the transferor or the transferee** within **60 days** from the date of execution,
  - → along with the certificate of securities or the letter of allotment of securities.

- ✓ **Exception**: Where the transfer is between persons both of whose names are entered as holders of beneficial interest in the records of a depository.

- ✓ **Where the instrument is lost or not delivered within prescribed time**:
  The company may register the transfer on such terms as to indemnity as the Board may think fit.



11.2 Transmission of Shares

Transmission of shares shall take place in following cases:

a) Death	→ Transmitted to Legal Representative
b) Insolvency	→ Transmitted to his Official Receiver
c) Lunacy of original shareholder	→ Transmitted to the administrator appointed by the Court

A company shall **register an intimation of transmission of any right to securities**, received by it, from any person to whom such right has been transmitted.

11.3 Transfer of partly paid shares

Where an **application** for transfer of partly paid shares is **made by the transferor**,

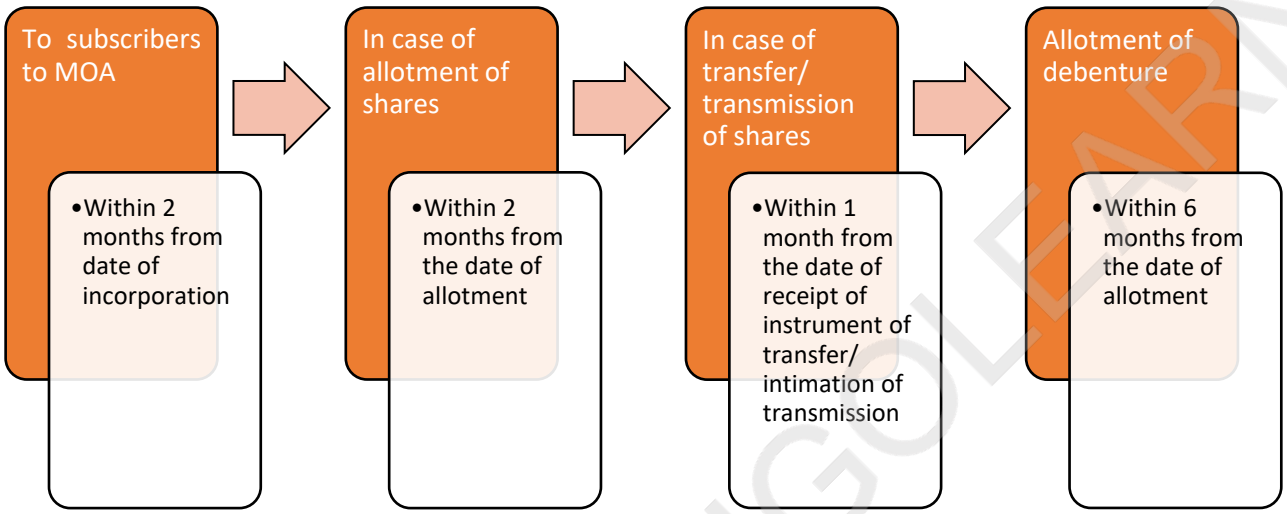
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→ the company shall give the **notice** of such application in **Form SH-5 to the transferee** [prescribed by **Rule 11 (3)** of the Companies (Share Capital and Debentures) Rules, 2014], *and*

→ the **transferee gives no objection** to the transfer **within 2 weeks** from the date of receipt of notice, *and*

→ the **company shall register** such transfer of partly paid shares

11.4 Time period for delivery of certificates



11.5 Transfer of securities of a deceased shareholder

The transfer of any securities or interest of a deceased person in a company by the **legal representative** shall be valid as if he had been the holder at the time of execution of the instrument of transfer.

11.6 Punishment for default

Company	Officer of the company in default	Depository
Penalty of ₹50,000	Penalty of ₹50,000	Where any depository or depository participant has transferred shares with an intention to defraud a person, it shall be **liable u/s 447.**

11.7 Forged transfer

Forged transfer takes place when a company effects the transfer of shares on the basis of an instrument of transfer containing forged signatures of the transferor.

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A forged transfer is a 'nullity' and is not legally binding.

However, if the transferee of the 'forged transfer' transfers the shares to another buyer who does not know about the forgery and the company also registers the transfer in the name of the new buyer and endorses the share certificates,

→ The company cannot deny the ownership rights of the new genuine buyer but
→ It cannot also deny the ownership rights of the **original shareholder** as forged transfer is *void-ab-initio,* and therefore the company has to **restore his name**.
→ Hence, the company shall **compensate the new genuine buyer** who exercised good faith in purchasing the shares.
→ The company shall **get itself indemnified by the first transferee** who used the forged instrument to get the shares transferred to his name.

PUNISHMENT FOR PERSONATION OF SHAREHOLDER

Section 57 of the Companies Act, 2013 contains provisions relating to punishment for personation of a shareholder.

If any person deceitfully personates –

a) As the owner of any security or interest in a company, or
b) As an owner of any share warrant or coupon issued in pursuance of the Companies Act, 2013

Such person shall be punishable with:

✓ **Imprisonment** – not less than **1 year** but may extend **to 3 years**, *and*
✓ **Fine** – not less than **₹1 lakhs** but which may extend **to ₹5 lakhs.**

REFUSAL OF REGISTRATION AND APPEAL AGAINST REFUSAL

Section 58 of the Companies Act, 2013 contains procedures to be followed by a company while refusing to register the transfer of securities and the process for filing appeal against such refusal.

13.1 Private Company refuses to register transfer/ transmission of securities

→ The **company shall send a notice of refusal** to the transferor and the transferee or to the person giving intimation of such transfer, **within 30 days** from the date on which the instrument of transfer, or the intimation of such transmission, was delivered to the company.

→ The **transferee may appeal** to the Tribunal against the refusal
  - **Within 30 days** of receipt of notice of refusal, *or*

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- **Where notice of refusal is not sent** by the company, **within 60 days** from the date on which the instrument of transfer/ intimation of transmission was delivered to the company.

13.2 Public Company refuses to register transfer/ transmission of securities without sufficient cause

The securities or other interest of any member in a public company are freely transferrable.

If a public company refuses **without sufficient cause** to register transfer/ transmission of securities within a period of 30 days from the date on which the instrument of transfer/ intimation of transmission was delivered to the company, the **transferee may appeal to the Tribunal** –

- **Within 60 days** of receipt of notice of refusal, *or*
- **Where notice of refusal is not sent** by the company, **within 90 days** from the date on which the instrument of transfer/ intimation of transmission was delivered to the company.

13.3 Order of the Tribunal

Tribunal shall **either dismiss** the appeal **or order** –

a) **Transfer/ transmission** to be registered within **10 days**, *or*
b) **Rectification of register** and also direct the **company to pay damages**, if any, sustained by any aggrieved party.

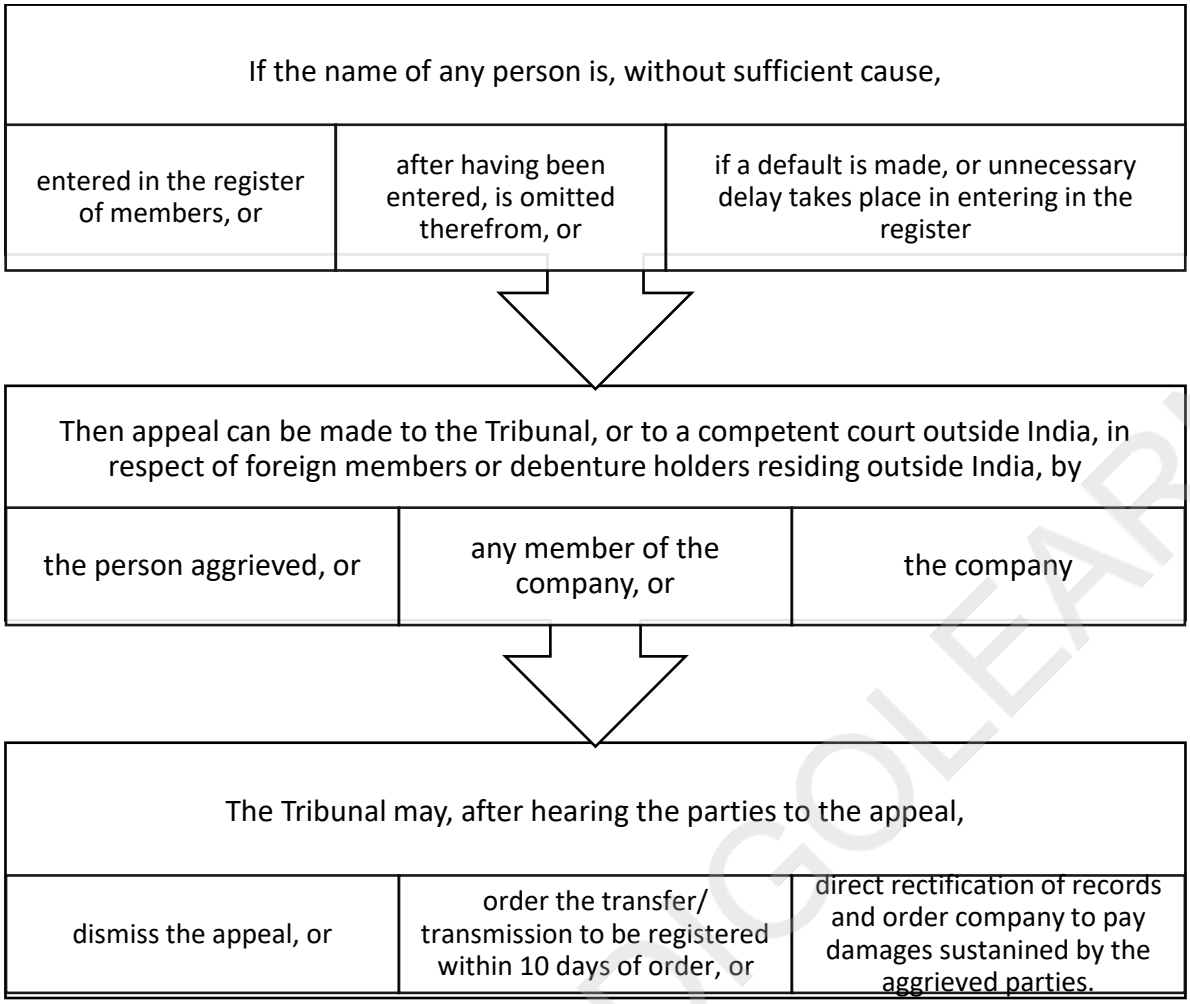
Punishment for contravention of order of Tribunal:

→ **Imprisonment**: for not less than **1 year** which may extend **to 3 years**, *and*
→ **Fine**: not less than **₹1 lakhs** which may extend **to ₹5 lakhs**.

RECTIFICATION OF REGISTER OF MEMBERS

Section 59 of the Companies Act, 2013 provides the procedure for rectification of register of members.

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ALTERATION OF SHARE CAPITAL

A limited company having a share capital may alter its MOA in its general meeting to:

Section 61 of the Companies Act, 2013 provides provisions for alteration of capital clause of the MOA.

(i) **Increase its Authorised share capital**,
(ii) **Consolidate and divide** all or any of its share capital into shares of a larger amount than its existing shares, *[Consolidation which results in change in the voting percentage of shareholders should be approved by the Tribunal]*

(iii) **Convert** all or any of its fully paid-up shares **into stock**,
(iv) **Reconvert** stock into fully paid-up shares of any denomination,

Section 2(8) defines **Authorised Share Capital** to mean such capital as is authorised by the MOA of a company to be the maximum amount of share capital of the company.

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(v) **Sub-divide** its shares into shares of smaller amount than is fixed by the MOA *[However, the ratio between the amount paid and unpaid shall remain unchanged]*.

(vi) **Cancel the unsubscribed shares** and thus diminish the amount of share capital. *[Such cancellation shall not be deemed to be a reduction of share capital].*

The company shall within 30 days of alteration of share capital, give a notice to the Registrar in Form SH-7 along with the altered MOA.

The alteration must be authorised by the Articles of Association.

Section 62 of the Companies Act, 2013 deals with further issue of share capital.

FURTHER ISSUE OF SHARE CAPITAL

Further issue of shares can be through:

- ✓ Rights issue,
- ✓ Employee Stock Options, or
- ✓ Preferential allotment

A **right issue** involves pre-emptive subscription rights to buy additional securities in a company **offered to existing shareholders**.

If a company announces '1:10 rights issue', it means an existing shareholder can buy one extra share for every 10 shares held by him/her. Usually, right shares are issued at less than the prevailing market price to encourage subscription.

Employees Stock Option means

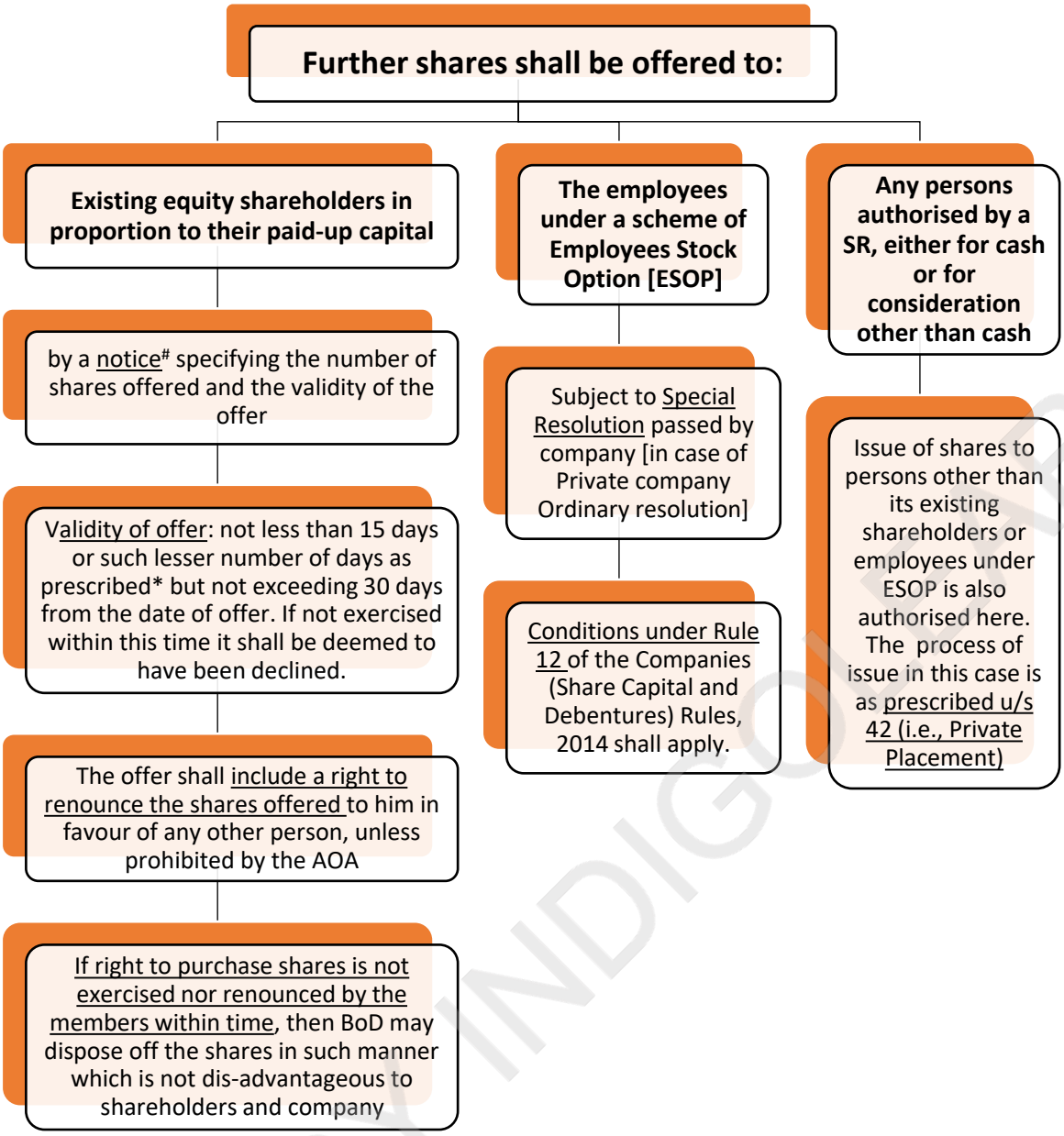
→ the **option given to the directors, officers or employees** of a company or of its holding company or subsidiary company or companies, if any,

→ 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 [Section 2 (37)].

Preferential allotment means **issue of shares or other securities by a company to any selected person or group of persons**, whether or not those persons include existing shareholders or employees, on a preferential basis.

→ Thus, company is authorised to **issue to persons other than its existing shareholders and to employees under ESOP**. The issue of those shares is **covered u/s 42 of the Act (Private Placement**).

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#The notice shall be dispatched through registered post/ speed post/through electronic mode/ courier/ any other mode having proof of delivery to all the existing shareholders at least 3 days before the opening of the issue.

*As per Rule 12A time period within which offer shall be made for acceptance shall be **not less than seven days** from date of offer.

Section 62 shall not apply to conversion of Convertible Preference shares/ Debentures into shares.

16.1 Conversion of Debentures issued by/ Loan obtained from the government

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- ✓ Where any debenture issued/ loan obtained from any government by a company, the Government may **if it is considered necessary in public interest to do so**, by an **order**, direct that such debenture/ loans or part thereof shall be converted into shares of the company. This is possible even if the original terms of issue of debenture/ raising of loan did not include a term for conversion.
- ✓ If the **terms and conditions of such conversion are not acceptable** to the company, it may **appeal** to the Tribunal **within 60 days** of communication of such order.
- ✓ The Tribunal shall hear the company and the government and pass such order as it thinks fit.
- ✓ In case of conversion, the fresh issue of shares shall be **deemed increase in 'authorised share capital'** of the company. Accordingly, MOA shall be altered.

16.2 Conditions for issue of shares under ESOP Scheme [Rule 12]

In case of an **unlisted company desirous to issue shares under ESOP Scheme** to its directors, officers or employees, Rule 12 requires certain conditions to be fulfilled.

The **conditions** prescribed by Rule 12 are as follows:

> Listed company while issuing shares under ESOP Scheme shall follow the provisions under SEBI (Share Based Employee Benefits) Regulations, 2014.

(i) **Approved by the shareholders** of the company by passing a **SR** [Rule 12 (1)].

(ii) Specified disclosures shall be made by company in the **explanatory statement** annexed to the notice for passing SR [Rule 12 (2)].

(iii) The companies granting the ESOP will have the **freedom to determine the exercise price** [Rule 12 (3)].

(iv) **Rule 12 (6)** –

a. There shall be a **minimum period of one year** between the grant of options and vesting of option.
b. The company shall have freedom to specify the **lock-in-period** for the shares pursuant to exercise of option.
c. The employees shall **not have right to receive any dividend or to vote** or in any manner enjoy the benefits of a shareholder, **till the shares are issued on exercise of option**.

(v) **Rule 12 (8)** –

a. The option granted shall **not be transferrable** to any other person.
b. The option granted to employees **shall not be pledged, hypothecated, mortgaged,** or otherwise encumbered or alienated in any other manner.
c. No person other than the employees to whom the option is granted shall be entitled to **exercise the option**.

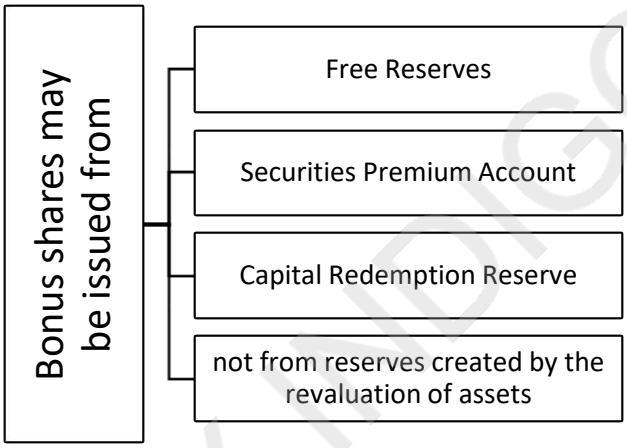
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d. In the event of **death of the employee** while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.
e. In case employee suffers a **permanent incapacitation**, all the options granted shall vest in him on that day.
f. In the event of **termination of employment**,
    - all options not vested in the employee on that day shall expire.
    - The options which are vested within the period specified in this behalf, can be exercised by the employee subject to the terms and conditions under the scheme.

ISSUE OF BONUS SHARES

Section 63 of the Companies Act, 2013 prescribes the condition and the manner of issue of fully paid-up bonus shares.

17.1 Source of issue of bonus shares



17.2 Other conditions for the issue of bonus shares

a) Authorised by the **AOA**,
b) **Authorised in the general meeting** of the company on the recommendation of the Board,
c) **Not defaulted in payment of interest/ principal** in respect of fixed deposits or debt securities issued by it,
d) **Not defaulted in the payment of statutory dues** of the employees,
e) **Partly paid-up shares**, if any, outstanding on the date of allotment are **made fully paid-up**,
f) such **conditions as prescribed by Rule 14** – company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same

Hon'ble Supreme Court in case of Standard Chartered Bank v Custodian

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Bonus share is an accretion. A bonus share is issued when the company capitalises its profits by transferring an amount equal to the face value of the share from its reserve to the nominal capital.

In other words, the undistributed profit of the company is retained by the company under the head of capital against the issue of further shares to its shareholders. Bonus shares have, therefore, been described as a distribution of capitalised undivided profit.

In the case of issue of bonus share there is an increase in the capital of the company by transferring of an amount from its reserve to the capital account and thereby resulting in additional shares being issued to the shareholders.

A bonus share is a property which comes into existence with an identity and value of its own and capable of being bought and sold as such.

17.3 Not issued in lieu of dividend

According to Section 63 (3), the **bonus shares shall not be issued in lieu of dividend**. But its permissible for a company to capitalise its profits or reserves for the purpose of issuing bonus shares.

NOTICE TO BE GIVEN TO REGISTRAR FOR ALTERATION OF SHARE CAPITAL

Section 64 of the Companies Act, 2013 provides provisions for notifying the Registrar in case of alteration of Share capital.

Where a company **alters its share capital** as specified u/s 61 or 62, **or redeems any redeemable preference share,** the company shall file a notice in **Form SH-7** with the Registrar **within 30 days** of such alteration/ redemption, along with an altered memorandum.

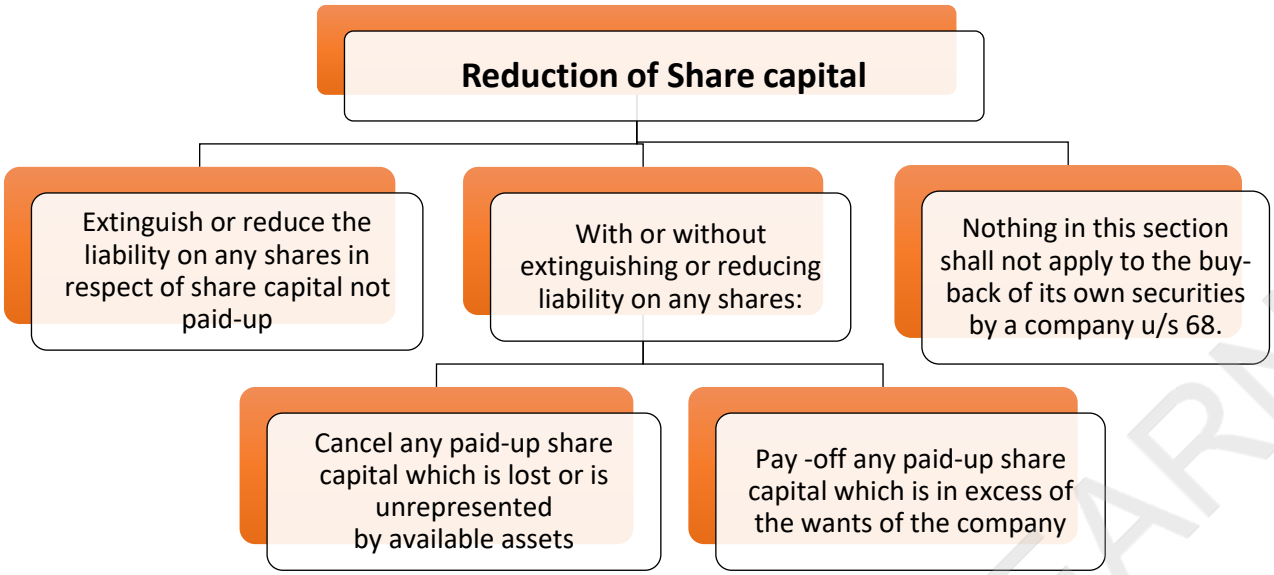
Upon default, the company and every officer in default shall be liable to a penalty of

- ✓ ₹500 for each day during which the default continues,
- ✓ subject to maximum of ₹5L in case of company, and ₹1L in case of an officer who is in default.

REDUCTION OF SHARE CAPITAL

Section 66 of the Companies Act, 2013 deals with the reduction of share capital.

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18.1 Conditions for reduction of Share Capital

(i) **Applicable** to company limited by shares or limited by guarantee and having share capital,
(ii) **Prior confirmation by the Tribunal** is required
(iii) Authorised by **Special resolution**
(iv) No reduction shall be made if the company is in **arrears in repayment of any deposits** accepted by it or the interest payable thereon.

18.2 Issue of Notice to the Tribunal and order of the Tribunal

→ The Tribunal shall **notify the CG, Registrar and SEBI, in case of listed companies, and the creditors** and also **consider the representations** made to it by these parties **within 3 months** within the date of receipt of the notice. If no representation is received within this time, it shall be presumed that there is no objection to the reduction.

→ The Tribunal may make an **order confirming the reduction of share capital** if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained.

→ The Tribunal shall not sanction an application for reduction of share capital unless
- the **accounting treatment,** proposed by the company for such reduction is in **conformity with the accounting standards u/s 133** or any other provision of the Act, **and**
- a **certificate to that effect by the company's auditor** has been filed with the Tribunal.

→ A **certified copy of the order of the Tribunal and of the minute approved by the Tribunal** showing –
- The amount of share capital,
- The number of shares into which it is to be divided,

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- The amount of each share, and
- The amount if any, deemed to be paid up on each share.

shall be **delivered to the ROC within 30 days** of receipt of order of the Tribunal. The ROC shall register the same and issue a certificate to that effect.

→ **Order of the Tribunal confirming the reduction in share capital shall be published** in such manner as may be directed by the Tribunal.

18.3 No liability to members

No member of the company, past or present, shall be liable **to any call or contribution in respect of any share held by him, which exceeds the difference, if any, between** –

a) The **amount paid on the share**, or reduced amount, if any, which is deemed to have been paid thereon, **and**
b) The **amount of the share as fixed by the order of reduction**.

18.4 In case a creditor who was entitled to object has not been included in the list of Creditors [Section 66 (8)]

Where the name of any creditor entitled to object to the reduction of capital is **not entered into the list of creditors by reason of his ignorance**, and **after such reduction, the company commits a default**, within the meaning of Section 6 of the Insolvency and bankruptcy Code, 2016 –

a) **Every person who was a member of the company on the date of registration of the order of reduction by the ROC, shall be liable to contribute to the payment of that debt or claim**, an amount not exceeding that which would have been liable to contribute if the company had commenced winding up on the day immediately before the said date **and**

b) **If the company is wound up**, the Tribunal may, on an application made by any such creditor and proof of his ignorance, if it thinks fit,
   → settle a list of person so liable to contribute and
   → make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

> Nothing contained in sub-section (8) shall affect the rights of the contributories among themselves.

18.5 Punishment

If any **officer of the company** –

- Knowingly **conceals** the name of the creditor entitled to object to the reduction,
- Knowingly **misrepresents** the nature or amount of debt or claim of any creditor, or

liable u/s 447

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- **Assists or is party** to any such concealment or misrepresentation

RESTRICTION ON PURCHASE BY COMPANY OR GIVING OF LOANS BY IT FOR PURCHASE OF ITS SHARES

Section 67 of the Companies Act, 2013 deals with the restrictions on purchase by the company of its own shares.

- ✓ **No company** having a share capital shall **buy its own shares unless the consequent reduction of share capital is effected** under the provisions of this Act.
- ✓ A **public company** cannot, directly or indirectly, **lend money**/give financial assistance to any person **to purchase its own shares** or the shares of its holding company.

Exceptions to this:

a) Lending by a **banking company** in the ordinary course of business,
b) Lending money by a company in accordance with any **scheme approved by the company by a SR for the employees**.
c) Loan to **employees (other than directors or KMP)** for purchase of shares of company up to 6 months of their annual salary. Disclosure in board report must be made if such employees have not exercised voting rights.

Note1:

1. In case the shares of the company are **listed** - Such purchase of shares shallbe made only through a recognized stock exchange and not by way of private offers or arrangements.
2. Where shares of a company are **not listed** - the valuation at which shares are to be purchased shall be made by a **registered valuer**.
3. The **value of shares** to be purchased or subscribed in the aggregate **shallnot exceed five percent** of the aggregate of paid up capital and free reserves of the company;
4. Disclosures in respect of **voting rights not exercised directly** by the employees in respect of shares to which the scheme relates shall be made in theBoard's report for the relevant financial year, namely:
   (a) Names of the employees who have not exercised the voting rightsdirectly;
   (b) Reasons for not voting directly;
   (c) Name of the person who is exercising such voting rights;
   (d) Number of shares held by or in favour of, such employees and the percentage of such shares to the total paid up share capital of thecompany;
   (e) Date of the general meeting in which such voting power was exercised;

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(f) Resolutions on which votes have been cast by persons holding suchvoting power;

(g) Percentage of such voting power to the total voting power on eachresolution;

(h) Whether the votes were cast in favour of or against the resolution.

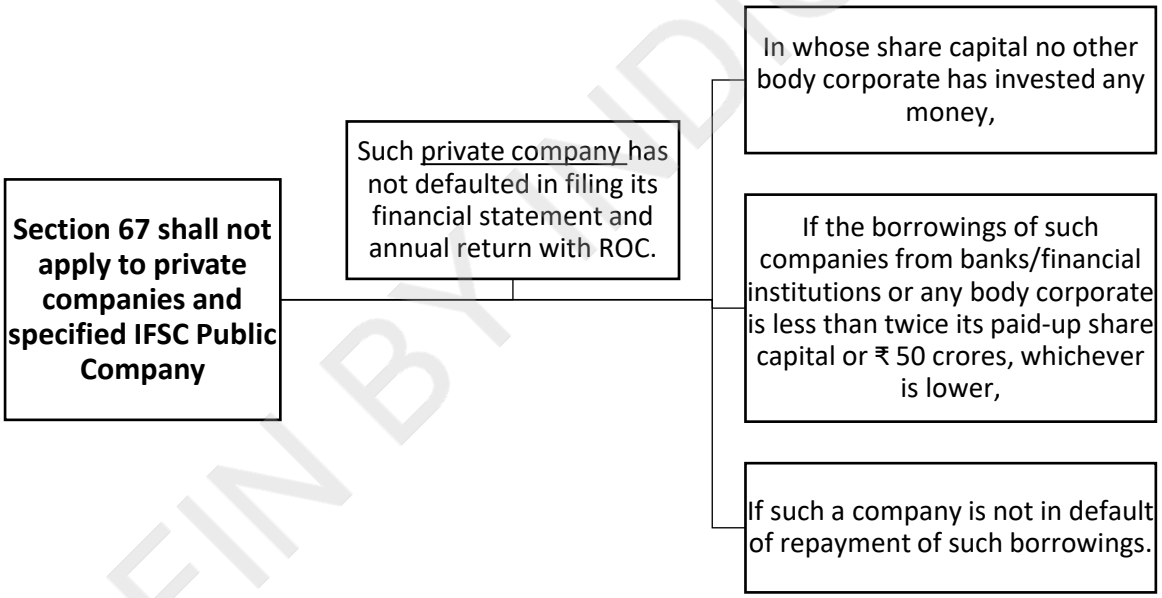
Note2:

Section 67 sub section (1) shall not apply to Nidhi Companies, when shares are purchased by the company from a member on his ceasing to be a depositor or borrower and it shall not be considered as reduction of capital under Section 66 of the Companies Act, 2013. While complying with such exception, the Nidhi Companies shall ensure that the interests of their shareholders are protected.

(Sub section 1 is No.company having a share capital shall buy its own shares unless the consequent reduction of share capital is effected under the provisions of this Act)

Section 67 **does not affect** the right of a company to **redeem** any **preference shares.**

20.1 Non applicability of Section 67



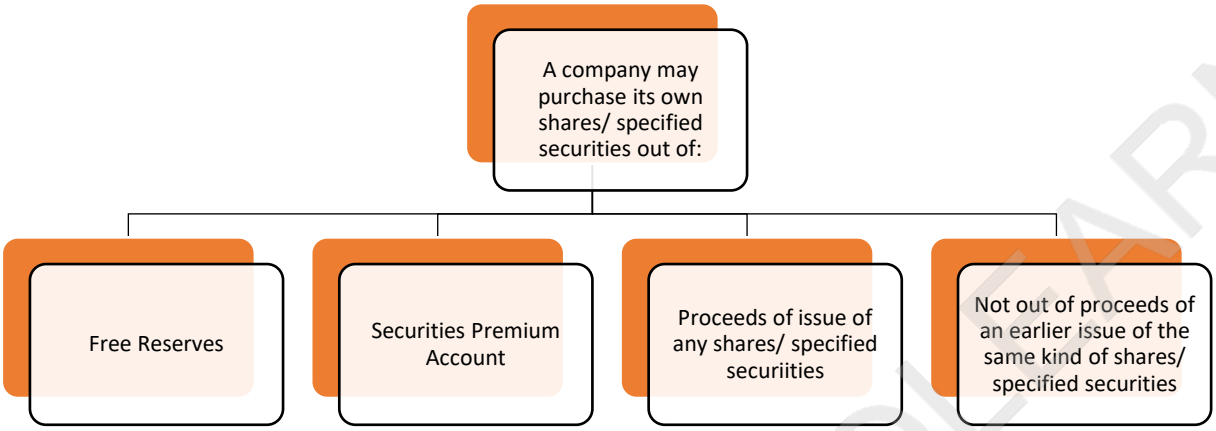
20.2 Punishment for contravention:

Company: **Fine**: Minimum ₹1 lakh Maximum ₹25 lakhs	**Every officer in default:** **Imprisonment** : may extend to 3 years **Fine** : Minimum ₹1 lakh Maximum ₹25 lakhs

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Section 68 to 70 of the Companies Act, 2013 contains the provisions for buy back of securities by the issuer company.

21.1 Power of company to purchase its own securities [Section 68]



* Specified securities includes ESOP or other securities as may be specified by the CG.

21.1.1 *Conditions for Buy-back*

→ Authorised by the **AOA**,

→ Authorised by **SR** passed in the general meeting,
Exception: No SR is required where the buy-back is 10% or less of the total paid-up equity capital and free reserves of the company, and it has been authorised by a Board resolution.

→ Buy-back is **25% or less of aggregate of paid up capital and free reserves** of the company.

→ **Maximum buy-back in a financial year** shall not exceed 25% of its total paid up equity capital in that F.Y.

The expression **"free reserves"** includes **securities premium** account.

The **ratio of aggregate debts owed by the company after buy-back** is not more than twice the paid-up share capital and its free reserves.

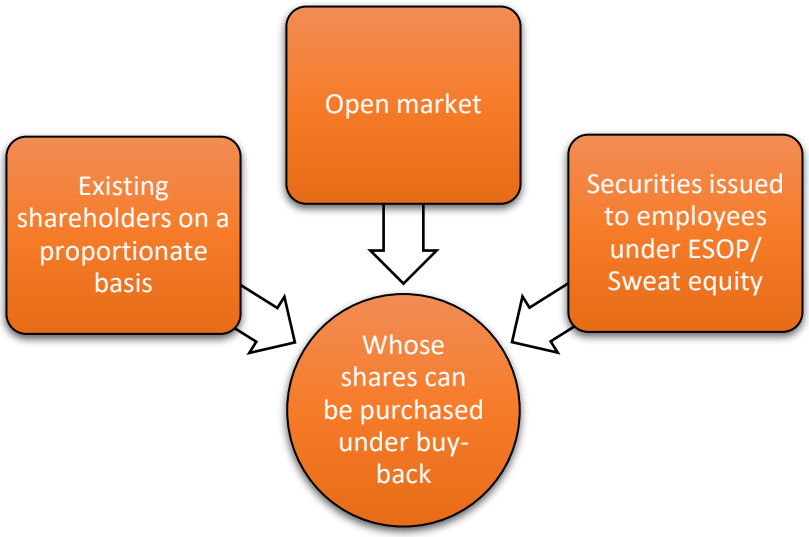
→ $\frac{Debts(secured\ and\ unsecured)after\ buyback}{Paid\ up\ share\ capital+Free\ reserves} \leq 2$

→ All the shares/ specified securities for buy-back are **fully paid up**,

→ The **buy-back of listed shares**/ specified securities is in accordance with the regulations of SEBI,

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21.1.2 *Whose shares are to be purchased under buy-back*



21.1.3 *Procedure for Buy-back*

(1) The notice of meeting at which SR is proposed to be passed shall be accompanied by an **explanatory statement**. Such explanatory statement shall **contain following details**:
- Full and complete disclosure of all material facts,
- Necessity for buy-back,
- Class of shares/ securities intended to be bought back,
- Amount to be invested under buy-back,
- Time limit for completion of buy-back.

(2) The buy-back shall be **completed within 12 months of passing the SR** or a resolution passed by the Board authorising the buy-back.

(3) Before making the buy-back, the company shall **file with the ROC** and SEBI *(if listed company)*,
- a **declaration of solvency** in Form SH-9 and
- verified by an **affidavit** to the effect that the Board has made a full enquiry of the company and that the company is capable of meeting its liabilities and will not be rendered insolvent within a period of 1 year from the date of declaration of solvency.
- This declaration shall be **signed by at least 2 directors**, one of whom shall be the MD, if any.

(4) The company shall **extinguish and physically destroy the shares** or securities so bought-back **within 7 days** of the last date of completion of buy-back.

(5) After buy-back of shares, the company shall **not make further issue of the same kind of shares** including allotment u/s 62 or specified securities **within 6 months** except-
- By way of bonus shares or
- In discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity shares, or conversion of preference shares/ debenture into equity shares.

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(6) After completion of buy-back company shall **file a return in Form SH-11** with the ROC and SEBI *(if listed company)*, within 30 days of completion.

(7) A company shall **maintain a register** of shares or securities bought back in **Form SH-10**.

Time Check Points and Procedural aspects of Buy-Back

The company before the buy-back of shares, file with the Registrar a **letter ofoffer** in Form No. SH.8, along with the fee. The letter of offer shall be dispatchedto the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than **twenty days** from its filing with the Registrar of Companies.

The **offer** for buy-back **shall remain open** for a period of not less than **fifteendays** and not exceeding **thirty days** from the date of dispatch of the letter of offer, but where all members of a company agree, the offer for buy-back may remain open for a period **less than fifteen days.**

In case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to be bought back by the company, the acceptance per shareholder shall be on **proportionate basis** out of the total shares offered for being bought back.

The company shall **complete the verifications** of the offers received within **fifteen days from the date of closure** of the offer and the shares or other securities lodged shall be deemed to be accepted unless a **communication ofrejection is made within twenty one days** from the date of closure of the offer.

The company shall **make payment within seven days of verification process** and **make payment** in cash to those shareholders or security holders whose securities have been accepted. Company will **return the share certificates** to the shareholders or security holders whose securities have not been accepted at all or the balance of securities in case of part acceptance

21.1.4 *Penalty for default*

Company: **Fine**: Minimum ₹1 lakh Maximum ₹3 lakhs	**Every officer in default:** **Fine** : Minimum ₹1 lakh Maximum ₹3 lakhs

21.2 Transfer of certain sums to CRR Account [Section 69]

Where a company purchases its own shares out of free reserves or securities premium account, then a **sum equal to the nominal value of share so purchased** shall be transferred to the CRR and details of such transfer shall be disclosed in the balance sheet.

21.3 Prohibition for buy-back in certain cases [Section 70]

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Prohibited Buy-back of shares/ specified securities	Buy-back through any subsidiary company includings its own subsidiary
	Buy-back through any investment company or group thereof
	Buy-back if a default is made in repayment of deposits or interest payments thereon, redemption of prefernce shares, payment of dividend to any shareholder, or repayment of any term loan or interest thereon to any financial institutions. However where default is remedied and 3 years have lapsed after such default ceased to subsist, then buy-back is not prohibited.
	If company has not complied with provisions of : Section 92- Annual Return Section 123- Declaration and payment of dividend Section 127- Punishment for failure to distribute dividend Section 129- Financial Statement

DEBENTURES

Section 71 of the Companies Act, 2013 provides the manner in which a company may issue debentures.

22.1 Debenture

As per **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.

However, the **following shall not be treated as debentures**:

a) Instruments referred to in Chapter III-D of the RBI Act, 1934, and
b) Such other instrument as may be prescribed by the CG in consultation with the RBI, issued by a company.

22.2 Features of a Debenture

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Smallest unit of a sizeable amount of loan

Debture certificates are issued(sealed and signed) within 6 months

May be redeemed at the end of full term or in installemts

Rate of interest is pre-fixed

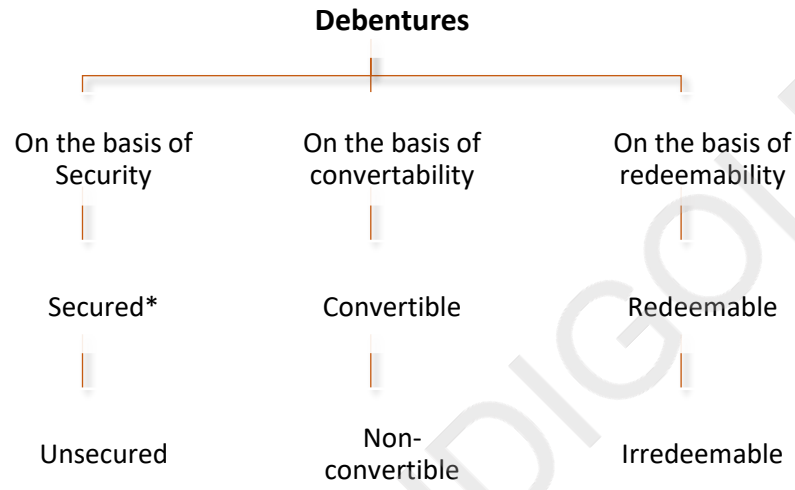
Voting rights are not available

Periodic interest is paid till fully redeemed

May be secured or unsecured

May be converted at maturity into equity shares [approved by SR]

22.3 Types of Debentures



*Secured debentures shall be issued in compliance with **Rule 18** of Companies (Share Capital and Debentures) Rules, 2014, which states that:

a) **Date of redemption** of secured debentures shall not exceed **10 years**,

b) Following companies can issue debentures for a period **exceeding 10 years but not exceeding 30 years**,

- Companies engaged in setting up of infrastructure projects,
- Infrastructure finance companies,
- Infrastructure debt fund NBFC,
- Companies permitted by Ministry or Department of CG, RBI, or by the National Housing Bank or any other statutory body.

c) Shall be **secured by creation of a charge** on the properties or assets of the company/ its subsidiaries/ its holding company/ associate companies. Such assets or properties shall be of value which is sufficient for the due repayment of the amount of debentures and interest thereon.

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d) The company shall **appoint a debenture trustee** before issuing prospectus or letter of offer for subscription.

e) **Within 60 days** of allotment of debentures, company shall execute a **debenture trust deed in Form SH-12** to protect the interest of the debenture holders.

22.4 Creation of Debenture Redemption Reserve (DRR) and Investment

Where debentures are issued by a company, the company shall create a DRR **out of the profits** of the company available for payment of dividend and the amount credited shall be **utilised only for redemption of debentures**.

For this, provision of **Rule 18(7)** are as follows:

All India Financial Institutions and Banking Company	Public issue/ Private Placement	N/A	N/A
Other Financial Institution u/s 2(72) Companies Act 2013	Public issue/ Private Placement	Same as on NBFC (i.e., N/A)	N/A
Listed companies. except 1.	Public issue of debentures by (i) NBFC registered with RBI & (ii) Housing finance companies registered with National Housing Bank. (iii) Other listed company	N/A	15% of outstanding Debenture **
	Or Private placement of debentures by above companies	N/A	N/A
Unlisted Companies except 1	Private placement of Debentures by (i) NBFC registered with RBI & (ii) Housing finance Companies registered with National housing bank	N/A	N/A
	Other Unlisted Companies	10% of outstanding debentures	15% of outstanding Debenture**

**Note: Provided that the amount remaining invested or deposited shall not any time fall below 15% of the amount of the debentures maturing during the year ending on 31st day of March of that year.
Allowed Investments:

- (A) in deposits with any scheduled bank, free
- (B) in unencumbered securities of the Central methods of deposits or from any charge or lien; Government or any State Government.

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• (C) in unencumbered securities mentioned in sub-clause (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882. • (D) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882
→ Use of DRR and Investments = Only for the redemption of Debentures.

22.5 Limitation on issue of prospectus/offer/invitation to the public [Section 71 (5)]

No company shall issue a prospectus/make an offer or invitation to the public or its members exceeding 500, unless company has before issue/offer appointed one or more debenture trustees.

22.6 Conditions for appointment of Debenture Trustee [Rule 18 (2)]

The company shall appoint debenture trustee u/s 71 (5), after complying with the following conditions given in the rule:

→ The **names of debenture trustee shall be stated in the letter of offer** and in all subsequent notices/other communications sent to debenture holders.

→ Before appointment, a **written consent** shall be obtained from such proposed debenture trustees.

→ **Disqualifications** to be appointed as a debenture trustee –

(1) Beneficially **holds shares** in the company,

(2) Is a **promoter, director, or KMP, or any other officer or employee** of the company/holding/subsidiary/associate company,

(3) **Beneficially entitled to moneys** which are to be paid by the company otherwise than as remuneration payable to the debenture trustee,

(4) **Indebted** to the company/holding/subsidiary/associate/subsidiary of such holding company,

(5) **Furnished any guarantee** for debts secured by debentures/ interest thereon,

(6) **Pecuniary relationship** with company amounting to-

- 2% or more of its gross turnover, or Total income, or
- ₹ 50 lakhs, or such higher amount as prescribed,

Whichever is lower, during the 2 immediately preceding F.Y. or during current F.Y.

(7) **Relative** of promoter/ any person in employment as director/KMP of the company.

→ **Casual vacancy in the office of the debenture trustee** may be filled by the BOD. However, while such vacancy continues, remaining trustee or trustees, if any, may act.

→ Where the **casual vacancy is caused by the resignation of the debenture trustee**, the vacancy shall only be filled with the written consent of the majority of debenture holders.

→ **Removal of debenture trustee from office before the expiry of his term** – Only if it is **approved by the holders of not less than 3/4th in value** of the debentures outstanding, at their meeting.

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22.7 Debenture trustee to protect the interest of debenture holders

A debenture trustee shall take steps to **protect the interests of the debenture holders** and redress their grievances.

Convening of meetings of debenture holders to protect their interests [Rule 18 (4)]: The meeting of all the debenture holders shall be convened by the debenture trustee on –

a) **Requisition in writing** signed by debenture holders having at least 1/10th in value of the debentures for the time being outstanding.
b) The happening of any event which constitutes a **breach, default** or which affects the interest of the debenture holders.

22.8 Liability of debenture trustee [Section 71 (7)]

There shall be no provision in a trust deed for securing the issue of debenture trust deed, or in any contract with the debenture holders, or in any contract with the debenture holders, which would have the effect of **exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust**, where he fails to show the degree of care and due diligence required of him as a trustee. Such a provision shall be void.

Also, the liability of the debenture trustee shall be **subject to such exemptions as may be agreed upon by a majority of debenture holders holding not less than 3/4th in value of the total debentures** at a meeting held for the purpose.

→ He can **file a petition with the tribunal** if he concludes that assets of the company are insufficient to meet its debts.

22.9 Payment of Interest and Redemption of Debentures

A company shall pay interests and redeem the debentures **in accordance with the terms and conditions of their issue**.

22.10 Filing of Petition before the Tribunal and order thereon [Section 71 (9)]

✓ The debenture trustee may file a petition before the Tribunal where at any time he concludes that the **assets of the company are insufficient or likely to be insufficient to discharge the principal amount** as and when it becomes due.

✓ The Tribunal may, after hearing the company and or any other person interested in the matter, **by an order, impose restrictions on the incurring of any further liabilities by the company** as considered necessary by the Tribunal.

22.11 Failure to redeem debenture or pay interest [Section 71(10)]

Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest thereon when it is due, the **Tribunal may,**

- On an **application of all or any of the debenture holders or debenture trustee**, and
- After **hearing the parties** concerned,

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direct, by an order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

22.12 Specific Performance of the contract [Section 71(12)]

A contact with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

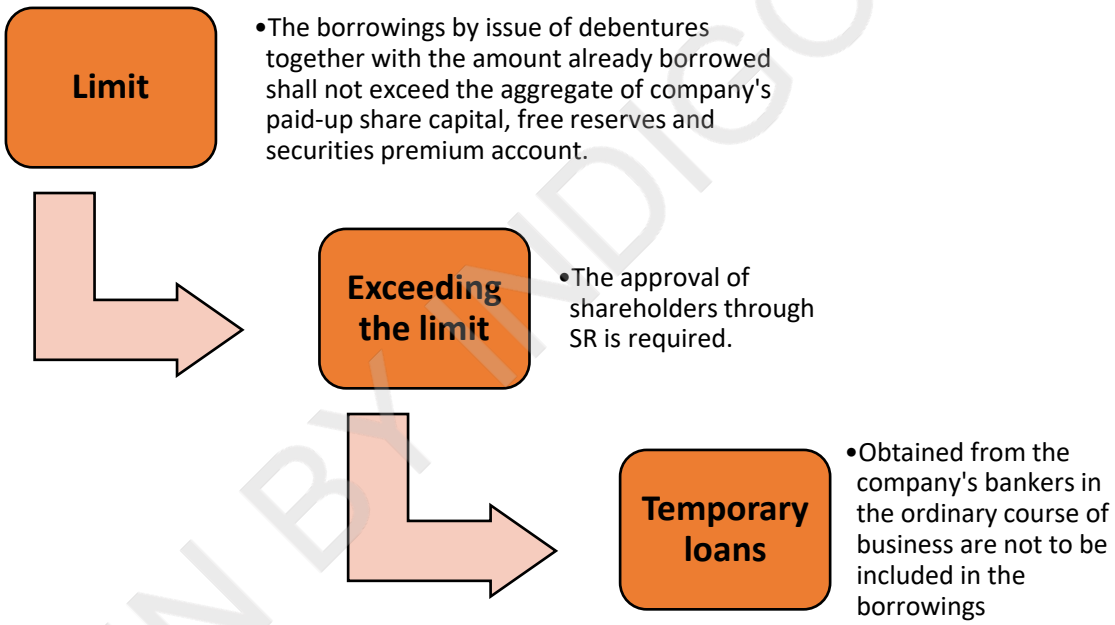
22.13 Procedure to be prescribed by the CG [Section 71(13)]

The CG may prescribe the procedure –

- For securing the issue of debentures,
- For the form of debenture trust deed,
- For inspection of the trust deed by the debenture holders and to obtain copies thereof,
- For the quantum of DRR required to be created, and
- Such other matters.

The procedures have been prescribed in Rule 18 of the Companies (Share capital and Debentures) Rules, 2014.

22.14 Limit on Borrowing through Debentures* [Section 71(14)]



**Not applicable to a Private Company*

22.15 Return of Allotment [Section 71(15)]

If a **company having share capital** makes an allotment of any debentures, a Return of Allotment in **Form PAS 3** shall be filed with the Registrar **within 30 days** of allotment.

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ACCEPTANCE OF DEPOSITS BY COMPANIES

Learning Outcomes –

- Understand the meaning of the term 'Deposit'.
- Know the requirements for and restrictions on acceptance of deposits from members and public.
- Know about the 'eligible companies' which can accept deposits from public in addition to their members.
- Know the punishment for contravention of the provisions related to acceptance of deposits by companies.

INTRODUCTION

Deposits are an importance source of finance for companies. It is necessary to control the companies which invite deposits to safeguard the general and wider interest of all those persons who offer deposits out of their hard-earned money.

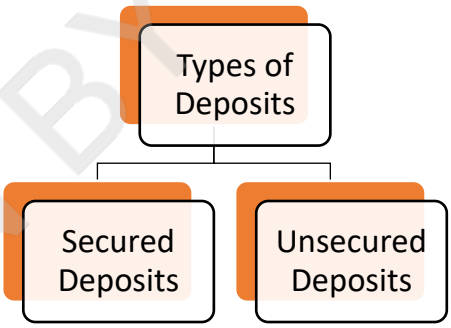
The statutory provisions as contained in **Chapter V (Section 73 to 76A)** of the Companies Act, 2013 and the **Companies (Acceptance of Deposits) Rules, 2014** govern the acceptance of deposits and their renewal.

DEPOSIT

2.1 Meaning of Deposit

According to **Section 2(31)**, the term '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 RBI.



2.2 Features

(i) The above definition of 'deposit' is inclusive one.

(ii) It includes any money received by way of:

a) deposit; or

b) loan; or

c) in any other form.

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(iii) Repayment of 'deposit' is time-bound.

(iv) It can be secured or unsecured.

(v) It does not include prescribed categories of amounts (as stated in the 'Acceptance of Deposits' Rules).

(vi) It may be accepted in joint names not exceeding three persons.

(vii) A depositor may nominate any person at any time.

(viii) Every deposit accepted by the company shall be repaid with interest.

(ix) Premature repayment of a deposit can be made by the company.

(x) A private company can accept deposits from its members only.

(xi) A public company can accept deposits from its members and also from the public if it fulfills certain parameters.

2.3 Amounts not considered as Deposits

(1) Amount received **from the Central government** (CG) **/ State government** (SG), or from any other source whose **repayment is guaranteed by the CG/SG**, or from any local authority, or any amount received from a statutory authority constituted under any Act,

(2) Any **amount from foreign governments**, foreign or international banks, multinational financial institution, foreign governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to FEMA, 1999,

(3) any amount received as **a loan or facility from any banking company** or from State Bank of India or its subsidiary banks or from a notified banking institution or a corresponding new bank or from any co-operative bank,

(4) any amount received as a **loan or financial assistance from Public Financial Institutions**, any regional financial institutions or insurance companies or any scheduled banks.

(5) any amount **received against issue of commercial paper** or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(6) any amount received by a company **from any other company**. (Mainly known as **Inter Company Deposits (ICD))**

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(7) any amount **received and held towards subscription to any securities** (including share application money or advance towards allotment of securities, pending allotment), so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

If the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of 60 days, such amount shall be treated as a deposit under these rules.

(8) any amount received from a person who, at the time of the receipt of the amount, was a **director of the company or a relative of the director of the private company**;

The director of the company or relative of the director of the private company from whom money is received is required to furnish to the company at the time of giving the money, a **declaration in writing** to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and the **company shall disclose the details of money so accepted in the Board's report**;

(9) any amount raised by the **issue of bonds or debentures secured by a first charge** or a charge ranking *pari passu* with the first charge on any assets referred to in Schedule III of the Act **excluding** intangible assets of the company or bonds or debentures compulsorily convertible into shares of the company within 10 years;

However, if such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Act, excluding intangible assets, **the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer.**

(9a) any amount raised by **issue of non convertible debenture not constituting** a charge on the assets of the company and listed on a recognized stock exchange;

(10) any **amount received from an employee of the company not exceeding** his annual salary under a contract of employment with the company in the nature of non-interest bearing security deposit;

(11) any non-interest bearing amount **received or held in trust**;

(12) any **amount received in the course of, or for the purposes of, the business** of the company–

(a) as an **advance for the supply of goods or provision of services** accounted for in any manner whatsoever provided that such advance is appropriated against supply of goods or provision of services within a period of **365 days** from the date of acceptance of such advance:

However, in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of three hundred and sixty five days shall not apply.

(b) as **advance**, accounted for in any manner whatsoever, received in connection with **consideration for an immovable property** under an agreement or arrangement, provided that such advance is adjusted against such property in accordance with the

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terms of agreement or arrangement;

(c) as **security deposit** for the performance of the contract for supply of goods or provision of services;

(d) as **advance** received under **long term projects** for **supply of capital goods** except those covered under item (b) above;

However, it is clarified that if the **amount received under items (a), (b) and (d) above becomes refundable** (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall **be deemed to be a deposit on the expiry of 15 days** from the date they become due for refund under these rules.

(e) as an **advance towards consideration for providing future services** in the form of a **warranty or maintenance contract** as per written agreement or arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;

(f) as an **advance** received and as allowed by any **sectoral regulator** or in accordance with directions of Central or State Government;

(g) as an **advance** for **subscription towards publication**, whether in print or in electronic to be adjusted against receipt of such publications;

(13) any **amount brought in by the promoters** of the company by way of *unsecured loan* in pursuance of the stipulation of any lending financial institution or a bank subject to the *fulfilment of following conditions*:

(a) the loan is brought because of the stipulation imposed by the lending institutions on the promoters to contribute such finance;

(b) the loan is provided by the promoters themselves or by their relatives or by both; and

(c) Such exemption shall be available only till the loans of financial institution or bank are repaid and not thereafter.

(14) any **amount accepted by a Nidhi company** in accordance with the rules made under section 406 of the Act;

(15) any amount received by way of subscription in respect of a **chit** under the Chit Fund Act, 1982

(16) any amount received by the company under any **collective investment scheme** in compliance with regulations framed by the Securities and Exchange Board of India;

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(17) an **amount of twenty five lakh rupees or more received by a start-up company, by way of a convertible note** (convertible into equity shares or repayable within a period not exceeding **ten years** from the date of issue) in a single tranche, from a person;

(18) any **amount received by a company from Alternate Investment Funds**, Domestic Venture Capital Funds, Infrastructure Investment Trusts, Real Estate Investment Trusts and Mutual Funds registered with the Securities and Exchange Board of India in accordance with regulations made by it.

Convertible note means an instrument evidencing receipt of money initially as a **debt**, which is repayable at the option of the holder, or which is convertible into such number of equity shares of the start-up company upon occurrence of specified events and as per agreed terms and conditions.

Example: Greedwood limited ('the company) which is register as start-up company register under Companies Act, 2013 has received an amount of ` 20 lacs and ` 10 lakh on different date by way of a convertible note. Though the company has received an amount of twenty-five lakh rupees or more, the said amount will be considered as deposit since the aggregate amount has not received in single tranche in terms of the rule stated above Sub-clause (xvii)]

DEPOSITOR

As per **Rule 2(1)(d)**, the term 'Depositor' means:

(a) Any **member of the company who has made a deposit with the company** in accordance with section 73(2) of the Act, or
(b) Any **person who has made a deposit with a public company** in accordance with section 76 of the Act.

ELIGIBLE COMPANY

As per **Rule 2(1)(e)**, the term'Eligible Company' means a **public company** as referred to in section 76(1), having

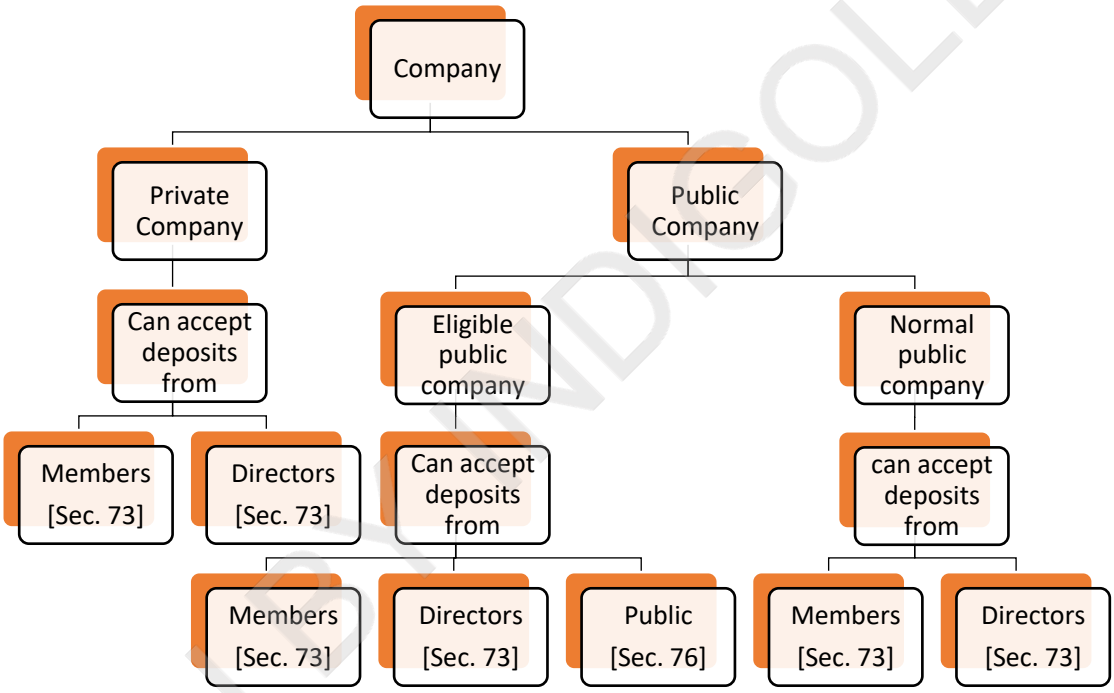
→ a **networth** of not less than ₹ 100 crores *or*
→ a **turnover** of not less than ₹ 500 crores *and*
→ which has obtained the prior consent in general meeting by means of a **SR** *and*
→ also **filed the SR** with the Registrar before making the invitation to the public for acceptance of deposits.

An ordinary resolution is sufficient if an eligible company is accepting deposits within the limits specified under section 180(1)(c).

PROHIBITION ON ACCEPTANCE OF DEPOSITS FROM PUBLIC

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Section 73 of the Companies Act, 2013 prohibits the acceptance of deposits from the public by companies.



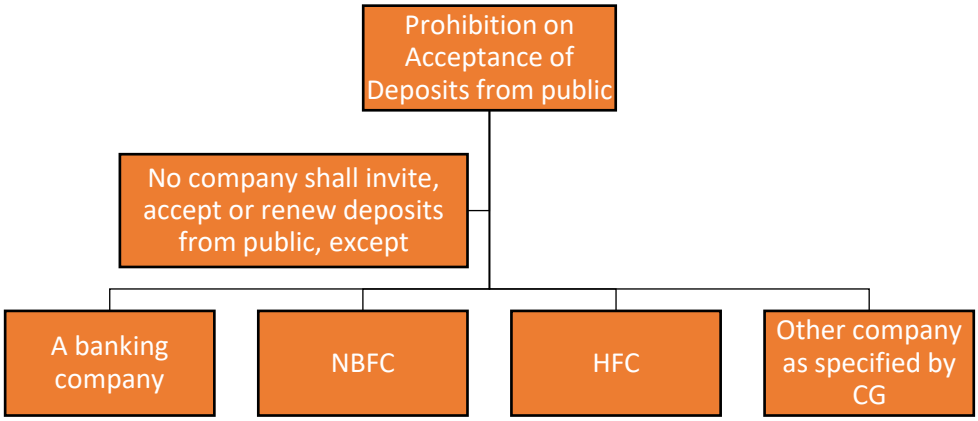
5.1 Acceptance of deposits from public [Section 73(1)]

No company shall invite, accept or renew deposits from public unless it follows the manner provided under this chapter (i.e., Chapter V of the Act).

However, this **prohibition shall not apply to** the following companies:

- A **banking company**,
- A non-banking financial company (**NBFC**) as defined in the RBI Act, 1934,
- Any housing finance company (**HFC**) registered with the National Housing Bank, and
- Such **other company as the CG may specify**, after consultation with the RBI.

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5.2 Acceptance of deposits from members [Section 73(2)]

A company may accept or renew deposits from its members subject to the following conditions:

(a) A **resolution is passed** in the general meeting.

(b) **Circular** is issued by the company to its members including therein a statement showing:
- The financial position of the company,
- The credit rating obtained,
- The total number of depositors and
- The amount due towards deposits in respect of any previous deposits accepted by the company and
- Such other particulars in prescribed form and manner.

(c) The copy of the circular shall be **filed with the Registrar 30 days** before issue of the circular.

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Rule 4 - Form and Particulars of Advertise-ments or Circulars	Such circular shall be issued to all its members by re**gistered post with acknowledgement due or speed post or by electronic mode** in **Form DPT-1.**
	Circular may be **published in English language in an english newspaper** and in **vernacular language in a vernacular newspaper** having wide circulation in the State where Registered office of the company is situated.
	A **certificate of the statutory auditor** shall be attached in Form DPT-1, stating that the comapny has not committed default in the repayment of deposits or payment of interest thereon. If the company had made such a default, the certifcate of the statutory auditor shall state that company has made good the default and a period of 5 years has lapsed since the date of making good such default.
	The **advertisement shall remain valid till** the earliest of: (a) upto 6 months from the closure of the F.Y. or (b) the date on which FS are laid down before the company at AGM, (c) or in case no AGM has been held, the latest day on which AGM should have been held.
	A **fresh circular shall be issued for each F.Y.** for inviting deposits during that fiancial year.

(d) Deposit, on or before 30th April of each year, **at least 20%** of the amount of deposits maturing during the following F.Y. and kept in a scheduled bank account to be called the **deposit repayment reserve account**.
Such amount shall not at any time fall below 20% of the amount of deposits maturing during the F.Y.

(e) **Company certifies** that it has **not committed any default** in repayment of deposits accepted or payment of interest thereon. In case any default had occurred, the company shall make good the default and 5 years had lapsed since the date of making good the default.

(f) Company **may provide security** for the due repayment of the amount of deposit or the interest thereon. In case company does not secures or only partially secures such deposits, then the deposits shall be termed as "unsecured deposits".

Example: Ray Pharmaceuticals Limited issued a Circular inviting 'deposits' from its members on 14-02-2022. Its Annual General Meeting (AGM) was held on 07-09-2022. Since, six months from the closure of FY 2021-22 end on 30-09-2022, the Circular remains

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valid till 07-09-2022 only. After this date, a fresh Circular shall be issued if the company wants to invite further deposits from its members.

5.2.5 *Repayment of Deposits*

- ✓ Every deposit accepted shall be **repaid with interest** in accordance with the terms and conditions of the agreement.

Conditions (b) to (e) shall not apply to a private company:

- ✓ Which accepts from its members monies not exceeding (paid up share capital + free reserves + securities premium account), or
- ✓ Which is a start-up, for 5 years from the date of its incorporation, or
- ✓ Which fulfils all of the following conditions:
  - Not an associate or subsidiary company of any other company,
  - Borrowings from such banks or financial institutions or body corporates is less than twice the paid-up share capital or ₹ 50 crores, whichever is less, and
  - Such company has not defaulted in repayment of such borrowings subsisting at the time of accepting deposits.

However, these companies shall file the details of such deposits accepted to the Registrar in Form DPT-3.

- ✓ In case a **company fails to repay the deposit** or part thereof or any interest thereon, the depsoitor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him due to such non-payment.
- ✓ The amount deposited in the Deposit Repayment Reserve Account shall be utilised only for repayment of deposits.

5.2.6 *Maximum amount of deposits from members [Rule 3(3)]*

- ✓ The maximum amount of deposits that a company can accept or renew, including other deposits outstanding as on a date, from its members, shall be **35% of aggregate of Paid-up share capital+ Free reserves+ securities premium account**.

- ✓ **Exception**: Specified **IFSC Public Company and private company** can accept deposits from its members up to 100% of aggregate of Paid-up share capital+ Free reserves+ securities premium account.

- ✓ Maximum limit **not applicable to following class of private companies**:
  - → A private company which is a **start-up**, for 10 years from date of incorporation,
  - → A private company which **fulfils all of the following conditions**:
    - (a) *Not associate/ subsidiary* of another company,
    - (b) *Borrowings from such banks or financial institutions* or body corporates is less than twice the paid-up share capital or ₹ 50 crores, whichever is less, and

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(c) Such company has *not defaulted in repayment* of such borrowings subsisting at the time of accepting deposits.

5.2.7 *Deposits in Joint names [Rule 3(2)]*

Deposits may be accepted in joint name but **not more than 3 joint depositors**.

5.2.8 *Ceiling on rate of interest and brokerage payable [Rule 3(6)]*

Interest rate on deposits & Brokerage shall **not exceed the maximum rate** prescribed by RBI in case of **NBFCs for acceptance of deposits**.

5.2.9 *Altering the terms [Rule 3(7)]*

The **company has no right to alter any terms and conditions** of the deposit, deposit trust deed and deposit insurance contract which may be detrimental to the interest of the depositors after circular is issued and deposits are accepted.

ACCEPTANCE OF DEPOSITS FROM PUBLIC BY ELIGIBLE COMPANIES

Section 76 of the Companies Act, 2013 and the Companies (Acceptance of Deposits) Rules, 2014 deals with the acceptance of deposits from public by eligible companies.

Only '**eligible companies**' are permitted to accept deposits from the public, in addition to their members.

A **special resolution** shall be passed in the general meeting which shall be **filed with the ROC** before making any invitation to the public for acceptance of deposits.

6.1 Obtaining Credit Rating

The eligible company shall be required to obtain the rating from a recognised credit rating agency **at least once in a year**. The copy of the credit rating shall be **sent to the ROC** along with the Return of deposits in Form DPT-3.

6.2 Charge creation on assets

- ✓ Every company which accepts secured deposits from the public shall **within 30 days**, create a charge on its assets.
- ✓ Charge shall be created **only on tangible assets** and not on intangible assets.

6.3 Appointment of Trustee for depositors [Rule 7]

- ✓ The company shall appoint one or more trustees for creating security for depositors.
- ✓ A written consent shall be obtained from the trustees before their appointment and a statement to this effect shall be given in the circular or advertisement.
- ✓ The company shall execute a trust deed in Form DPT-2 at least 7 days before issuing the circular.

Trustee to call Meeting of Depositors :

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The trustee for depositors shall call a meeting of all the depositors in the following cases:

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

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

Disqualification of Trustee

A person shall not be eligible to be appointed as the trustee if the person:

(a) Is a **director, KMP or any other officer or an employee** of the company/ its holding/ subsidiary/ associate company or a **depositor in the company**,
(b) Is **indebted** to the company/ its holding/ subsidiary/ associate company/ subsidiary of such holding company,
(c) Has any **material pecuniary relationship** with the company,
(d) Has **entered into any guarantee arrangement** in respect of principal debts secured by the deposits or interest thereon,
(e) Is **related to any person specified in (a)** above.

Removal of Trustee

- ✓ No trustee for depositors shall be removed from office after the issue of circular or advertisement and before the expiry of his term except with the **consent of all the directors present at a meeting of the Board**.
- ✓ In case the **company is required to have independent directors**, **at least one independent director shall be present** in such meeting of the Board.

6.4 Maximum amount of deposits [Rule 3(4), (5)]

Eligible company		**Eligible government company**
From its members	**From persons other than members**	
Amount of deposit together with outstanding deposit on the date of acceptance or renewal can be maximum **10%** of aggregate of paid-up share capital, free reserves, and securities premium account. $\boldsymbol{New\ depsoit + outstanding\ deposit \leq 10\%\ (paid\ up\ share\ capita + free\ reserves + securities\ premium\ accou}$	Amount of deposit together with outstanding deposit on the date of acceptance or renewal can be maximum **25%** of aggregate of paid-up share capital, free reserves, and securities premium account. $\boldsymbol{New\ depsoit + outstanding\ deposit \leq 25\%\ (paid\ up\ share\ capita + free\ reserves + securities\ premium\ accou}$	Amount of deposit together with outstanding deposit on the date of acceptance or renewal can be maximum **35%** of aggregate of paid-up share capital, free reserves, and securities premium account. $\boldsymbol{New\ depsoit + outstanding\ deposit \leq 35\%\ (paid\ up\ share\ capital + free\ reserves + securities\ premium\ accoun}$

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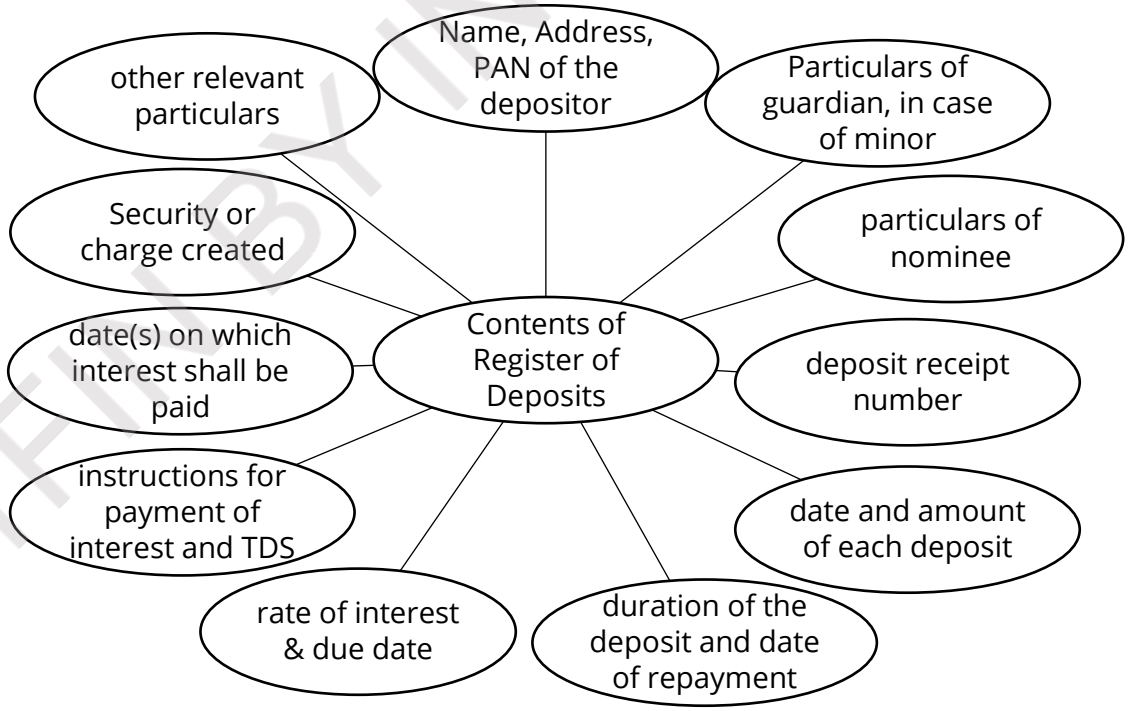
6.5 Issuance of Circular in the form of Advertisement [Rule 4]

- ✓ An eligible company intending to invite deposits is required to issue a circular in the form of an advertisement in **DPT-1.**
- ✓ Such advertisement **shall be published in English and vernacular language** in an English newspaper and vernacular newspaper having wide circulation in the state in which registered office is located. It shall also be placed on the website of the company, if any.
- ✓ A copy of the circular duly signed by a majority of directors or their authorised representatives shall be **filed with the ROC** for registration **at least 30 days before the issue of advertisement**.
- ✓ The **advertisement shall remain valid till** the earliest of:
  - (a) up to 6 months from the closure of the F.Y. or
  - (b) the date on which FS are laid down before the company at the AGM.
  - (c) or in case no AGM has been held, the latest day on which AGM should have been held.
- ✓ A **fresh advertisement** shall be issued in each succeeding F.Y. for inviting deposits during that F.Y.

6.6 Deposit Receipt [Rule 12]

- ✓ The company shall furnish a deposit receipt **to the depositor or his agent within 21 days** receipt of money or realization of cheque or renewal.
- ✓ It shall be **signed by the duly authorised officer**.
- ✓ It shall state the date of deposit, the name and address of the depositor, the amount of deposit, the rate of interest and maturity date.

6.7 Register of Deposits [Rule 14]



- The Register of Deposits shall be maintained in the registered office of the company.

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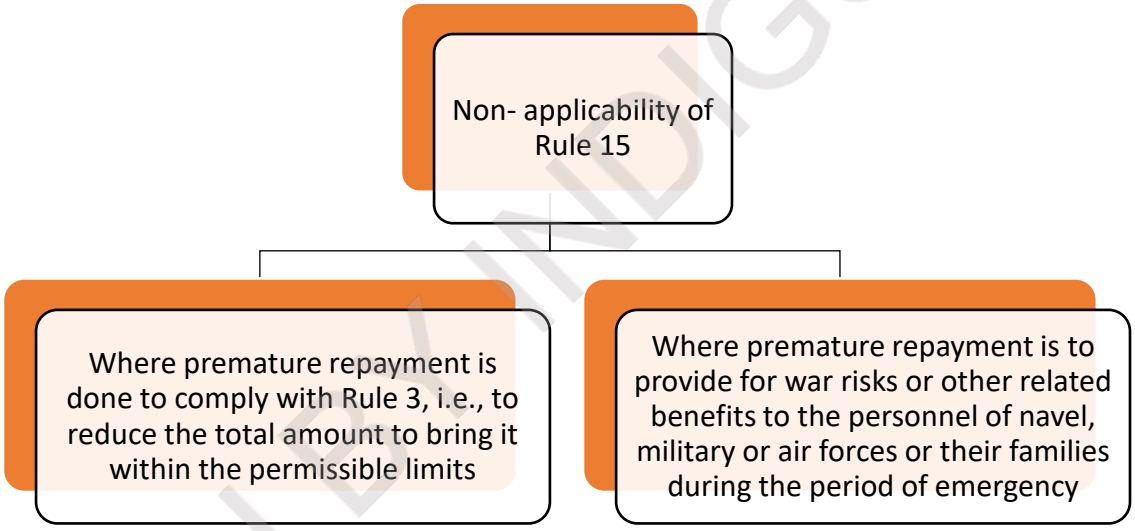
- The **entries shall be made within 7 days** from the date of issue of receipt and it shall be duly authenticated by a director or secretary of the company or any other authorised by the Board for this purpose.
- The register shall be **maintained for not less than 8 years** from the F.Y. in which the latest entry is made in the register.

6.8 Premature Repayment of Deposits [Rule 15]

Where a company makes a repayment of deposits,

→ **on the request of the depositor**,
→ **after the expiry of a period of six months** from the date of such deposit but before the expiry of the period for which such deposit was accepted,
→ the **rate of interest payable on such deposit shall be reduced by 1%** from the rate which the company would have paid had the deposit been accepted for the period for which such deposit had actually run.

Where the **premature closure of a deposit is for the purpose of earning a higher rate of interest**, the higher interest shall be paid by the company only if the deposit is renewed for a period longer than the unexpired period of deposit.



TENURE FOR WHICH DEPOSITS CAN BE ACCEPTED [RULE 3(1)]

✓ A company shall not accept or renew any deposit repayable on demand.

✓ The **minimum tenure** for which a deposit shall be accepted is **6 months** and **maximum period** of acceptance shall be **36 months.**

Exception: A company may accept or renew deposits for repayment earlier than 6 months to meet any short-term fund requirements, subject to the **condition** that:

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(i) Such deposits shall **not exceed 10% of (paid-up share capital+ free reserves+ securities premium account)**, *and*

(ii) Such deposits are **repayable only on or after 3 months** from the date of such deposits or renewal.

Example : Continuing the example of Swapnil Traders Private Limited, it is assumed that aggregate of its paid-up share capital, free reserves and securities premium account is ` 2,00,00,000. In order to meet its short-term requirement of funds, it can raise deposits maximum up to ` 20,00,000 (being 10% of ` 2,00,00,000) whose repayment tenure can be less than six months; but such tenure cannot be less than three months. Therefore, Swapnil Traders Private Limited must ensure that the short-term deposits so accepted are repaid only on or after three months from the date of such deposits.

OTHER RULES RELATED TO DEPOSITS

8.1 Filing return of deposits [Rule 16]

A duly audited return of deposits in **DPT-3** shall be filed with the ROC along with fees **on or before 30th June** of that year and declaration to that effect shall be submitted by the auditor in Form DPT-3.

8.2 Penal rate of Interest [Rule 17]

In case a company fails to repay deposits on maturity, after they are claimed, it shall pay penal interest of **18%** for the overdue period.

8.3 Punishment for contravention [Rule 21]

If any company inviting deposits or any other person contravenes any of the 'deposit rules' for which no punishment has been provided, the company and every officer-in-default shall be punishable as under:

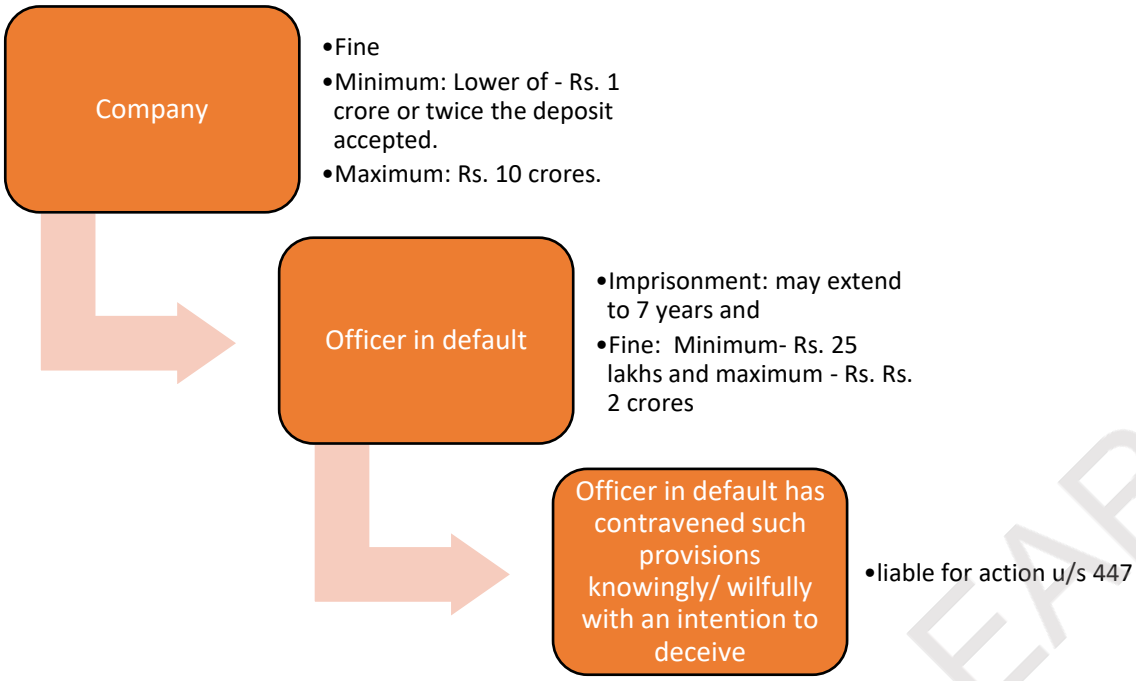
→ **Fine** which may **extend to ₹ 5,000/-**, *and*

→ In case of *continuing contravention*, **further fine upto ₹ 500/- for each day** during which the contravention continues.

PUNISHMENT FOR CONTRAVENTION OF SECTION 73 OR 76

Section 76A of the Companies Act, 2013 provides the punishments for contravention of the provisions of Section 73 or Section 76.

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REPAYMENT OF DEPOSITS ACCEPTED BEFORE COMMENCEMENT OF THE COMPANIES ACT, 2013

10.1 Filing of statement of deposits and repayment thereafter

Section 74 of the Companies Act, 2013 contains the provisions regarding repayment of deposits accepted before the commencement of this Act.

In case of a deposit accepted by a company before the commencement of this Act, the company shall:

→ **File** with the ROC, **within 3 months** from the date of commencement or from the date on which payments are due, **a statement** of all the deposits accepted by the company and sums remaining unpaid and interest payable thereon along with the arrangements for repayment, and

→ **Repay within 3 years** from the date of commencement of this Act or on or before the expiry of the period for which deposits were accepted, whichever is earlier.

10.2 Extension of time for repayment

The **Tribunal** may, on an **application made by the company**, allow further time as considered reasonable to the company to repay the deposit.

For this purpose, the Tribunal shall consider:

(a) Financial condition of the company,
(b) Amount of deposit and interest payable thereon, and
(c) Such other matters.

10.3 Punishment for Non-repayment of deposits

- Company – Fine minimum of ₹ 1 crores and maximum of ₹ 10 crores.

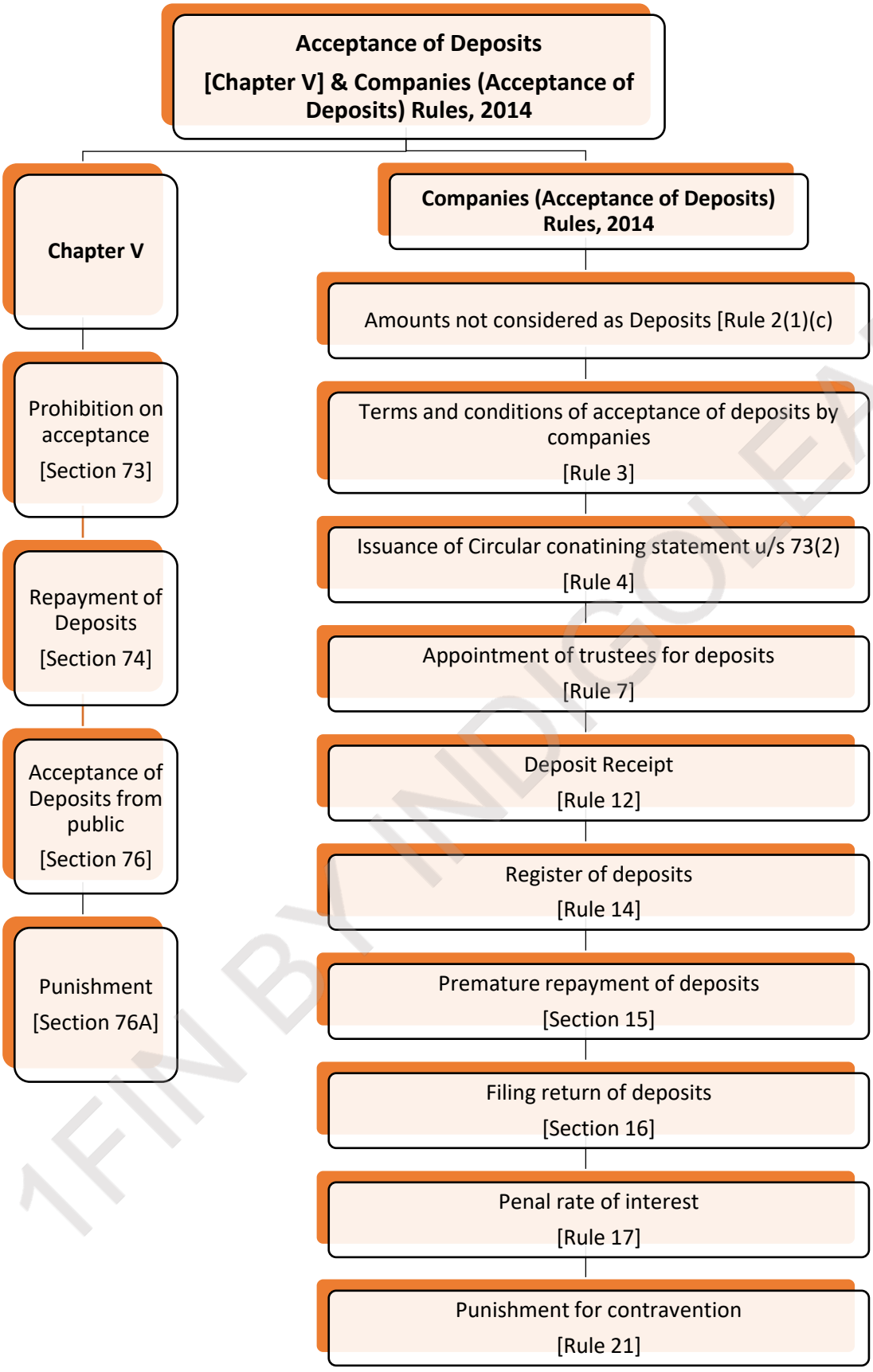
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- Every officer in default –
    - **Imprisonment** extendable to 7 years, or
    - **Fine** minimum of ₹ 25 lakhs and maximum of ₹ 2 crores, or
    - **Both**.

POWER OF CENTRAL GOVERNMENT TO DECIDE CERTAIN QUESTIONS

As per Rule 18, If any question arises as to the applicability of these rules to a particular company, such question shall be decided by the Central Government in consultation with the Reserve Bank of India.

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REGISTRATION OF CHARGES

Learning Outcomes –

- Understand the meaning of 'Charge'.
- Understand the difference between a Floating charge and a Fixed charge.
- Know the steps involved in registration of charges.
- Understand the consequences of non-registration of a charge and the steps to be followed for registering satisfaction of charge.
- Know the penal provisions in case of default.

INTRODUCTION

Whenever a company borrows money by way of loans including term loans or working capital loans from financial institutions or banks or any other persons, by offering its property or assets, a charge is created on such property or assets in favour of the lender. Such a charge is compulsorily registrable.

The law relating to registration of charges has been dealt in **Chapter VI** of the Companies Act, 2013 consisting of **sections 77 to 87** as well as the **Companies (Registration of Charges) Rules, 2014**.

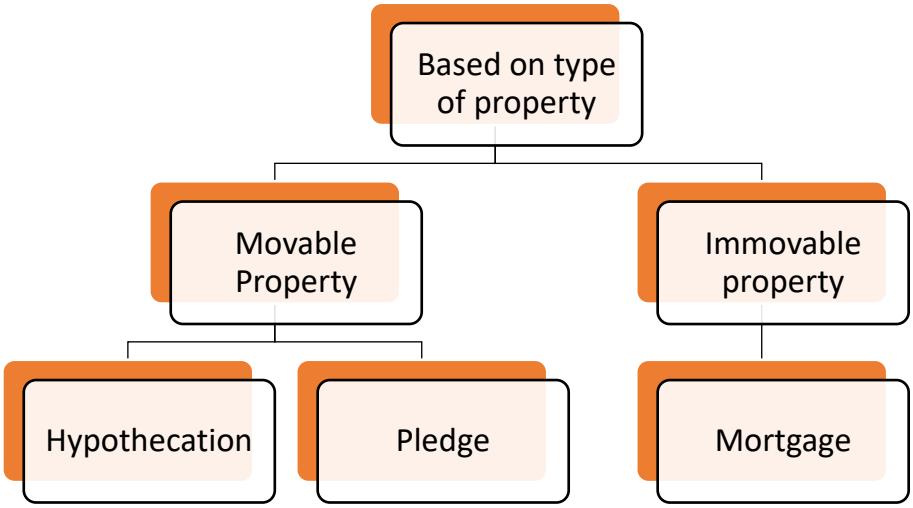
1.1 Charge

Section 2(16) defines "charge" as **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**.

- Charge is an interest or lien
- It is created on the property or assets of a company/ any of its undertakings
- It is created as security for repayment of a loan
- Charge includes mortgage

1.2 Types of Charge

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A charge may be either **fixed or floating**.

1.2.1 *Fixed charge*

→ A fixed charge is a charge **on specific assets** of the borrowing company.
→ These **assets are of permanent nature** like land & building, office premises, machinery etc.
→ These assets are **identified at the time of creation of charge**.
→ Usually created by way of **mortgage or deposit of title deeds**.
→ The borrowing company is not permitted to sell such assets though it may use them. They **can be sold only with the permission of the charge-holder**.
→ A fixed charge is **vacated when the money borrowed** against the assets subject to fixed charge **is repaid in full**.

Example : Pearl Electronics Limited raised a term loan ` 10 lakh from Everest Commercial Bank Limited, against the security of its office building. In this case, the company shall create a charge on specific asset i.e. its office building and such charge shall be a fixed charge. The company can sell this particular office building either by repaying the borrowed amount in full or after seeking permission from the charge-holder i.e. lender bank.

1.2.2 *Floating charge*

→ **Created on assets** or a class of assets which are **of fluctuatig nature** like raw material, stock-in-trade, debtors, etc.
→ The assets under floating charge keep on changing because **company is pemitted to use them** for trading or producing final goods for sale.

Example: A retail showroom contains numerous articles for sale. The owner may borrow against the security of all those goods. But he can still sell or deal with them in the ordinary course of business. The buyer of such goods will get it free of charge.

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→ When the creditor enforces the security or the company goes into liquidation, the floating charge will become fixed charge on all the assets available on that date and which may come into existence thereafter. This is called **crystallization of floating charge**.

→ Crystallization of floating charge **occurs** –

- When the **terms & conditions** of the floating charge are **violated**, or
- Company **ceases to continue its business**, or
- Company goes into **liquidation**, or
- The **creditors enforce the security** covered by the floating charge.

Example: Prism Limited had taken a loan from ABC Bank, on the security of it stock. Now, in the event of Prism Limited failing to repay the security interest or entering liquidation, the floating charge will change to a fixed charge. Once a floating charge gets converted to a fixed charge, the stock can neither be sold nor used by the company in its business operations.

DUTY TO REGISTER CHARGES, ETC.

Section 77 of the Companies Act, 2013 contains provisions regarding registration of charges by the company with the Registrar.

2.1 Registration of Charges

Regsitration of charges		
By the company creating the charge [Section 77]	By the charge-holder [Section 78]	By the purchaser [Section 79]
• It shall be the duty of the company creating the charge, within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise and situated in or outside India, to register the particulars of the charge.	• In case the company creating a charge fails to register the charge within the time limit, the person in whose favour the charge is created can get the charge registered.	• Where a company purchased some property in whose case a charge was already registered, the company purchasing the property shall get the charge registered in its name in place of seller in the records of the Registrar.

✓ The charge may be created in or outside India,

✓ The subject matter of the charge, i.e., the property or assets or any of the companies undertakings, may be situated within or outside India,

✓ The property may be tangible / intangible / financial asset.

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- ✓ **A charge created by depsoit of title deeds is also registrable** by the borrowing company.

Thus, the requirements of Rule 3 relating to Registration of Creation or Modification of Charge doesn't apply to above company.

2.2 How to register charge

The **particulars of the charge** –

- ✓ in **Form CHG-1** *or*
- ✓ in **Form CHG-9 (in case of debentures**),

along with the **copy of the instrument of charge**, if any, creating the charge duly signed by the company and the charge-holder shall be filed with the ROC **within 30 days** of creation of charge along with the prescribed fees.

2.3 Verification of Instrument of charge

Instrument or deed relates solely to a property situated outside India

- The copy shall be verified by a certificate issued
- (a) under the seal, if any, of the company, or
  (b) under the hand of any director or CS of the company, or an authorised officer of the charge holder, or
  (c) under the hand of some person other than the company who isintered in the mortgage or charge.

Instrument or deed relates to the property sitauted in India (wholly or partially)

- The copy shall be verified by a certificate issued
- under the hand of any director or CS of the company, or an authorised officer of the charge holder

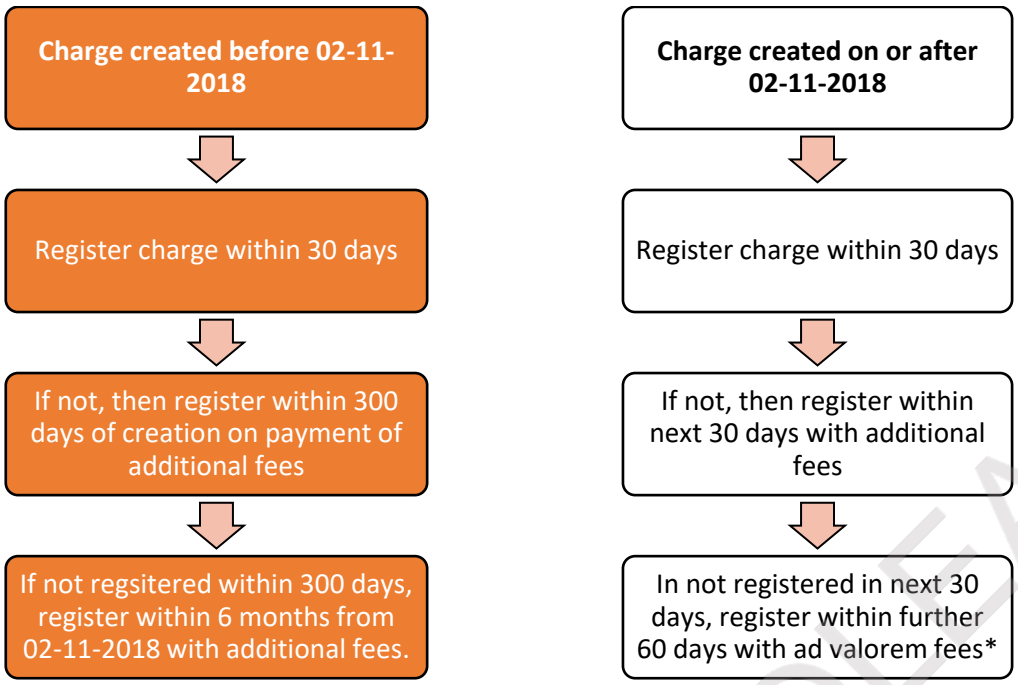
2.4 Exception – Registration of Creation/Modification of Charge

→ Any charge required to be created or modified by a banking company under section 77 in favour of the Reserve Bank of India

→ when any loan or advance has been made to it under sub-clause (d) of clause (4) of section 17 of the Reserve Bank of India Act, 1934 (2 of 1934)

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2.5 Extension of Time Limit



*ad valorem fees means fees in proportion to the value of the charge.

→ The company shall make an **application** to the ROC **in Form CHG-1 or CHG-9** (in case of debentures) seeking for extension of time.

→ The application shall be **supported by a declaration** from the company signed by its CS or a director that such belated filing shall not adversely affect the rights of any other intervening creditors of the company.

→ The ROC, upon being satisfied that the *company had sufficient cause for not filing the particulars of charge and instrument of charge, if any, within 30 days*, shall allow the extension of period.

2.6 Certificate of Registration

- Upon due registration of a charge, the ROC shall issue a certificate of registration in **Form CHG-2**. (*Form CHG-3 for modification of charge*)
- Such certificate shall be **conclusive evidence** that the requirements of this Chapter and rules thereunder have been complied with.

Section 77 shall not apply to certain charges which are prescribed in consultation with RBI.

2.7 Consequences of Non- Registration of Charges

✓ No **charge shall be taken into account by the liquidator** appointed under this Act or the

It may be noted that the failure to register charge shall not absolve the company from its liability in respect of any offence under this Chapter.

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Insolvency and bankruptcy Code, 2016 or any other creditor unless it is duly registered, and a certificate of registration is given by the ROC.

- ✓ This means that the **charge will be void**.
- ✓ **However, the debt is valid** and may be enforced against the company through the courts by filing a suit, but the security is lost.
- ✓ **Charge-holder loses his priority**.

APPLICATION FOR REGISTRATION OF CHARGE BY CHARGE-HOLDER

→ If a charge is created but the **company primarily responsible for registering the charge fails to do so** within the prescribed preriod of 30 days, the charge-holder (i.e., person in whose favour charge is created) may apply to the Registrar for registration of the charge along with the instrument of charge within the prescribed time, form and manner.

Section 78 of the Companies Act, 2013 empowers the holder of charge to get the charge registered in case the company creating the charge on its property fails to do so.

→ The ROC shall, upon receipt of the application from the charge holder, give a **notice to the company**.

→ If no objection is received from the company, the ROC shall **register the charge within 14 days of giving the notice to the company** on payment of prescribed fees.

→ The ROC shall **not allow registration by the charge holder if**:

i. Company itself registers the charge, or
ii. Company shows sufficient cause why such charge should not be registered.

Where registration of charge is effected on application by the charge-holder, such person shall be entitled to recover from the fees and additional fees paid by him to the ROC for the purpose of registration of charge.

ACQUISITION OF PROPERTY SUBJECT TO CHARGE AND MODIFICATION OF CHARGE

4.1 Company acquiring any property subject to charge

Section 79 of the Companies Act, 2013 deals with the provisions relating to acquisition of a property already subject to charge and the modification of charge.

Where a **property where charge is already registered is sold with the permission of the charge holder**, it shall be the duty of the company acquiring such property to get the charge registered in accordance with section 77.

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This means that the **earlier charge would get vacated** and a **new charge is registered** by the company acquiring the property.

4.2 Modification of charge when there is change in terms and conditions etc.

Where there is any **modification in the charge**, it shall be registered by the company in accordance with section 77 and the Registrar shall issue a **certificate of modification of charge in Form CHG-3**.

Examples of modification:

a) Change in terms & conditions of the existing charge through an agreement,
b) Any agreement for enhancing or decreasing the limits,
c) Ceding a *pari passu* charge*,
d) Change in rate of interest,
e) Change in repayment schedule of loan,
f) Partial release of the charge on a particular asset or property.

**A pari passu charge holder is entitled to a proportionate share in the mortgaged property. When this is ceded a charge holder will become a second charge holder and his right of entitlement will be subject to full satisfaction of the First charge holders claim.*

REGISTER OF CHARGES

5.1 Register of Charges to be kept by the Registrar

Section 81 of the Companies Act, 2013 contains provisions regarding Register of Charges to be kept by the Registrar.

Section 81 (1) states that the Registrar shall, in respect of every company, keep a register containing particulars of the charges registered under Chapter VI in the prescribed form and manner.

In addition, Rule 7 (1) states that the particulars of charges maintained on the Ministry of Corporate Affairs portal (www.mca.gov.in/MCA21) shall be deemed tobe the register of charges for the purposes of Section 81.

Inspection of Register: According to section 81 (2) such register shall be open to inspection by any person on payment of such fees as may be prescribed for each inspection.

Similarly, Rule 7 (2) states that the Register shall be open to inspection by any person on payment of fee.

5.2 Register of Charges to be kept by the company

Section 85 of the Companies Act, 2013 contains provisions regarding Register ofCharges to be kept by a company.

(i) According to section 85 (1):

- Every company shall keep a Register of Charges in the prescribed form[17] and manner at its registered office.
- The Register shall include all charges and floating charges affecting any property or assets

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of the company or any of its undertakings, indicating in each case the prescribed particulars.

(ii) According to Proviso to section 85 (1):

- A copy of the instrument creating the charge shall also be kept at the registered office along with the Register of Charges.

(iii) Provisions of Rule 10 are as under:

- According to Rule 10 (1), the company shall enter in the Register particulars of all the charges registered with the Registrar on any of its property, assets or undertakings and the particulars of any propertyacquired subject to a charge as well as particulars of any modificationof a charge and satisfaction of charge.
- According to Rule 10 (2), the entries in the Register shall be madeforthwith after the creation, modification or satisfaction of charge, asthe case may be.
- According to Rule 10 (3), the entries in the Register shall beauthenticated by a director or the secretary of the company or anyother person authorised by the Board for the purpose.

Inspection of Register of Charges and Instrument of Charges:

As regards inspection, section 85 (2) states that the register of charges and the instrument of charges shall be open for inspection[18] during business hours:

(a) by any member or creditor without any payment of fees; or

(b) by any other person on payment of prescribed fees. subject to suchreasonable restrictions as the company may, by its articles, impose.

Preservation of Register:

According to Rule 10 (4) the register of charges shall be preserved permanentlyand the instrument creating a charge or modification thereon shall be preservedfor a period of eight years from the date of satisfaction of charge.

REGISTRATION OF CHARGE TO ACT AS A CONSTRUCTIVE NOTICE

Section 80 of the Companies Act, 2013 provides that the registration of charge shall act as a constructive notice.

→ All charges registered with the ROC are public documents.
→ Where a charge is registered u/s 77, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be **deemed to have notice of the charge** from the date of such registration.
→ In case a person **enters into a transaction without making any enquiry** and later on suffers any loss/ damage, **he cannot claim the loss from the company** for it shall be deemed that he had notice of the charge.

COMPANY TO REPORT SATISFACTION OF CHARGE

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✓ A company shall give an intimation of payment or satisfaction* in full of any charge earlier registered, to the ROC in **Form CHG-4 within a period of 30 days** (**may be extended to 300 days** on an application made to the Registrar) from the date of such payment or satisfaction.

Section 82 of the Companies Act, 2013 deals with the requirement to intimate the Registrar of satisfaction any registered charges.

Satisfaction happens when the amount is not repaid but an asset of equal value is offered in the place of the property being released from charge.

✓ On receipt of such application, ROC shall cause a **notice to be sent to the charge holder** calling upon him to **show cause within such time as may be specified in the notice but not exceeding 14 days**, as to why payment/ satisafction in full should not be recorded.

- **No cause is shown**:- ROC shall order entering a memorandum of satisfaction in the register of charges kept by him and inform the company of having done so.
  ROC shall *issue a certificate of registration of satisfaction of charge in* ***Form CHG- 5*** *(Rule 8)*
- **If any cause is shown**:- ROC shall register a note to that effect in the Register of charges and inform the company.

✓ The instrument creating a charge/ modification shall be **preserved for 8 years** from the date of satisfaction of charge by the company.

POWER OF THE REGISTRAR TO MAKE ENTRIES OF SATISFACTION AND RELEASE IN THE ABSENCE OF INTIMATION FROM COMPANY

Section 83 of the Companies Act, 2013 empowers the ROC to make entries with respect to satisfaction and release of charges even if no intimation has been received from the company.

If the company hasnot informed the satisfaction of charge to the ROC & ROC receives evidence of satisfaction of charge from other source, then,

→ **ROC will enter in the Register of Charges himself** as a memorandum and
→ **within 30 days**, intimate affected parties.
→ Accordingly, '**Certificate of satisfaction of Charge' in Form CHG-5** shall be issued by ROC (Rule 8).

INTIMATION OF APPOINTMENT OF RECEIVER OR MANAGER

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Section 84 of the Companies Act, 2013 deals with the appointment of a receiver or manager and of giving intimation to the company and the Registrar.

Section 86 of the Companies Act, 2013 deals with the punishments for the company and officer in default in case of contravention of the provisions relating to registration of charges.

PUNISHMENT FOR CONTRAVENTION

If any person obtains an order for the appointment of a receiver or a person to manage the property subject to any charge, or if any person appoints such receiver or manager under any power contained in any instrument, he shall give a notice of such appointment in Form CHG-6 to the company and the receiver along with a copy of the order/ instrument within 30 days of passing such order or making the appointment.

The ROC shall register the particluars of the receiver, person, or instrument in the register of charges.

On ceasing to hold the appointment the person appointed as receiver/ manager shall give a notice to that effect in Form CHG-6 to the company and the ROC, and ROC shall register such notice.

Company:
Penalty - ₹5L

Every defaulting officer:
Penalty - ₹50,000

Any person wilfully furnishes any false or incorrect information or knowingly supresses material information which is required to be registered u/s 77 - liable u/s 447.

RECTIFICATION BY CENTRAL GOVERNMENT IN REGISTER OF CHARGES

10.1 Defaults upon which rectification order may be passed by CG

Section 87 of the Companies Act, 2013 and **Rule 12** empowers the CG to order rectification of Register of Charges.

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The CG may order rectification of Register of Charges in the following cases of default:

a) **Omission in giving intimation to the ROC** w.r.t. payment or satisfaction of charges within specified time,
b) **Omission or misstatement of any particulars in any filing** previously made to the ROC relating to any charge or related matters.

10.2 Application to the CG

Where such default is made, the **company or any interested person** shall make an application to the CG in **Form CHG-8.**

Before making an order for rectification, the **CG needs to be satisfied that such default was**

- **accidental** or
- due to **inadvertence** or
- because of some other **sufficient cause** or
- it **did not prejudice the position** of the creditors/ shareholders.

10.3 Order of the CG

The Central Government may-

1) Direct **rectification of the omission/ misstatement** of any particulars in any filing previously recorded with the ROC,
2) Direct **extension of time for satisfaction of charge**, if such filing is not made within 300 days from the date of payment or satisfaction of charge.

SIGNING OF CHARGE E-FORMS FOR COMPANIES UNDER RESOLUTION OR LIQUIDATION

➔ Form No. CHG-1, CHG-4, CHG-8 and CHG-9
➔ shall be signed by
  - Insolvency resolution professional or
  - resolution professional or
  - liquidator

for companies under resolution or liquidation, as the case may be and

➔ filed with the Registrar [Rule 13]

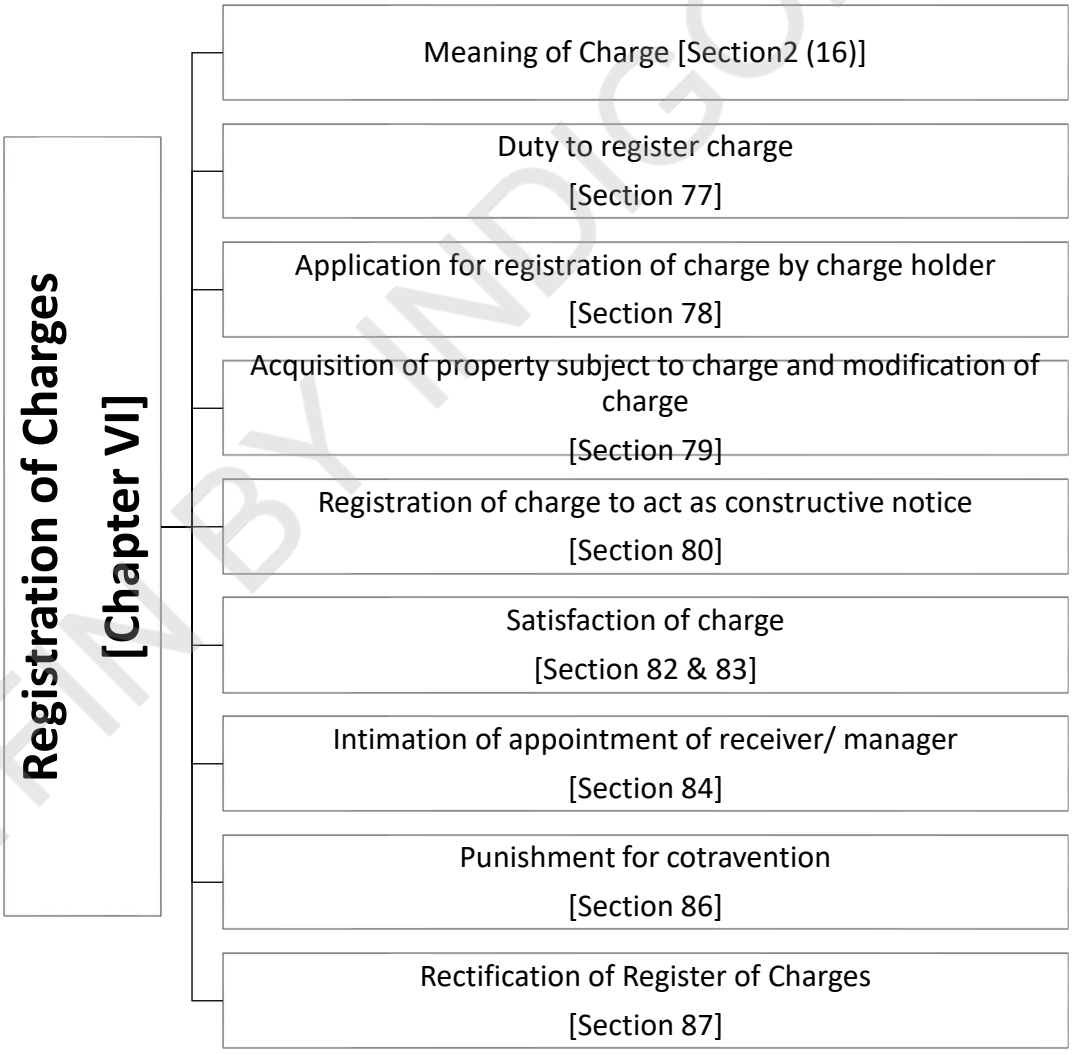
LIST OF FORMS TO BE FILLED WITH ROC

S.No.	E-Form	Purpose
1.	CHG-1	Creating or Modifying charge (for other than Debentures)
2.	CHG-2	Certificate of Registration of charge.
3.	CHG-3	Certificate of Modification of charge.

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4.	CHG-4	Intimation of the satisfaction to the Registrar.
5.	CHG-5	Memorandum of satisfaction of charge.
6.	CHG-6	Notice of appointment or cessation or receiver or manager.
7.	CHG-7	Register of charges.
8.	CHG-8	Application for condonation of delay shall be filed the CG
9.	CHG-9	Creating or modifying the charge in (for debentures including rectification)
10.	CHG-10	Application for delay to the registrar.

OVERVIEW



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MANAGEMENT AND ADMINISTRATION

Learning Outcomes –

- State the meaning, need and importance of management & administration of company.
- Learn about the maintenance of registers and other documentation required to be kept by a company.
- Know about meeting for conduct of the business.
- Explain the requirements for convening of a valid meeting.

INTRODUCTION

The provisions relating to management and admisnistration of companies have been dealt with under **Chapter VII** of the Companies Act, 2013 [**Section 88 to 122**] and the **Companies (Management & Administration) Rules, 2014.**

This Chapter applies to all companies, public and private, and has special provisions applicable to One Person Company (OPC).

REGISTER OF MEMBERS, ETC

2.1 Register of members, debenture holders & other security holders

Section 88 of the Companies Act, 2013 contains provisions regarding maintenance of registers of members, debenture holders and other security holders.

- ✓ **Every company** shall keep and maintain the register of members, debenture holders and other security holders.
- ✓ **Form of Register** :

Register of Members (company limited by shares)	Form MGT-1
Register of debenture holders/ other security holders	Form MGT-2

- ✓ **Entries** have to made in the Register **within 7 days of the date of approval by the Board or Committee** thereof, the allotment/transfer of shares, debentures, or any other securities.
- ✓ The Register shall be **maintained at the registered office** of the company.

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Other Requirements applicable to all the Registers

Rule 5 contains certain requirements which are applicable to all types of registers (i.e. Register of Members, Register of Debenture-holders and Register of any Other Security Holders). These are stated as under:

- **Time period for making entries in Register**

As per Rule 5 (1), entries have to be made in the Register within 7 days of the date of approval by the Board or Committee thereof by approving the allotment or transfer of shares, debentures or any other securities, as the case may be.

- **Place of maintaining Register**

According to Rule 5 (2), the registers shall be maintained at the registered office of the company unless a special resolution is passed ina general meeting authorising the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than 1/10th of thetotal members entered in the register of members reside.

- **Other information also to be referred in register**

1. In terms of Rule 5 (6), if any order is passed by any judicial or revenue authority or by Security and Exchange Board of India (SEBI) or competent authority attaching the shares, debentures or other securities and giving directions for remittance of dividend or interest, the necessary reference of such order shall be indicated in the respective register.
2. According to Rule 5 (7), in case of companies whose securitiesare listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held bythe promoter including the names of pledgee/pawnee and any revocation therein shall be entered in the register within fifteendays from such an event.
3. According to Rule 5 (8), if promoters of any listed company, which has formed a joint venture company with another company have pledged or hypothecated or created charge or lien in respect of any security of the listed company in connection with such joint venture company, the particulars ofsuch pledge, hypothecation, charge and lien shall be entered inthe register members of the listed company within fifteen days from such an event.

- **Updating of change in status of members**

Rule 5 (4) states that if any change occurs in the status of a member or debenture-holder or any other security holder:

- whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund (IEPF) or due to any other reason entries thereof explaining the change shall be made in the respective registers.

- **Rectification in register**

According to Rule 5 (5), if any rectification is made in the register maintained under section 88 by the company pursuant to any order passed by the competent authority under the Act, the necessary reference of such order shall be indicated in the respective register

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- ✓ **Particulars in register of members [Rule 3]**:
  - Name of the member, address, email address, PAN/CIN, Nationality,
  - In case member is a minor – name of his guardian and the date of birth of the member, name, and address of the nominee
  - Date of becoming the member,
  - Date of cessation,
  - Amount of guarantee, if any,
  - Any other interest, if any, and
  - Instructions, if any, given by the member with regard to sending of notices, etc.

- ✓ Every register shall include an **index of names** included therein. Index is not required wherein the number of members is less than 50.

- ✓ The **register and index of beneficial owners** maintained by a depository shall be **deemed to be corresponding register and index**.

- ✓ The entries made in the registers and index shall be **authenticated** by the CS of the company or any other person authorised by the Board for this purpose.

2.2 Foreign Register [Section 88(4) r.w. Rule 7]

A company ***may***, if so **authorised by the AOA**, **keep in any country outside India, a part of the register** of members, or debenture holders, or other security holders, or of beneficial owners, **resident in that country**. Such a register may be referred to as "**Foreign Register**".

2.2.1 Conditions:

a) **Within 30 days** of opening the foreign register**, file with the ROC notice** of the situation of the office in **Form MGT-3.**

b) In case of **change in situation of such office or of its discontinuance**, **within 30 days file a notice in Form MGT-3** with ROC of such change or discontinuance.

c) Maintained in the **same format as the principal register**.

d) **Inspection** of foreign register, closing, taking extracts therefrom and copies thereof – **same manner** as applicable to principal register. **Exception**: The advertisement before closing the register shall be inserted in at least 2 newspapers circulating in the place wherein foreign register is maintained.

e) The company shall –
   - **Transmit a copy of every entry made in foreign register** to its registered office in India **within15 days** of making such entry.
   - Keep at such office a **duplicate register** of every foreign register, duly updated from time to time.
   - **Not register any transaction** relating to any share, debenture or security holder which is registered in a foreign register, **in any other register**.

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f) Where the company **discontinues the keeping of any foreign register**, all the entries in that register shall be transferred to some other foreign register kept by the company outside India or to the principal register.

g) The entries made in the foreign register shall be **authenticated** by the CS of the company or any other person authorised by the Board by appending his signature to each entry.

2.3 Penalty for failure to maintain the register

The company and every officer in default shall be liable to penalty of ₹3L and ₹50,000 respectively.

Register of members - Rule 3; Form MGT - 1	Register of debenture-holders/any OSH - Rule 4; Form MGT - 2	Maintenance of Registers of members etc.- Rule 5
Index of names of members - Rule 6	Foreign Register - Rule 7	

DECLARATION IN RESPECT OF BENEFICIAL INTEREST IN ANY SHARE

Section 89 of the Companies Act, 2013 contains provisions relating to declaration in respect of beneficial interest in any share.

Members not holding beneficial interest in the company [Sec. 89(1)]	Person holding beneficial interest in the shares [Sec. 89(2)]	Any changes in the beneficial interest [Sec. 89(3)]
•File declaration in Form MGT-4. •Specify the name and other particulars of the person who holds the beneficial interest in such shares.	•Declaration to the company in Form MGT- 5. •Specify the nature of interest, particulars of the person in whose name such shares stand registered in the books of the company and other particulars	•Change occurs in the beneficial interest in any shares in respect of which a declaration has been filed u/s 89(1) & (2).

Shall file a declartion of beneficial interest with the company within 30 days and company shall file a return to ROC in Form MGT- 6 within 30 days.

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Where any declaration required u/s 89 is **not filed** by the beneficial owner, then any **right w.r.t. such shares shall not be enforceable** by the beneficial owner or any person claiming through him.

The duty of the company to pay **dividend shall not be affected** by this section.

3.1 Beneficial interest [Section 89(10)]

Beneficial interest in a share **includes**

- → Directly or indirectly,
- → Through any contract, arrangement or otherwise,
- → the **right or entitlement** of a person alone or together with any person to-
  - (i) **exercise** or cause to be exercised any or all the **rights attached to such share**, or
  - (ii) **receive or participate in any dividend** or other distribution in respect of such share.

Trust which is created, to set up a Mutual Fund or Venture Capital Fund or such other fund as may be approved by SEBI, **need not file the declarations** as envisaged under this section

3.2 Penalty for default

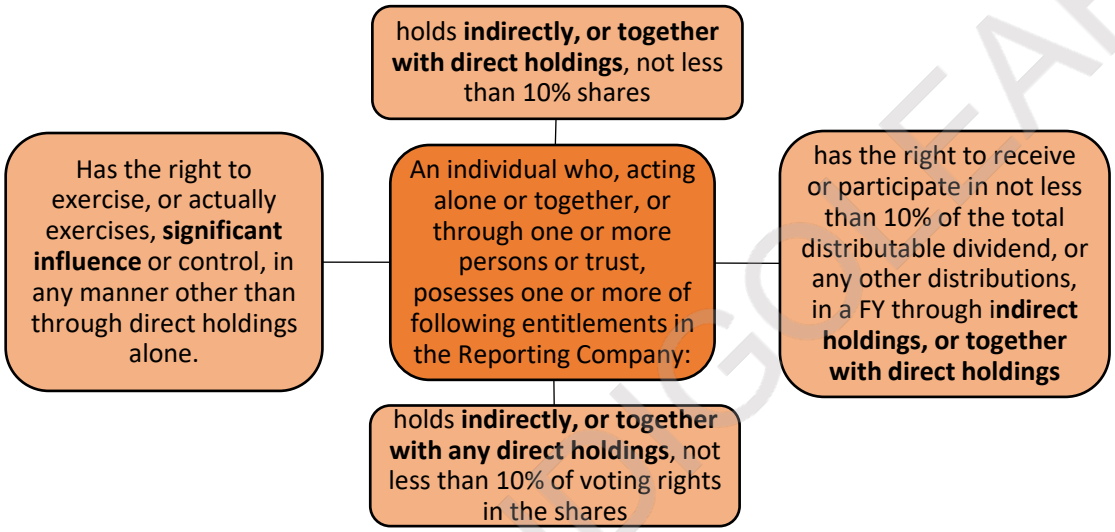
Any person fails to make declaration u/s 89	Company fails to file the return to ROC within 30 days
• Penalty - ₹50,000 • In case of continuing default further penalty of ₹200 for each day after the first during which failure continues. • *Subject to a maximum of ₹5L*	• Company and every officer in default shall be liable to penalty of ₹1,000 for each day during which such failure continues, subject to max. of ₹5L - in case of company ₹2L - in case of officer in default

- **Section 89 shall not apply to a government company** which has not committed a default in filing its financial statements u/s 137 or Annual Return u/s 92 with the ROC.
- **Central Government may, by notification, exempt** any class (es) of persons from complying with any of requirements of section 89, except sub-section (10), if it is considered necessary to grant such exemption in public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

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4.1 Significant Beneficial Owner (SBO)

Section 90 of the Companies Act, 2013 states the requirement for every significant beneficial owner to state his interest and other particulars to the company. MCA has issued **Companies (Significant Beneficial Owners) Rules, 2018 (SBO)**, which deals with identification and reporting in connection with SBO.



4.1.1 Direct or indirect shareholding

Direct shareholding:	**Indirect shareholding:**
• Shares in the relevant company are held in the name of such individual, or • The individual holds or acquires a beneficial interest in the shares of the relevant company and has made a declaration in this regard.	When a shareholder is a • Body corporate, • HUF, • Partnership, • Trust, • Pooled Investment vehicle.

4.1.2 Significant Influence

The **power to participate**, directly or indirectly, **in the financial and operating policy decisions** of the reporting company but is not control or joint control of those policies.

4.1.3. Majority Stake

- ✓ holding more than one-half of the equity share capital in the body corporate; or
- ✓ holding more than one-half of the voting rights in the body corporate; or
- ✓ Having the right to receive or participate in more than one-half of the distributable dividend or any other distribution by the body corporate.

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4.2 Duty of the reporting company

(1) To give **notice in the Form BEN-4** to the person whom the **company knows or has reasonable cause to believe** –

- → **To be an SBO** of the company,
- → To be **having knowledge of the identity of an SBO** or another person likely to have such knowledge, or
- → To have **been an SBO of the company at any time during the 3 years** immediately preceding the date on which notice is issued

Who have not registered themselves with the company as SBO. (i.e., unregistered SBOs)

(2) Maintain a **register of SBOs** in **Form BEN-3** which shall be open for inspection during the business hours on payment of such fee as may be prescribed by the company, but not exceeding ₹ 50 for each inspection.

4.3 Application to the tribunal

- → Where the **person fails to give the company information** required by the notice in Form BEN-4 **within 30 days** or, the information given is not satisfactory, the **company shall apply to the Tribunal within 15 days** of the expiry of the period specified in the notice.

- → The Tribunal may, after giving an opportunity of being heard to the parties concerned, make such **order restricting the rights attached with the shares within 60 days** of receipt of application or such other period as may be prescribed.

- → Any **person aggrieved with the order** of the tribunal **may make an application to the Tribunal** for relaxation or lifting of the restrictions **within 1 year** from the date of such order.

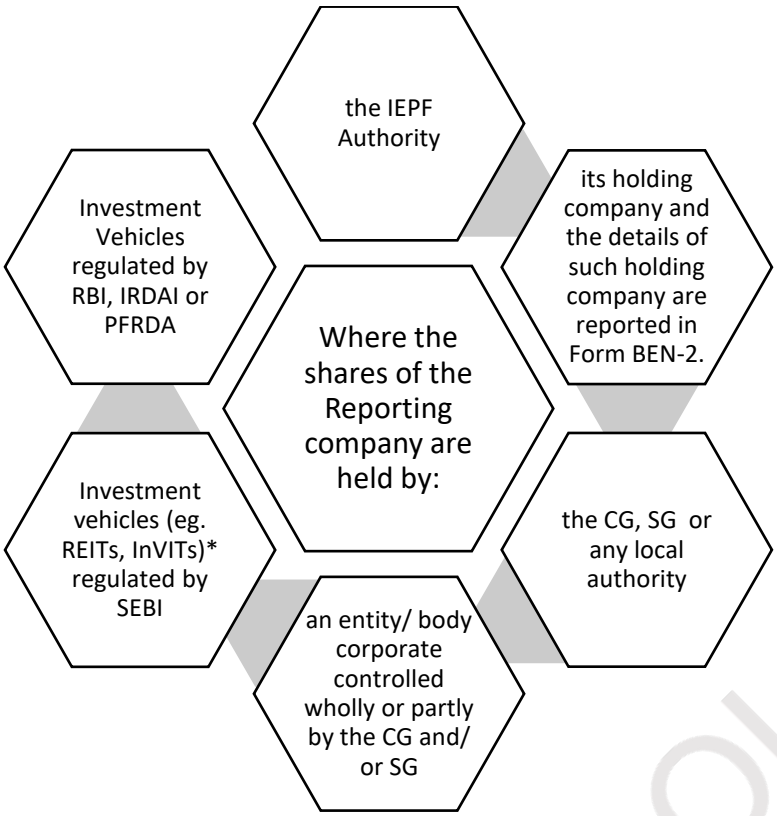
- → If **no such application has been filed within 1 year**, such **shares shall be transferred**, without any restrictions, to the Investors Education and Protection Fund (**IEPF**).

4.4 Declaration by SBO

Every individual who becomes a SBO in the reporting company or whose significant beneficial ownership undergoes any change, is required to **file a declaration** with the Reporting company in **Form BEN-1 within 30 days**.

4.5 Non-applicability of Companies (Significant Beneficial Owners) Rules, 2018

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*REIT – Real Estate Investment Trust

*InVIT – Infrastructure Investment Trusts

4.6 Punishment for contravention

SBO fails to give required disclosure	Reporting company fails to maintain register of SBO/ file return of SBO with ROC/ denies inspection
• Penalty – ₹50,000 If the failure continues – Further penalty of ₹1,000 for each day after the first day during which the failure continues. Subject to maximum of ₹2L	**Company** • Penalty – ₹1L • If the failure continues –Further penalty of ₹500 for each day, after first during which such failure continues • Subject to maximum of ₹5L **Officer in default** • Penalty – ₹25,000 • If the failure continues –Further penalty of ₹200 for each day, after first during which such failure continues

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	• Subject to maximum of ₹1L
Such contravention is compoundable. Contravention with the intention commit fraud - liable u/s 447.	

Section 90 shall **not be applicable** to a **Government Company** which has not committed a default in filing its FS u/s 137 or Annual Return u/s 92.

POWER TO CLOSE REGISTER OF MEMBERS OR DEBENTURE HOLDERS OR OTHER SECURITY HOLDERS

Section 91 of the Companies Act, 2013 deals with the closing of register of members, debenture holders and other security holders.

- ✓ The register of members, debenture holders and other security holders may be closed by the company by giving **minimum 7 days' notice period** or such lesser period as specified by SEBI **to its members**.

- ✓ Company closing the register shall give a minimum 7 days' previous notice by an **advertisement at least once in an English & Vernacular language** in English & vernacular newspaper respectively having wide circulation in place where registered office is situated. It shall also be published on the website notified by the CG and **website of the company**, if any.

    - Listed company or company intending to get its securities listed to follow manner of giving 7 days' notice as may be specified by SEBI

    - Requirement of advertisement shall not applicable to private company provided that the notice has been served on all members not less than seven days prior to closure of the register

- ✓ **Maximum period for closing register**:
    - 30 days at a time and
    - 45 days aggregate in a year.

- ✓ **Punishment for contravention**:
    - **Company and every officer in default** – Penalty of ₹ 5,000/- per day subject to a maximum of ₹ 1,00,000, during which the register is kept closed.
    - The offence is **compoundable** u/s 441.

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6.1 Contents of Annual Return

Section 92 of the Companies Act, 2013 together with **Rules 11 & 12** of Companies (Management & Administration) Rules, 2014 provides the provisions with regard to Annual Return.

- Registered office, principal business activities, particulars of its holding, subsidiary and associate companies
- Its shares, debentures, and other securities and shareholding pattern
- Members and debenture holders along with the changes therein since the close of the previous F.Y.
- Promoters, directors, KMP, along with the changes therein since the close of the previous F.Y.
- Meetings of the members, BOD
- Remuneration of directors and KMP
- Penalty or punishment on directors, officers and details of compounding
- Matters relating to certification of compliances, disclosures
- Details as may be prescribed in respect of shares held by or on behalf of FII

6.2 Maintenance of Annual Return

- ✓ Every company shall prepare an annual return in **Form No. MGT-7.**
  - Except OPC and small company which shall file annual return from F.Y. 2020-2021 onwards in Form No.**MGT-7A**
- ✓ It shall be **signed by** –
  - A director and the CS of the company, if any,
  - In case of company has no CS, director, and a CS in practice,
  - OPC and Small Company and private company (which is a start-up) – by the CS of the company. If no CS, then director of the company.
- ✓ Central Government may prescribe **abridged form of annual return** for OPC, small company and such other class(es) of companies as may be prescribed
- ✓ **Certification by CS** –

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- In case of a listed company or company having paid-up share capital of ₹ 10 crore or more, or a turnover of ₹ 50 crore or more,
- Shall be certified by a **CS in practice**.
- Certificate shall be in **Form MGT-8**.

✓ Every company shall place a **copy** of the Annual Return **on the website** of the company, if any, and the web-link of such annual return shall be disclosed in the Board's report.

✓ Copy of the Annual Return shall be **filed with the ROC**

- **within 60 days** from the date on which AGM is held or
- where no AGM is held – within 60 days from the date on which AGM should have been held, along with reasons for not holding the AGM.

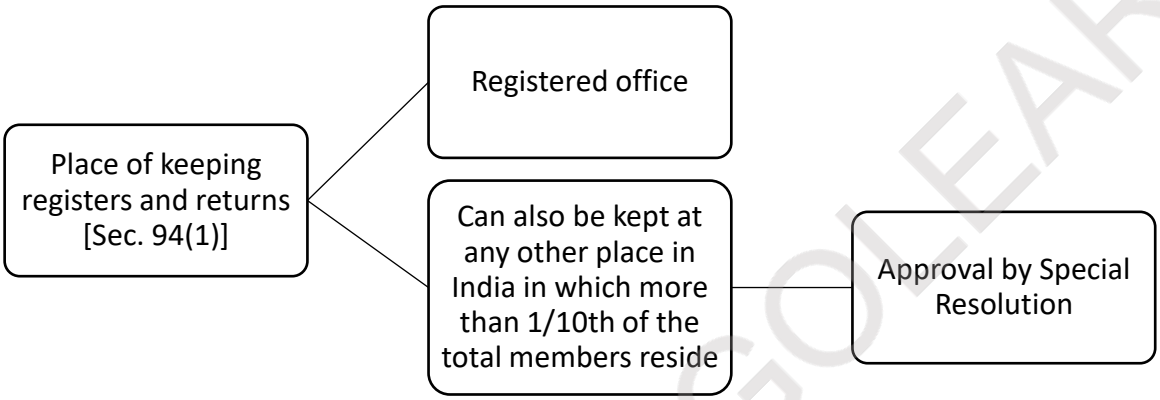
6.3 Punishment for contravention

Company fails to file the Annual Return	CS in practice certifes otherwise than in accordance with this section
• Company and every officer in default shall be liable • Penalty of ₹10,000 • In case of continuing failure - further penalty of Rs. 100/- for every day during which the failure continues • Subject to a maximum of • ₹2L - in case of company • ₹50,000 - in case of officer in default	• Liable to penalty of ₹2L

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7.1 Place of keeping registers and returns

Section 94 of the Companies Act, 2013 provides the provisions with regard to place of keeping the registers and returns of a company and their inspection.



7.2 Inspection of registers and returns [r.w. Rule 14]

- ✓ The registers and returns shall be open for inspection during **business hours**, at such reasonable time, on **every working day** as decided by the BOD,
  - → By any **member, debenture holder, other security holder or beneficial owner** without the payment of fee, and
  - → By any **other person on payment of fees** as prescribed by the BOD but not exceeding ₹ 50/- for each inspection.

- ✓ Any member, debenture holder, other security holder or beneficial owner can
  - → **take extracts** during business hours without payment of fee, and
  - → also **get copies** on payment of fee not exceeding ₹ 10/- for each page.

- ✓ Copies/ entries/ return shall be **supplied within 7 days** of deposit of fee.

- ✓ Following particulars of the register/index/return in respect of the members of a company shall not be made available for any inspection under S. 94(2) or for taking extracts or copies under S.94(3) :
  - i. address or registered address (in case of a body corporate);
  - ii. e-mail ID
  - iii. Unique Identification Number
  - iv. PAN Number

7.3 Preservation of register of members etc. and annual return [Rule 15]

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Preservation of register of members along with index

- Preserved permanently.
- Kept in the custody of Company Preservation of register of members secretary or any other person authorised by the BOD for such purpose.

Preservation of register of debenture holders/ other security holders

- Preserved for a period of 8 years from date of redemption of debentures or securities
- Kept in the custody of CS of the company or any other person authorised by the BOD for such purpose.

Preservation of documents filled with ROC

- Preserved for 8 years from the date of filing with the ROC.

Preservation of foreign register

- Preserved permanently unless discontinued and all entries are transferred to any other foreign register or to the principal register.
- Foreign register of debenture holders and other security holders shall be preserved for 8 years from the date of redemption of such denture or securities.

7.4 Penalty for refusing inspection or making any extract or copy required

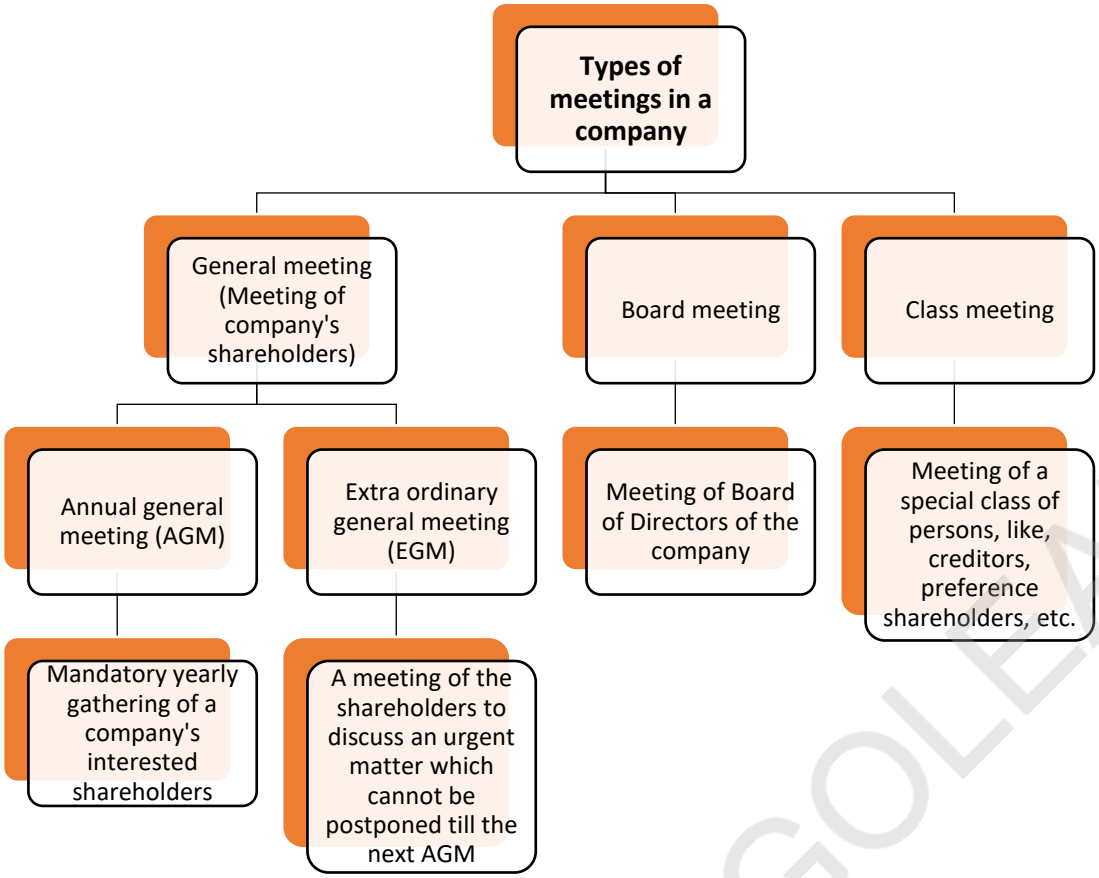
- ✓ **Company and every officer of the company in default** shall be liable to a **penalty of ₹ 1,000/- for every day subject to a maximum of ₹ 1,00,000/-** during which the default continues.
- ✓ The **CG may also direct an immediate inspection** of the document or direct that required extract be forthwith allowed to be taken by the person requiring it.

REGISTERS, ETC. TO BE EVIDENCE

Section 95 of the Companies Act, 2013 provides that the registers, indices, and copies of annual return shall be a **prima facie evidence** of any matter directed or authorised to be inserted therein.

TYPES OF MEETINGS IN A COMPANY

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NOTICE OF A MEETING

10.1 Notice of general meeting

Section 101 of the Companies Act, 2013 together with **Rule 18** of the Companies (Management & Administration) Rules, 2014 lays down the rules regulating the notice to be sent calling a meeting.

To properly call a meeting, a notice –

Of **at least 21 clear days** *(14 days for Section 8 company)*, before the meeting,

→ Should be **given to**:
- All the **members**,
- **Legal representative** of any deceased member,
- The **assignee** of any insolvent member,
- The **auditors**, and
- The **directors**,

21 clear days means that date on which notice is served, and date of meeting are excluded for sending the notice.

Company cannot reduce this requirement through its AOA.

→ In **writing / electronic mode / other prescribed mode**.

The notice shall be **placed** simultaneously **on the website** of the company, if any, and on any website notified by the CG.

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Note:

In case of Specified IFSC Public Company - Section 101 shall apply in case of a Specified IFSC public company, unless otherwise specified in the articles of the company. [Notification No. GSR 8 (E), dated 4th January, 2017.]

In case of section 8 company, in clause (1) of Sub-section (1) of Section 101 for the words "21 days", the words "14 days" shall be substituted. This exception shall be applicable to a section 8 company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar. [Notification No. GSR 466 (E), 5-6-2015 as amended by Notification No. GSR 584 (E), dated 13th June, 2017.

10.1.1 Electronic mode [Rule 18]

Where a notice for the GM is **sent by post**, it shall be **deemed to be served at the expiration of 48 hours** after the letter containing the same is posted. [Rule 35(6) of the Companies (Incorporation) Rules, 2014]

→ Any communication sent by a company **through its authorised and secured computer programme**
→ which is **capable of producing confirmation and keeping record** of such communication addressed to the email address provided by such member who is entitled to receive such communication.
→ A notice may be sent through e-mail as a –
  (a) Text, or
  (b) As an attachment to e-mail, or
  (c) As a notification providing electronic link, or
  (d) URL for accessing such notice.

10.1.2 Accidental omission to give notice [Sec. 101(4)]

Any accidental omission to give notice to or the non-receipt of such notice by, any member or other person who is entitled to such notice for any meeting **shall not invalidate the proceedings of the meeting**.

It is the **duty of the company to prove** that the omission was not deliberate.

10.2 Meetings held at shorter notice

A GM may be called at a shorter notice if **consent in writing/ by electronic mode** is given by:

(1) **In case of AGM**: *not less than 95% of the members* entitled to vote thereat.
(2) **In case of other GM**: by members of the company having

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- *Company having share capital – majority number* of members entitled to vote and who represent not less than 95% of paid-up share capital members entitled to vote in that meeting.
- Company not having share capital – not less than 95% of total voting power exercisable at that meeting.

10.3 Contents of the notice

- Day, date, hour of meeting,
- Place of meeting,
- Statement of business to be transacted at a meeting.

10.4 Authority to call a GM

- ✓ A GM has to be called by the **Board of Directors (BOD).**
- ✓ An individual director cannot call a GM.
- ✓ A **notice of the GM given without sanction of the BOD** is *invalid*. However, the same *can be ratified by the BOD*.

EXPALNATORY STATEMENT TO BE ANNEXED TO NOTICE

Section 102 of the Companies Act, 2013 provides the provisions relating to explanatory statement to be attached to a notice of a general meeting where any special business is to be transacted.

Where any **special business** is to be transacted at the company's general meeting, then an **"explanatory statement"** should be annexed to the notice calling such GM.

11.1 Content of the explanatory statement

1) The **nature of interest in respect of each items** to be transacted of
   - Every director and the manager if any
   - Every other KMP, and
   - Relatives of above persons.

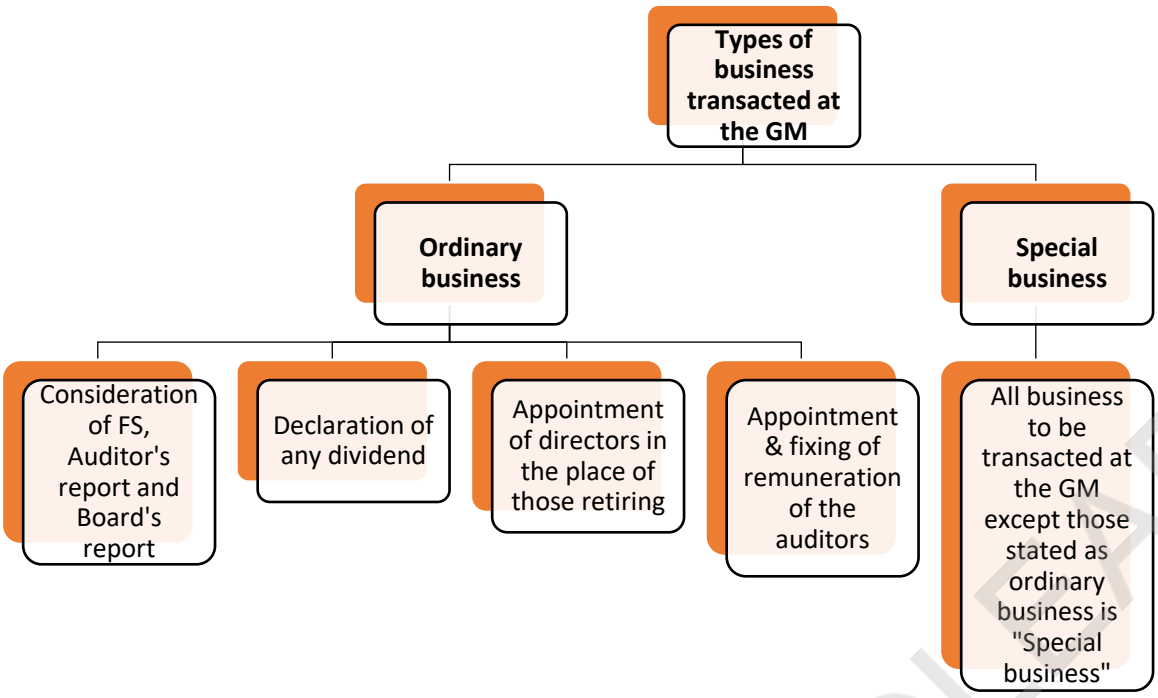
2) Any **other information / facts** that may enable the members to understand the meaning, scope, and implications of the items of business and to take decision thereon.

3) If the **special business relates to or affects any other company**, then the **extend of shareholding** in that other company of every promoter, director, manager and every other KMP **shall be disclosed**, *if the extend of shareholding is 2% or more of the paid-up capital of that other company.*

4) In case any business refers to any document to be considered at the meeting, then time and place where such document can be inspected.

11.2 Types of business transacted at GM

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11.3 Contravention of these provisions

1) If as a result of **non-disclosure or insufficient disclosure** in explanatory statement, **any benefit accrues** to a promoter, director, manager, other KMP, or their relatives,
   → Such person shall **hold such benefit in trust** for the company, **and**
   → Shall be liable to **compensate the company** to the extent of the benefit received by him.

2) If any **default is made in complying with the provisions** of this section, every promoter, director, manager, or other KMP of the company who is in default shall be liable to a **penalty of**
   → *₹ 50,000/- or*
   → *5 times the benefit* accruing to the promoter, director, manager, or other KMP or any of his relatives
   Whichever is higher.

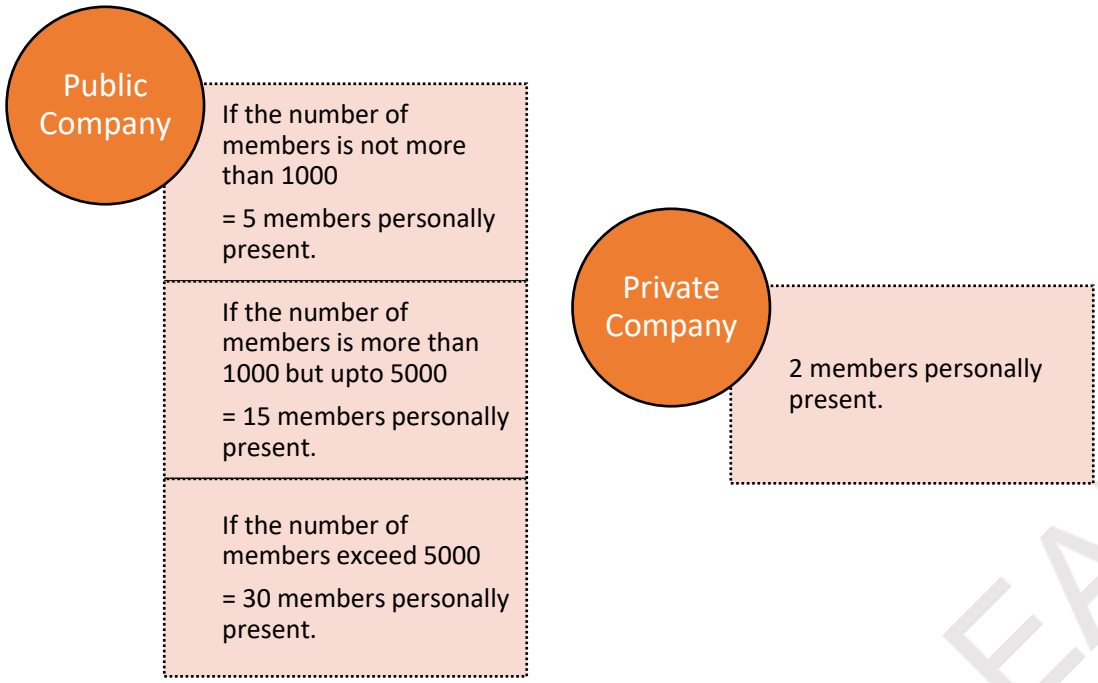
QUORUM FOR MEETINGS

Section 103 of the Companies Act, 2013 provides the quorum for the meetings of the company.

Quorum = *The minimum number of members who must be present in order to constitute a valid meeting.*

12.1 Quorum for the meeting

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Note: The AOA may provide for a larger number to be the quorum for meetings of the company.

12.2 Who shall be considered as quorum?

a) Proxies	×
b) Authorised representative of company	✓
c) Joint holders	Counted as 1
d) Person in dual capacity	Counted more than 1

12.3 Adjourned meeting due to want of Quorum

- ✓ If the **quorum is not present within half -an-hour** from the time appointed for the meeting of the company –
  a) The **meeting shall stand adjourned to the same day in the next week at the same time and place**, or to such other date, time and place as the BOD may determine, *or*
  b) If the *meeting was called by requisitionists u/s 100*, the meeting shall **stand cancelled**.

- ✓ In case of an **adjourned meeting**/ change of day, time or place of meeting , company shall give **not less than 3 days' notice** to the members –
  - Either individually, or
  - By publishing an advertisement in the newspapers (English & vernacular) having wide circulation at the place where the registered office is situated.

- ✓ If **quorum is not present in adjourned meeting** also within half-an-hour, *members present shall form the quorum*.

Note:

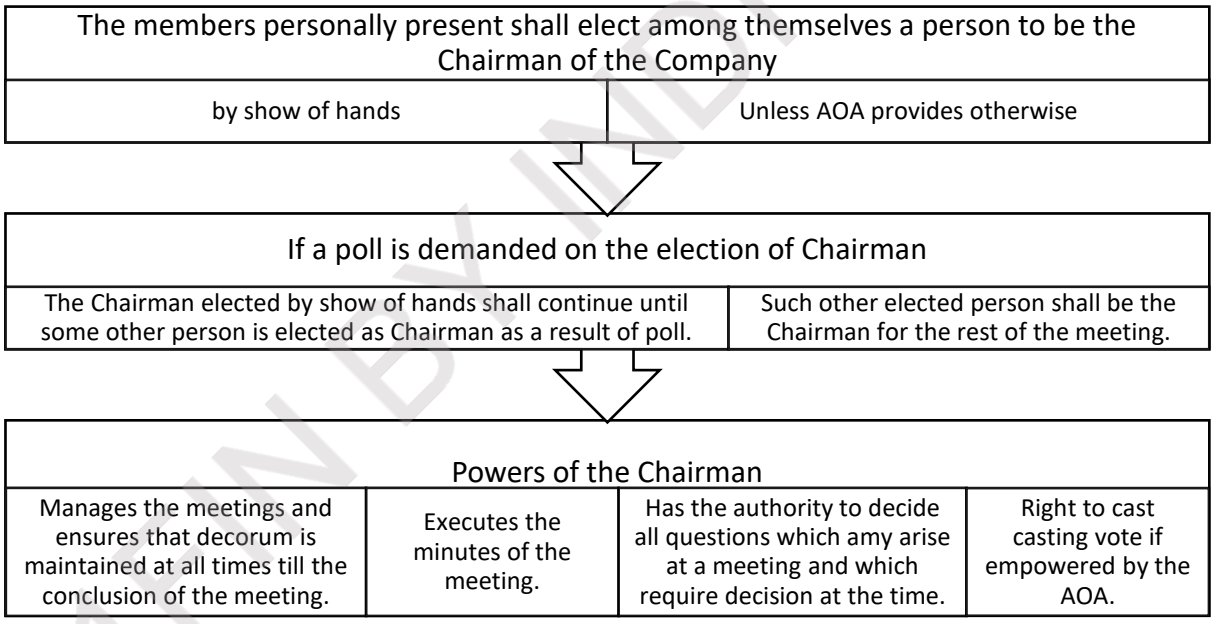
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The following points have been prescribed by Secretarial Standard – 2:

1. One person can be an authorised representative of more than one body corporate. In such a case, he is treated as more than one Member present in person for the purpose of Quorum. However, to constitute a meeting, at least two individuals shall be present in person. Thus, in case of a public company having not more than one thousand members with a Quorum requirement of five members, an authorised representative of five bodies corporate cannot form a Quorum by himself but can do so if at least one more member is personally present.
2. Quorum shall be present not only at the time of commencement of the Meeting but also while transacting business
3. Members who have voted by Remote e-voting have the right to attend the General Meeting and accordingly their presence shall be counted for the purpose of Quorum.
4. A Member who is not entitled to vote on any particular item of business being a related party, if present, shall be counted for the purpose of Quorum.
5. The stipulation regarding the presence of a Quorum does not apply with respect to items of business transacted through postal ballot.

CHAIRMAN OF MEETINGS

Section 104 of the Companies Act, 2013 provides the provisions relating to election of chairman of the company and his powers.



Casting vote = In the event of the equality of vote on a particular business being transacted at the meeting, the Chairman of the meeting shall have a right to cast a second vote. If there is no provision for a casing vote in the AOA, an ordinary resolution on which there is equality of votes is deemed to be dropped.

PROXIES

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14.1 Meaning of Proxy

Section 105 of the Companies Act, 2013 deals with the appointment of proxy of a member of the company.

Any member of a company who is entitled to attend and vote at a meeting of the company shall be entitled to **appoint another person as a proxy to attend and vote at the meeting on his behalf**.

14.2 Applicability

- Company having a **share capital**, *or*
- If the company has no share capital, the **AOA of the company provides** for appointment of proxy.

14.3 Who can be appointed as proxy

→ **Generally** – Non-member / member of the company
→ **Section 8 companies** – Only member of such company.

14.4 Role of Proxy

✓ Proxy shall **not have the right to speak** at such meeting,
✓ Proxy shall **not be entitled to vote except on a poll**.
✓ A person can **act as proxy of more than one member provided it is not more than**-
- 50 members **and**
- **Members holding in aggregate not more than 10% of total share capital** of the company carrying voting rights.
- A **person who is holding more than 10% of share capital** carrying voting rights **may appoint a single person as proxy** and such person shall not act as a proxy for any other person or shareholder.

14.5 Procedure to appoint Proxy

- In **every notice** calling a meeting of a company, there shall appear with reasonable prominence a **statement that a member entitled to attend, and vote is entitled to appoint a proxy**, or, where that is allowed, one or more proxies to attend and vote instead of himself, and that proxy need not be a member.

- Instrument for appointment of proxy – Form **MGT-11**

- It shall be **signed** by the appointer or his attorney duly authorised in writing.

  If the appointer is a body corporate – the instrument should be under its seal or signed by an officer or an attorney duly authorised by the body corporate.

In a listed company, the notice of the meeting shall clearly state that the members who have cast their vote by remote e-voting prior to the meeting may also attend the meeting but shall not be entitled to cast their vote again [Rule 20].

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- A proxy **shall be received 48 hours before the meeting** (even if articles provide for a longer period).

14.6 Inspection of Proxy

✓ **Every member** entitled to vote at a meeting of the company, or on any resolution to be moved thereat, shall be entitled to inspect the proxies.

✓ **Time for inspection** – during the **period beginning 24 hours before the commencement of meeting and ending with the conclusion of the meeting**, at any time during the **business hours**.

At least 3 days prior notice in writing of the intention so to inspect should be given to the company.

14.7 Penalty for default

** Officer shall not be **liable** by reason only of issue to member at his request in writing of a form of appointment naming the proxy, or of a list of persons willing to act as proxies, if the form or list is available on request in writing to every member entitled to vote at the meeting by proxy*

If the notice does not state the proxy may be appointed	• Every officer of the company in default shall be punishable • penalty of Rs. 5,000/-.
If an invitaton to appoint as proxy any specified person is sent to any member of the company entitled to attend and vote thereat by proxy*	• every officer of the company who issues invitation as aforesaid or authorises or permits their issue shall be liable to penalty of ₹50,000

RESTRICTION ON VOTING RIGHTS

Section 106 of the Companies Act, 2013 overrules the whole of the Act and provides for restriction on voting rights of a member.

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15.1 Grounds on which voting right may be restricted.

AOA may provide that no member shall exercise any voting right in respect of any share registered in his name

→ On which any **amount is due from him on calls** or
→ On which **any other sum payable to the company**, or
→ In regard to which the **company has exercised the right of lien**.

Voting right shall not be restricted on any other grounds.

Also, such a member **cannot sign a requisition for an EGM**.

15.2 Member entitled to more than one vote

On a poll taken at a meeting, **a member entitled to more than one vote**, or his proxy, where allowed, other another person entitled to vote for him, as the case may be, **need not**, if he votes

→ Use all his votes or
→ Cast in the same way all the votes he uses [Sec. 106(3)]

15.3 Vote of joint holders

- Joint shareholders **must vote in consensus** *unless the AOA provide otherwise*.
- The voting in case of joint holders is done in the **order of seniority**, which is determined on the basis of the order in which their names appear in the register of members. Joint holders have a right to instruct the company as to the order in which their name appears in the register.

15.4 Vote of Directors, who are also shareholders

- Directors, who are also shareholders of the company stand in a **fiduciary relationship** with the company in their capacity as directors.
- However, the director should **vote as a common shareholder** and need not be influenced by the fact of his being a director.

VOTING BY SHOW OF HANDS

Section 107 of the Companies Act, 2013 deals with the provisions relating to voting by show of hands in a meeting of the company.

✓ Unless the voting is demanded by way of poll or by electronic means, the **voting should be done by way of hands in the first instance**.

✓ The **declaration by the Chairman of the meeting in the minutes books** shall be conclusive evidence that the resolution is passed.

✓ Even an **insolvent shareholder can vote** at the meeting by show of hands provided:
  - He has no longer any beneficial interest in the shares and

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- The dividends are payable only to his trustee in bankruptcy.

VOTING THROUGH ELECTRONIC MEANS

17.1 Companies to provide facility to vote by electronic means

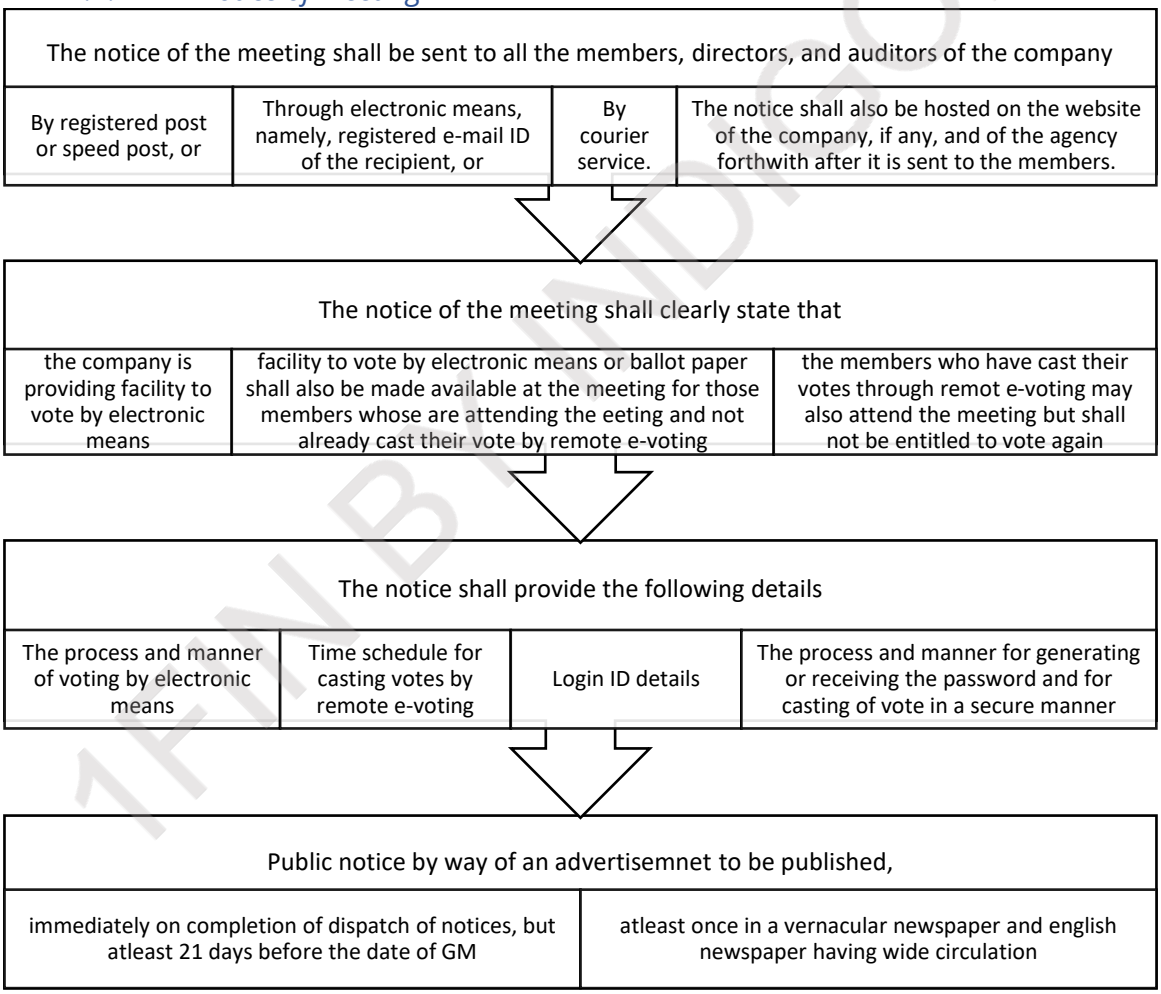
Section 108 of the Companies Act, 2013, together with Rule 20 of the Companies (Management & Administration) Rules, 2014 provides the procedure for electronic voting.

(i) Every listed company,
(ii) Every company having not less than 1,000 members.

Exception: A Nidhi Company or an enterprise or institutional investor referred to in Chapter XB and XC of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

17.2 Procedure to vote through electronic means

17.2.1 Notice of Meeting



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17.2.2 Remote e-voting

→ The time for remote e-voting shall remain **open for not less than 3 days** and shall **close at 5.00 p.m. on the date preceding the date of GM**.

→ Members having physical shares or dematerialised shares may opt for e-voting.

→ Once a member casts the vote, he shall not be allowed to change it subsequently or cast the vote again.

→ At the end of remote e-voting the facility shall forthwith be blocked.

Sending of Notice of Meeting through Electronic Mode:

As per *Rule 18 of the Companies (Management & Administration) Rules, 2014* , sending of notices through electronic mode has been statutorily recognized. Accordingly, it is permitted for a company to give notice through electronic mode.

The expression "electronic mode" shall mean any communication sent by a company through its authorized and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.

- A notice may be sent through e-mail as a–
  - Text; or
  - As an attachment to e-mail; or
  - As a notification providing electronic link; or
  - Uniform Resource Locator for accessing such notice.
- Rule 18(3)
  - The e-mail shall be addressed to the person entitled to receive such e-mail as per the records of the company as provided by the depository.

It is to be noted that the company shall provide an advanceopportunity at least once in a financial year, to the member to registerhis e-mail address and the changes therein and such request may be made by only those members who have not got their e-mail ID recorded or to update a fresh e-mail ID and not from the members whose e-mail ids are already registered.

a. The subject line in e-mail shall state the name of the company, noticeof the type of meeting, place and the date on which the meeting is scheduled.

b. If notice is sent in the form of a non-editable attachment to e-mail, such attachment shall be in the Portable Document Format or in a non-editable format together with a 'link or instructions' for recipient for downloading relevant version of the software.

c. The company's obligation shall be satisfied when it transmits the e-mail and the company shall not be held responsible for a failure in transmission beyond its control.

d. If a member entitled to receive notice fails to provide or update relevant e-mail address to the company, or to the depository participant as the case may be, the company shall not be in default for not delivering notice via e-mail.

e. The company may send e-mail through in-house facility or its registrar and transfer agent or

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authorise any third-party agency providing bulk e-mail facility.

f. The notice shall be placed simultaneously on the website of the Company, if any, and on the website as may be notified by Central Government.

17.2.3 Appointment and function of scrutinizer

The BOD shall **appoint one or more scrutinizer** who may be CA/ CS/ CWA in practice, or an advocate or any other person who is not in employment of the company. His function is **to count the votes** in a fair manner and prepare its report.

Scrutiniser shall **maintain a register** either manually or electronically to record the assent or dissent received with details of member. Register and all other papers shall **remain in the safe custody of the scrutiniser until minutes are prepared**.

17.2.4 Counting of votes

- The chairman shall **at the GM, allow the voting**, with the help of the scrutinizer, **by using ballot paper or by using an e-voting system** for all those members who are present at the meeting and have not cast their votes by availing the remote e-voting facility.
- The scrutinizer shall **after conclusion of voting at the GM** –
    - First **count the votes cast at the meeting**,
    - Thereafter, **unblock the votes cast through remote e-voting** in the presence of **at least 2 witnesses** not in employment of the company and
    - Make a **consolidated report, within 3 days** of conclusion of meeting, of the total votes cast in favour or against, to the chairman or the person authorised by him.
- The **chairman** or other person authorised by him shall **declare the result** of the voting forthwith.

17.2.5 Results and date of resolution

- ✓ The **results** declared along with the report of the scrutiniser shall be **placed on the website** of the company, if any, and on the website of the agency and the website of recognised stock exchange in case of listed shares, **immediately after the result is declared by the Chairman**.
- ✓ If required number of votes are received, the resolution shall be deemed to be passed on the date of the relevant general meeting.

Note:

Procedural aspect of Voting by E mode are covered in Rule 20. Rule 20(20) defines certain terms as under :

'cut-off date' means a date not earlier than seven days before the date of general meeting for determining the eligibility to vote by electronic means or in the general meeting. [Explanation II (ii) to Rule 20(2)]

✓ 'cyber security' means protecting information, equipment, devices, computer, computer resource, communication device and information stored therein from unauthorised access, use, disclosures, disruption, modification or destruction;

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✓ 'electronic voting system' means a secured system based process of display of electronic ballots, recording of votes of the members and the number of votes polled in favour or against, in such a manner that the entire voting exercised by way of electronic means gets registered and counted in an electronic registry in a centralised server with adequate cyber security. [Explanation II(iv) to Rule 20(2)]

remote e-voting' means the facility of casting votes by a member using an electronic voting system from a place other than venue of general meeting. [Explanation II(v) to Rule 20(2)]

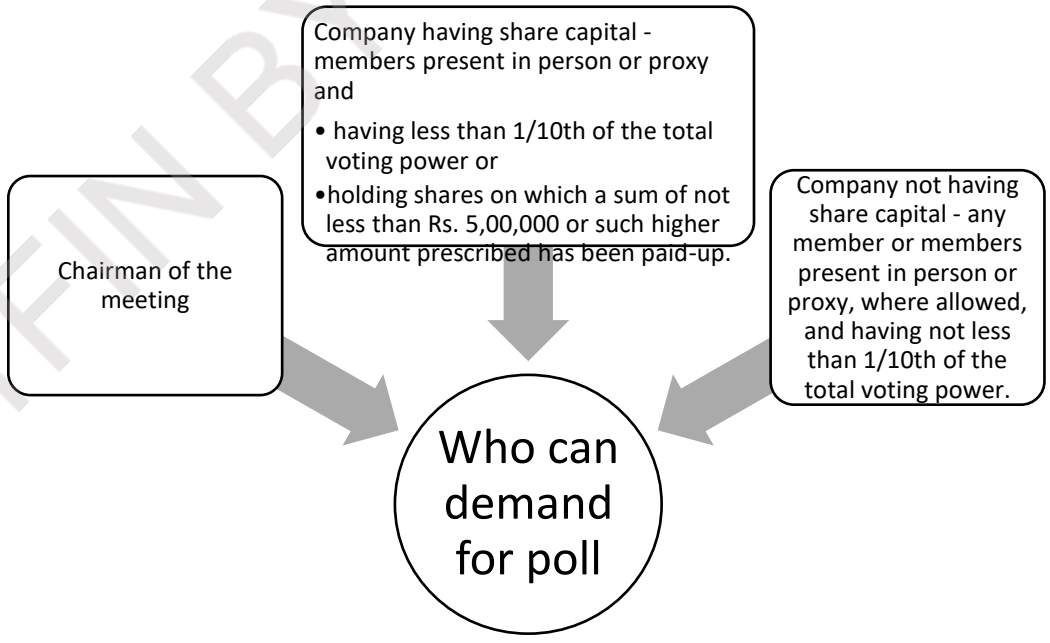
✓ 'secured system' means computer hardware, software, and procedure that - (a) are reasonably secure from unauthorised access and misuse; (b) provide a reasonable level of reliability and correct operation; (c) are reasonably suited to performing the intended functions; and (d) adhere to generally accepted security procedures; [Explanation II (vi) to Rule 20(2)]

✓ 'voting by electronic mean' includes "remote e-voting and voting" at the general meeting through an electronic voting system which may be the same as used for remote e-voting. [Explanation II (vii) to Rule 20(2)

DEMAND FOR POLL

18.1 Who can demand for poll

Section 109 of the Companies Act, 2013 provides the provisions for demand for voting through poll.



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The demand for poll may be withdrawn by the persons who made the demand, at any time.

18.2 Time for demanding for a poll

1) **Before declaration of result** of voting by show of hands, or
2) **On declaration** of such result.

18.3 When to take the poll

→ **Poll demanded for adjournment of the meeting/ appointment of Chairman of the meeting** – immediately

→ **Poll demanded on any other question** – taken at such time as Chairman may direct, but not later than 48 hours from the time of demand.

18.4 Procedure for conducting the poll

1) Chairman **appoints scrutinizer** for observing the poll process and to report thereon. → 2) Scruitnizers are **provided wth** register of members, specimen signature of members and register of proxies. → 3) Scrutinizers shall arrange for **polling papers** and deistrbute them to members and proxies present at the meeting. The polling paper shall be in **Form MGT-12**.

4) The scrutinixers shall keep a **record of poling papers** received in response to poll by initialling it. → 5) Scrutinizers shall **lock and seal empty polling box** in the presene of members and proxies. → 6) Scrutinizers shall **open the polling box** in the presence of 2 persons as witnesses after the voting process is over.

7) The scruitinizers shall **count the votes** cast on poll and prepare a report thereon addressed to the Chairman. → 8) In case of **poll conductd through electronic mode u/s 108**, the company shall provide all necessary support to the scrutinizers to conduct the voting and counting of results thereof. → 9) The **scrutinizers report** shall be in **Form MGT-13** and shall state the total votes cast, valid votes, votes in favour and against the resolution

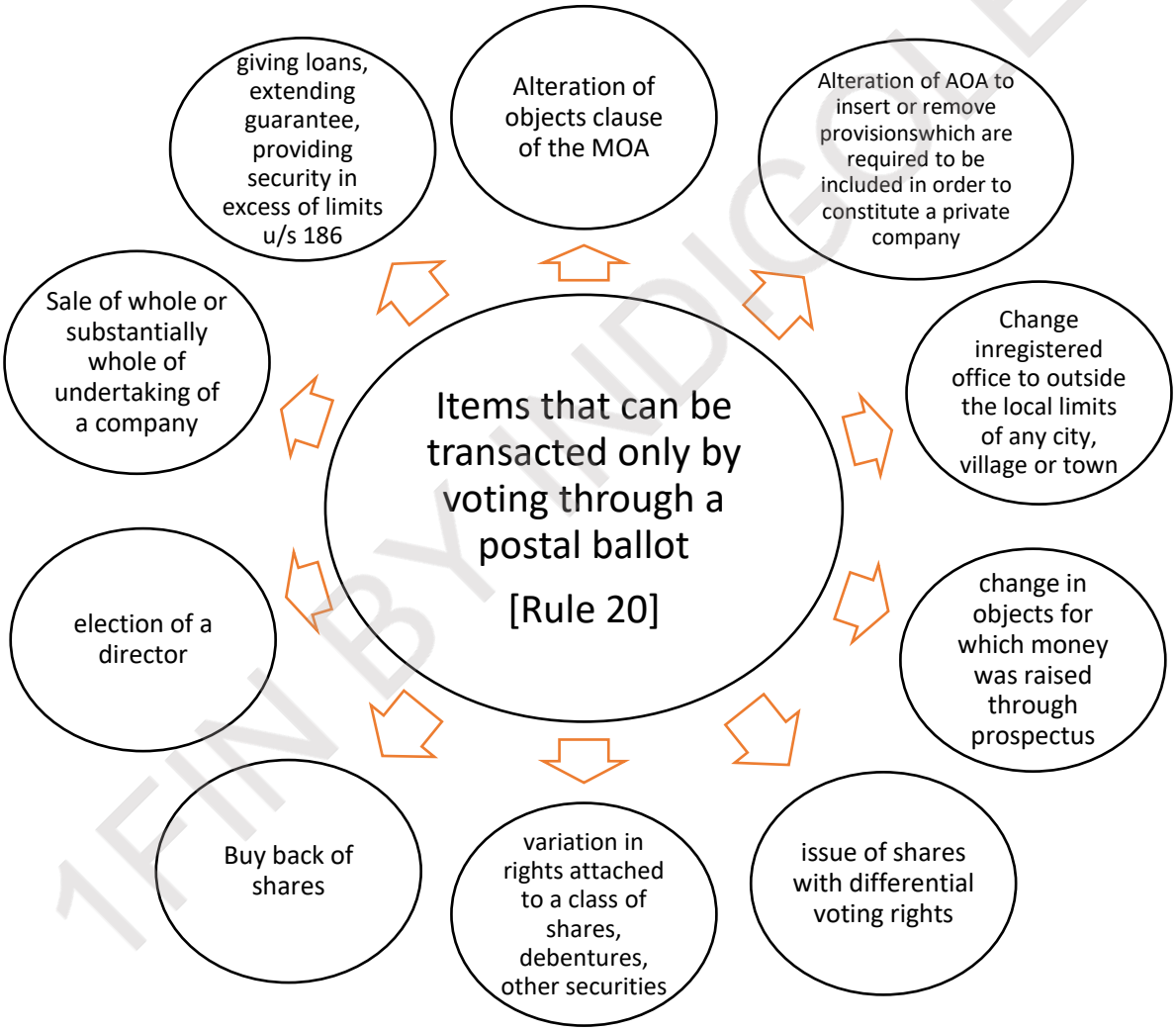
10) The scrutinizers report shall be **submitted to the Chairman within 7 days** from the date the poll is taken and he shall counter sign the same. → 11) The Chairman shall **declare the result** of voting on poll which shall be deemed to be the **decision of the meeting on the resolution**.

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19.1 Items of business that can be transacted by postal ballot

Section 110 of the Companies Act, 2013 r.w. Rule 22 of Companies (Management & Administration) Rules, 2014 covers the provisions relating to passing of resolution by postal ballot

- ✓ Items of business as **CG may declare** that can be transacted only by postal ballot.
- ✓ **Any other item** of business **other than** –
  - **Ordinary business** and
  - Any business **in respect of which directors or auditors have a right to be heard** at the meeting.

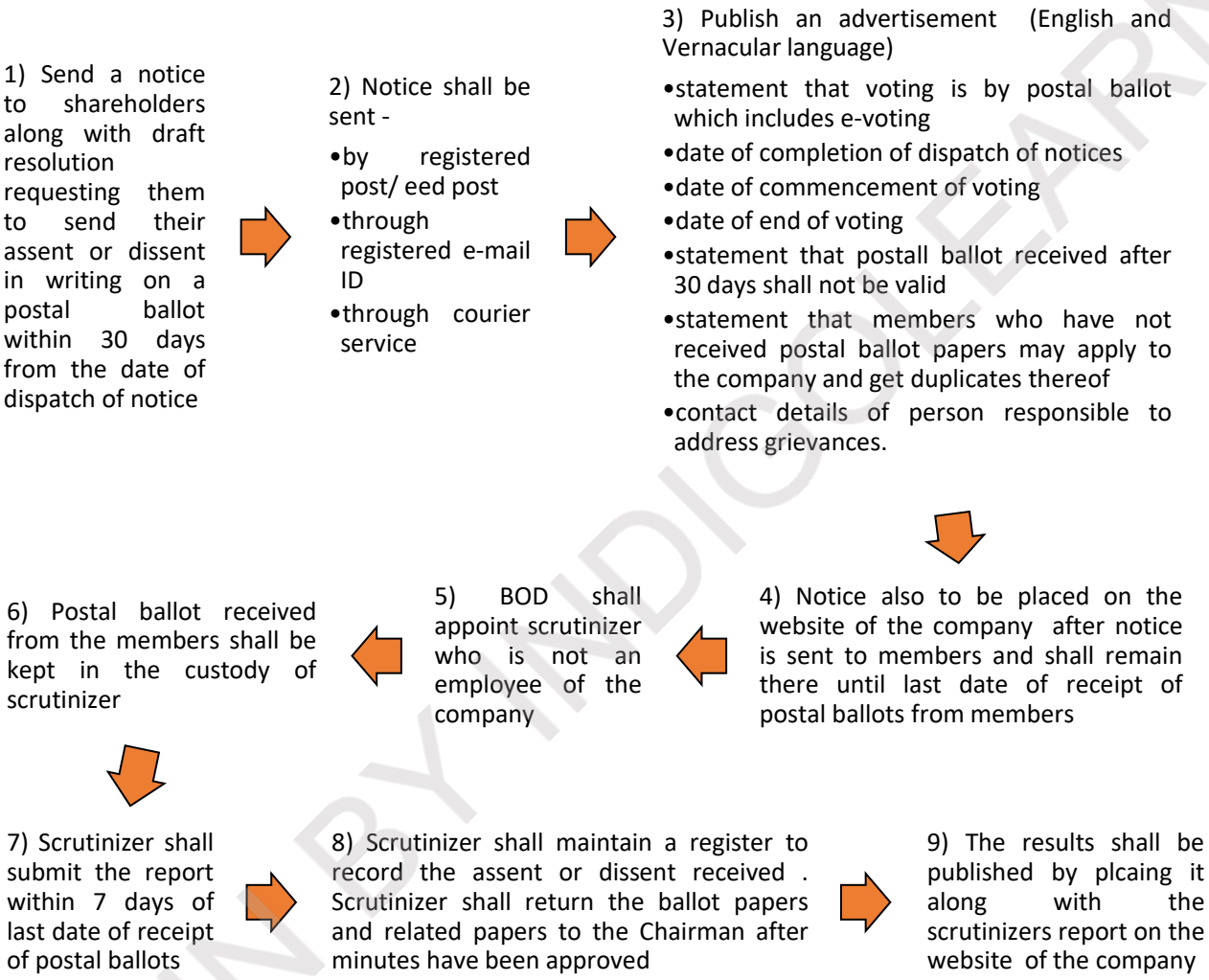


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These items may be transacted at a GM by a company which is required to provide the facility to members to vote by electronic means u/s 108.

OPC and other companies having members up to 200 are not required to transact any business through postal ballot.

19.2 Procedure for conducting postal ballot



19.3 Counting at the time of postal ballot

A member who is voting by way of postal ballot has votes in proportion to his share in the paid-up share capital of the company and he need not use all his votes in the same way. Therefore, 4 types of ballots may be received from the shareholders:

(i) Ballots which contain assents,
(ii) Ballots which contain dissents,
(iii) Ballots wherein the members have voted partially assenting and partially dissenting or not using all his votes in any particular way, and

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(iv) Invalid ballots (due to absence/ mismatch of signature, overwriting, etc)

CIRCULATION OF MEMBERS' RESOLUTION

Section 111 of the Companies Act, 2013 gives the right to propose resolutions for consideration at the general meetings.

20.1 Prerequisites of a valid requisition

- The **number of members required to make a valid requisition** under this section is the same as required to requisition a general meeting **u/s 100**.
- The requisition must be made in **writing**.
- It should be **signed** –
    - *In case of company having share capital* – by such number of members who hold, not less than 1/10th of such paid up share capital of the company having right to vote.
    - *In case of company not having share capital* – by such number of members who have not less than 1/10th of the total voting power of all the members having right to vote.
- **Time for requisition** – the requisition shall be deposited at the registered office of the company
    - *Requisition requiring notice of a resolution* - not less than 6 weeks before the meeting.
    - *Other requisitions* – not less than 2 weeks before the meeting.
- A **reasonable sum must be deposited** to meet the company's expenses in giving effect to proposing the resolution.

20.2 Notice to members

On receipt of a valid requisition u/s 111, the company shall **give a notice to the members of any resolution** to be moved and **circulate to members any statement** with respect to the matters referred to in proposed resolution/ business to be dealt with at the meeting.

The company is not duty bound to circulate the notice when the prerequisites are not complied with.

The **company shall not be bound to circulate any statement** if the **CG**, on an application received either on behalf of the company or of any person who claims to be aggrieved, **declares that the rights conferred are being abused** to secure needless publicity for defamatory matter.

20.3 Punishment for contravention

The company and every officer in default shall be liable to a **penalty of ₹ 25,000/-.**

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REPRESENTATION OF THE PRSEIDENT & GOVERNORS IN THE MEETING OF COMPANIES TO WHICH THEY ARE MEMBER

President of India or the Governor of a State if he is a member of a company, may **appoint his representative at any meeting**.

Section 112 of the Companies Act, 2013 provides for the representation of president & governors in companies in which they are member.

Such Representative shall **have all rights and powers of a member**.

REPRESENTATION OF CORPORATIONS MEETING OF COMPANIES AND CREDITORS

Any **Body Corporates who are members/creditor** of a company **may appoint their representative at any meeting** by resolution of its directors or other governing body. Such Representative shall **have all rights and powers of member**.

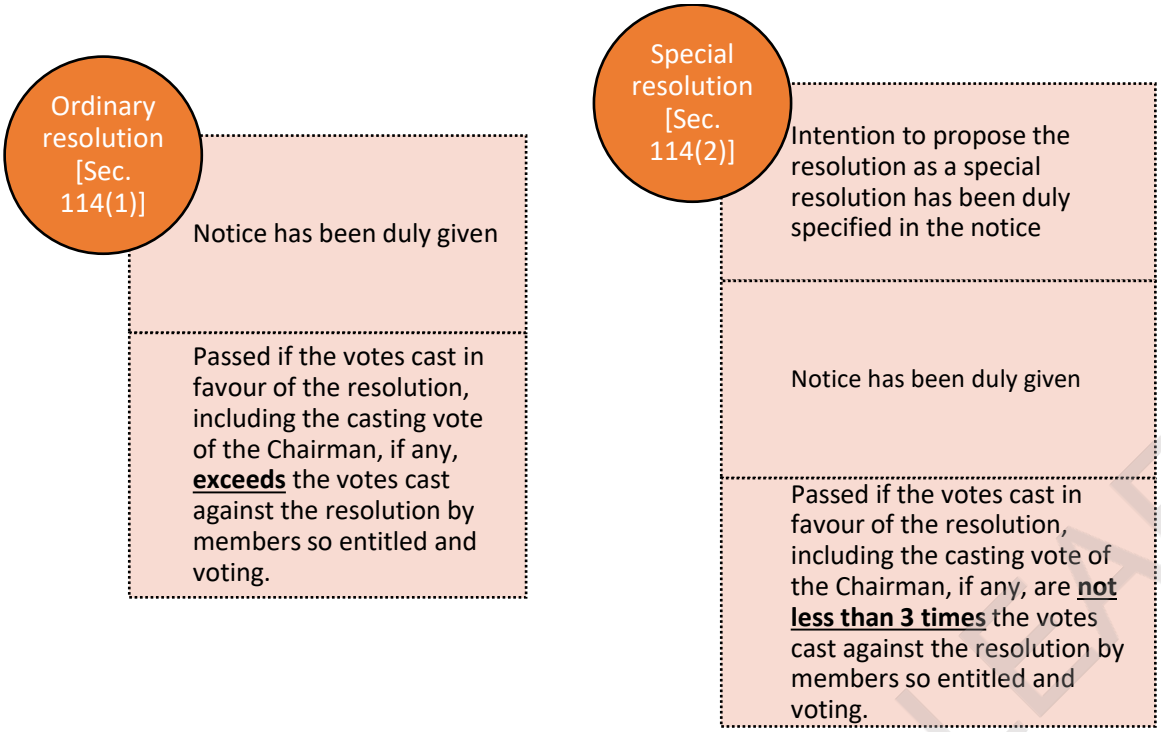
Section 113 of the Companies Act, 2013 provides for the representation of corporations meeting of companies and creditors.

Such representative shall be appointed by resolution of the board of directors or of the governing body of such corporation.

ORDINARY AND SPECIAL RESOLUTIONS

Section 114 of the Companies Act, 2013 defines an Ordinary and Special resolution.

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23.1 Difference between Motion and Resolution.

Motion	Resolution
Oral opinion or recommendation/ proposals of resolution to be passed.	Actual votes in favour and against are cast to adopt a motion.
No need of quorum	Quorum is mandatory
No types	2 types, Ordinary and special resolution
Eg: fixing a date of adjournment of GM	Eg: Appointing Auditor/Director: OR required

23.2 Moving two or more resolutions together

- ✓ Generally, resolutions are **moved separately.**
- ✓ However, there is **nothing illegal if the Chairman of the meeting desires that two or more resolutions can be moved together**, unless any member requires each resolution to be put to vote separately or unless a poll is demanded in respect of any.
- ✓ The only case where resolutions are to be moved separately is with regard to **appointment of directors in a GM**.

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RESOLUTIONS REQUIRING SPECIAL NOTICE

24.1 Situations where special notice is required

Section 115 of the Companies Act, 2013 r.w. Rule 23 of Companies (Management & Administration) Rules, 2014 deals with resolutions requiring special notice.

a) Resolution for **appointment of auditors other than retiring auditor** at an AGM.
b) Resolution at an AGM to provide that a **retiring auditor shall not be re-appointed**.
c) Resolution to **move a director before the expiry of his period** of office.
d) Resolution to **appoint another director in the place of the removed director**.

Further, *the AOA may provide for additional matters* which may require special notice.

24.2 Special notice

1) Special notice to be given to the company shall be **signed**, either individually or collectively by such **number of members**
   → holding **not less than 1% of the total voting power** *or*
   → holding shares on which an **aggregate sum of not less than ₹5,00,000/- has been paid up**.

2) Special notice shall be **sent** by the members to the company
   → **not earlier than 3 months** but
   → **at least 14 clear days before** the date of meeting at which resolution is to be moved

3) The company shall immediately after receipt of notice, **give its members notice of resolution at least 7 days before the meeting**.

4) Where company is **unable to give such notice of special resolution**, it shall **publish the notice in the newspaper** (English & vernacular) at least **7 clear days before the meeting** and also be posted on the website, if any, of the company.

RESOLUTIONS PASSED AT ADJOURNED MEETING

Section 116 of the Companies Act, 2013 provides the provisions relating to resolutions passed at adjourned meeting.

Where a resolution is passed at an adjourned meeting, the resolution shall be **treated as passed on the day it was actually passed** and not on any earlier date.

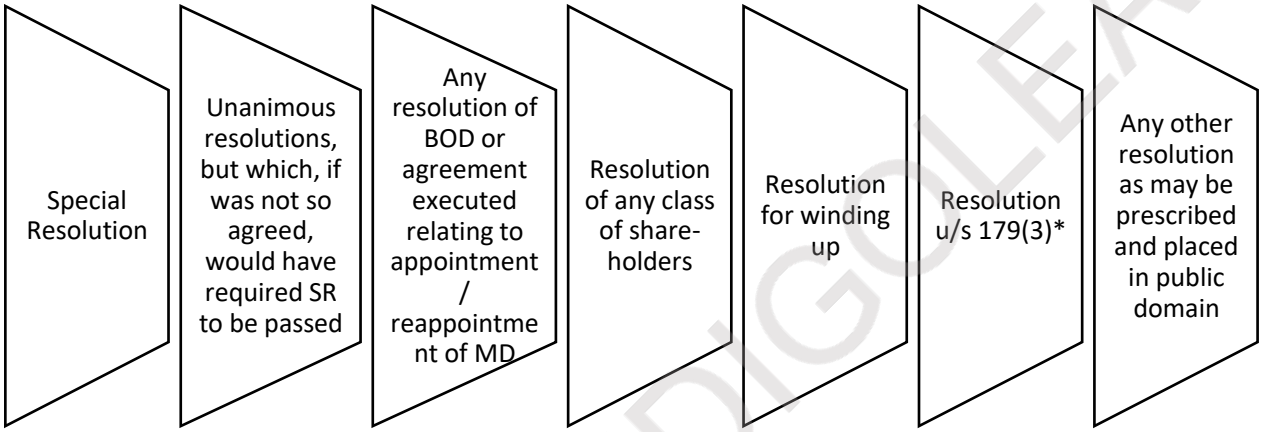
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Section 117 of the Companies Act, 2013 provides the provisions relating to filing of resolutions and agreements.

A copy of every resolution and an agreement in respect of matters specified therein together with an explanatory statement shall be **filed in Form MGT-14** with the ROC **within 30 days of its passing** and the ROC shall register the same.

Any **resolution/agreement that causes alteration of AOA** shall be annexed to every copy of AOA.

26.1 Resolutions and agreements to be filed with the ROC



*Provided no person shall be entitled under section 399 to inspect or obtain copies of such resolutions.

Provided further that nothing shall apply in respect of a resolution passed to grant loans, or give guarantee or provide security in respect of loans under section 179(3)(f) in the ordinary course of its business by ,—

(a) a banking company;

(b) any class of NBFC registered under Chapter IIIB of the Reserve Bank of India Act, 1934, as may be prescribed in consultation with the RBI;

(c) any class of HFC registered under the National Housing Bank Act, 1987, as may be prescribed in consultation with the NHB;

26.2 Penalty for failure to file the resolution and agreement

- Company →
  - Penalty of ₹10,000
  - Continuing failure = further penalty of ₹100 for each day after the first

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during which the failure continues, subject to maximum of ₹2,00,000

- Officer of the company in default (including liquidator of the company)

- Penalty of ₹10,000
- Continuing failure = further penalty of ₹100 for each day after the first during which the failure continues, subject to maximum of ₹50,000

MINUTES

→ Every company shall **prepare, sign, and keep minutes** of every general meeting, Board meeting or of every committee of the Board,

Section 118 of the Companies Act, 2013 provides the provisions relating to preparation and maintenance of minutes of the meeting.

→ **within 30 days** of the conclusion of every such meeting, or passing of resolution by postal ballot
→ in books kept for that purpose with their **pages consecutively numbered**.

27.1 Content of the minutes

- **Fair and correct summary** of proceedings that took place at the concerned meeting.
- All **appointments made** at any of the meetings aforesaid.
- In case of **Board meeting or meeting of committee of Board**:
  - The name of directors' present
  - For each resolution passed, names of directors dissenting from or not concurring with the resolution.
- **Following matters shall not be included**: Any matter, which in the opinion of the Chairman of the meeting –
  - Is or could be defamatory to any person,
  - Is irrelevant or immaterial to the proceedings,
  - Is detrimental to the interests of the company.
- The matters to be included or excluded shall be at the **absolute discretion of the Chairman of the meeting**.

27.2 Penalty for contravention

1) **Default in complying with this section** –
   - ✓ **Company** shall be liable to a penalty of **₹ 25,000/-**
   - ✓ Every **officer in default** shall be liable to a penalty of **₹ 5,000/-.**

2) Any person found guilty of **tampering with minutes** –
   - ✓ Punishable with **imprisonment** for a term which may extend **to 2 years** *and*
   - ✓ **Fine** which shall not be less than **₹ 25,000/-** but which may extend **to ₹ 1,00,000/-.**

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27.3 Procedure for maintenance of minutes [Rule 25]

Distinct Minute book	for each type of meeting
Time limit for entry	within 30 days of conclusion of the meeting
Resolution passed by postal ballot	a brief report of the postal ballot conducted including the resolution proposed shall be entered

- within 30 days from the date of passing of resolution

Initialling or signing	on every page

- last page shall be dated and signed by:
  - Board meeting/ Committee meeting - by the chairman of said meeting/ next succeeding meeting
  - General meeting - chairman of said meeting within 30 days or in the event of death/ inability of said chairman, by a duly authorised director
  - Resolution passed by postal ballot - by the chairman of the BOD within 30 days or in the event of death/ inability of said chairman, by a duly authorised director

Preservation of minutes of GM	shall be kept at the registered office of the company

- preserved permanently
- shall be kept in the custody of CS or any director duly authorised by the BOD

Preservation of minutes of meetings of Board/ committee	shall be preserved permanently

- shall be kept in the custody of CS or any director duly authorised by the BOD
- shall be kept at the registered office or such other place as BOD may decide

This section shall **not apply to Section 8 company** except that minutes may be recorded within 30 days in case of companies where AOA provide for confirmation of minutes by circulation.

INSPECTION OF MINUTE-BOOKS OF GENERAL MEETING

Section 119 of the Companies Act, 2013 provides the provisions relating to inspection of minutes book of general meeting.

28.1 Time for inspection

The minute books of general meeting shall be open for inspection

→ During **business hours**
→ By any **member**, without charge
→ Subject to such reasonable restrictions as specified in the AOA or as imposed in the GM.

At least 2 hours in each business day shall be allowed for inspection.

A **copy of the minutes referred shall be liable to be furnished** to the member, **within 7 days** after the request was made in that behalf to the company, and on payment of such fees as prescribed.

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28.2 Consequence of contravention

- ✓ **Contravention**: refusing right of inspection to a member or non-furnishing of copy of minutes within the time specified.
- ✓ **Penalty to company** – ₹ 25,000/-
- ✓ **Penalty to every officer in default** – ₹ 5,000/- for each such refusal or default.
- ✓ Also, **Tribunal may, by an order direct an immediate inspection** of the minute books or direct that copy required shall forthwith be sent to the person requiring it.

MAINTENANCE AND INSPECTION OF DOCUMENTS IN ELECTRONIC FORM

Section 120 of the Companies Act, 2013 provides the provisions relating to maintenance and inspection of documents, record, register or minute in electronic form.

Provisions prescribed in Rules 27, 28 and 29 of the Companies (Management and Administration) Rules, 2014 are relevant in this respect. Rule 30 states the penalty in case of contravention

Companies which may maintain records in electronic form:

Rule 27 of the Companies (Management and Administration) Rules, 2014 states as under:

1. Every listed company or a company having at least 1000 shareholders, debenture-holders and other security holders, may maintain its records, as required to be maintained under the Act or rules made thereunder, in **electronic form**.
2. The records in electronic form shall be maintained in such manner as the Board of directors may think fit:

Provided that -

(a) the records are maintained in the same formats and in accordance with all other requirements as provided in the Act or the rules made thereunder;

(b) the information as required under the provisions of the Act or the rules made thereunder should be adequately recorded for future reference;

(c) the records must be capable of being readable, retrievable and reproducible in printed form;

(d) the records are capable of being dated and signed digitally whereverit is required under the provisions of the Act or the rules made thereunder;

(e) the records, once dated and signed digitally, shall not be capable of being edited or altered;

(f) the records shall be capable of being updated, according to the provisions of the Act or the rules made thereunder, and the date of updating shall be capable of being recorded on every updating.

Who is responsible for the maintenance and security of electronic records:

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Rule 28 sets out that the Managing Director, Company Secretary or any other director or officer of the company as the Board may decide shall be responsiblefor the maintenance and security of electronic records.

The person who is responsible for the maintenance and security of electronic records shall-

(a) provide adequate protection against unauthorized access, alteration or tampering of records;

(b) ensure against loss of the records as a result of damage to, or failure of the media on which the records are maintained;

(c) ensure that the signatory of electronic records does not repudiate the signed record as not genuine;

(d) ensure that computer systems, software and hardware are adequately secured and validated to ensure their accuracy, reliability and consistent intended performance;

(e) ensure that the computer systems can discern invalid and altered records;

(f) ensure that records are accurate, accessible, and capable of being reproduced for reference later;

(g) ensure that the records are at all times capable of being retrieved to a readable and printable form

(h) ensure that records are kept in a non-rewritable and non-erasable format like pdf. version or some other version which cannot be altered or tampered;

(i) ensure that at least one backup, taken at a periodicity of not exceeding oneday, are kept of the updated records kept in electronic form, every backup is authenticated and dated and such backups shall be securely kept at such places as may be decided by the Board;

(j) limit the access to the records to the managing director, company secretary or any other director or officer or persons performing work of the company as may be authorized by the Board in this behalf;

(k) ensure that any reproduction of non-electronic original records in electronic form is complete, authentic, true and legible when retrieved;

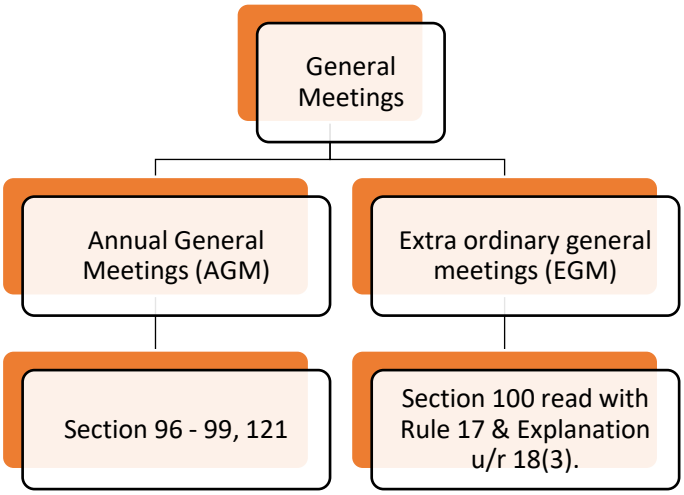
(l) arrange and index the records in a way that permits easy location, access and retrieval of any particular record; and

(m) take necessary steps to ensure security, integrity and confidentiality of records.

Inspection and copies of records maintained in electronic form:

Rule 29 states that the records maintained in electronic form shall be made available for inspection by the company in electronic form. Copies of the records maintained in electronic form, containing a clear reproduction of the whole or part thereof, shall be provided on payment of not exceeding 10 per page.

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30.1 Annual general meeting (AGM)

Section 96 of the Companies Act, 2013 provides the provisions relating to conducting Annual general meeting of a company.

30.1.1 Holding of AGM

→ AGM should be held **once every year**.
→ **First AGM** should be held *within 9 months of incorporation*.
→ **Subsequent AGM** should be held *within 6 months* from the closing of the FY.
→ The **gap between two AGMs** should not exceed **15 months**.

30.1.2 Extension of validity period of AGM

✓ If a company is unable to hold an AGM within the prescribed time, the ROC may, *for special reasons*, **extend the time within which AGM shall be held**.
✓ Such extension **cannot be for a period exceeding 3 months**.
✓ However, ROC **cannot grant extension for holding the first AGM**.

30.1.3 Time and place for holding AGM

✓ **Time** – during **business hours** (i.e., between 9.00 a.m. and 6.00 p.m.)
✓ **Day** – any day that is **not a national holiday**.
✓ **Place** – **registered office** or any other place within the same city, town, or village.
✓ AGM of **unlisted company** may be held at any place if consent is given in writing or by electronic mode by all the members in advance.

30.2 Power of Tribunal to call AGM

Section 97 of the Companies Act, 2013 deals with the power of Tribunal to call AGM in certain circumstances.

→ If the **company defaults in holding the AGM** u/s 96,
→ the Tribunal may, on an **application of any member** of the company,

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→ call, or direct the calling of an AGM and
→ **give** such ancillary or consequential **directions** (including the direction that one member of the company present in person or proxy shall be deemed to constitute a quorum).

30.3 Power of Tribunal to call meetings of members, etc

Section 98 of the Companies Act, 2013 deals with the power of Tribunal to call the meeting of members etc. in certain circumstances.

If it is impracticale to call an **EGM**, the Tribunal may,

→ Either ***suo moto***, *or*
→ On an **application of any director or member** of the company entitled to vote at the meeting,

order a meeting of the company to be called, held and conducted in the manner as Tribunal thinks fit, and **give ancilliary or consequential directions**.

30.4 Punishment for default in complying with Section 96 to 98

Section 99 of the Companies Act, 2013 provides the punishment for contravention of the provisions of sections 96 to 98, i.e., default in holding a meeting as AGM or on directions issued by the Tribunal.

Company and every officer in default shall be punishable with

- **Fine** which may extend to **₹ 1,00,000/-**
- In case of **continuing default**, with **further fine** which may extend to **₹5,000/-** for every day during which the default continues.

30.5 Report on AGM

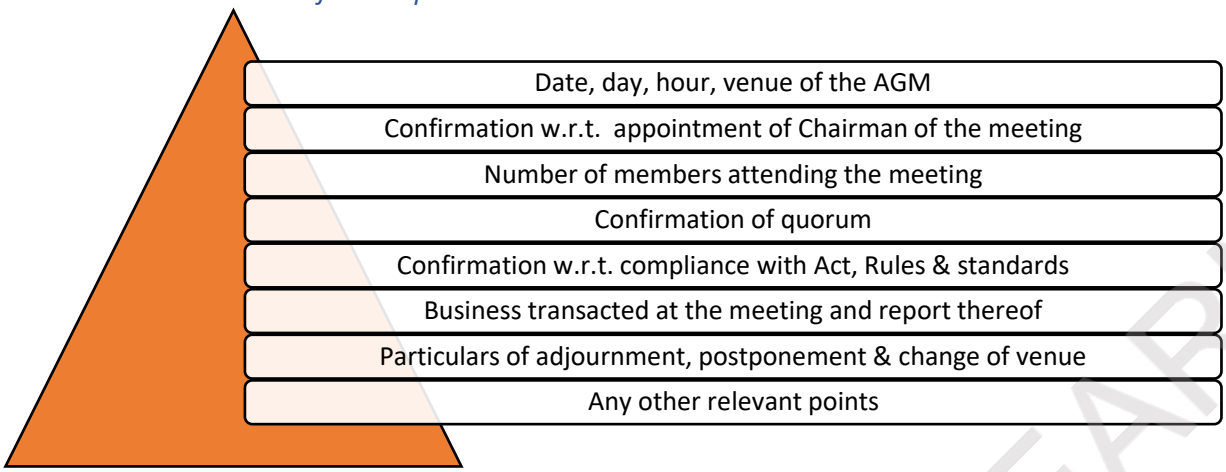
Section 121 of the Companies Act, 2013 r.w. **Rule 31** of the Companies (Management & Administration) Rules, 2014 provides the provisions relating to preparation of report on AGM and penalty for contravention.

→ Every **listed public company** shall prepare a report on each AGM
→ **including the confirmation** to the effect that the meeting was convened held and conducted as per the provisons of the Act and Rules.
→ A copy shall be filed with the ROC in **Form MGT-15** within **30 days** of conclusion of AGM along with prescribed fee.
→ This report shall be **in addition to the minutes of GM.**
→ The report shall be **signed and dated**
  ○ by the Chairman of the meeting or

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- in case of his inability to sign, by any two directors one of whom shall be MD and the CS of the company.

30.5.1 Content of the Report on AGM



30.5.2 Penalty for default

	Company	Officer in default
Penalty	₹ 1,00,000/-	Not less than ₹25,000/-
Continuing failure - further penalty	₹ 500/- for each day after the first during which failure continues	₹ 500/- for each day after the first during which failure continues
Maximum	₹ 5,00,000/-	₹ 1,00,000/-

6 30.6 Extra-ordinary general meetings (EGM)

Section 100 of the Companies Act, 2013 r.w. **Rule 17** of the Companies (Management & Administration) Rules, 2014 provides the provisions relating to extra ordinary general meetings.

30.6.1 Who can call an EGM?

1) **The Board** – the BOD may, whenever it deems fit, call an EGM of the company.

2) The board **on requisition** of –
   a. **In case of company having share capital** – such number of members who hold at least 1/10th of the paid up capital having voting right.
   b. **In case of company not having share capital** – such number of members who hold at least 1/10th of total voting power of all members having voting right.

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Within 21 days of receipt of a valid requisition, the BOD shall **proceed to call a meeting on a day not later than 45 days** from the date of receipt of such requisition.

3) **By requisitionists** –

The BOD does not proceed to call a meeting within 21 days of receipt of a valid requisition on a day not later than 45 days from the date of receipt of requisition → The requisitionists themselves may call and hold the meeting within **3 months** from the date of requistion

30.6.2 Place of holding EGM

a) **Generally** for all companies covered under the Act → any place within India

b) Wholly owned subsidiary of a company incorporated outside India → In/Outside India

APPLICABILTY OF THIS CHAPTER TO ONE PERSON COMPANY

Section 122 of the Companies Act, 2013 deals with the applicability of provisions of this chapter (i.e., Chapter VII) to OPC.

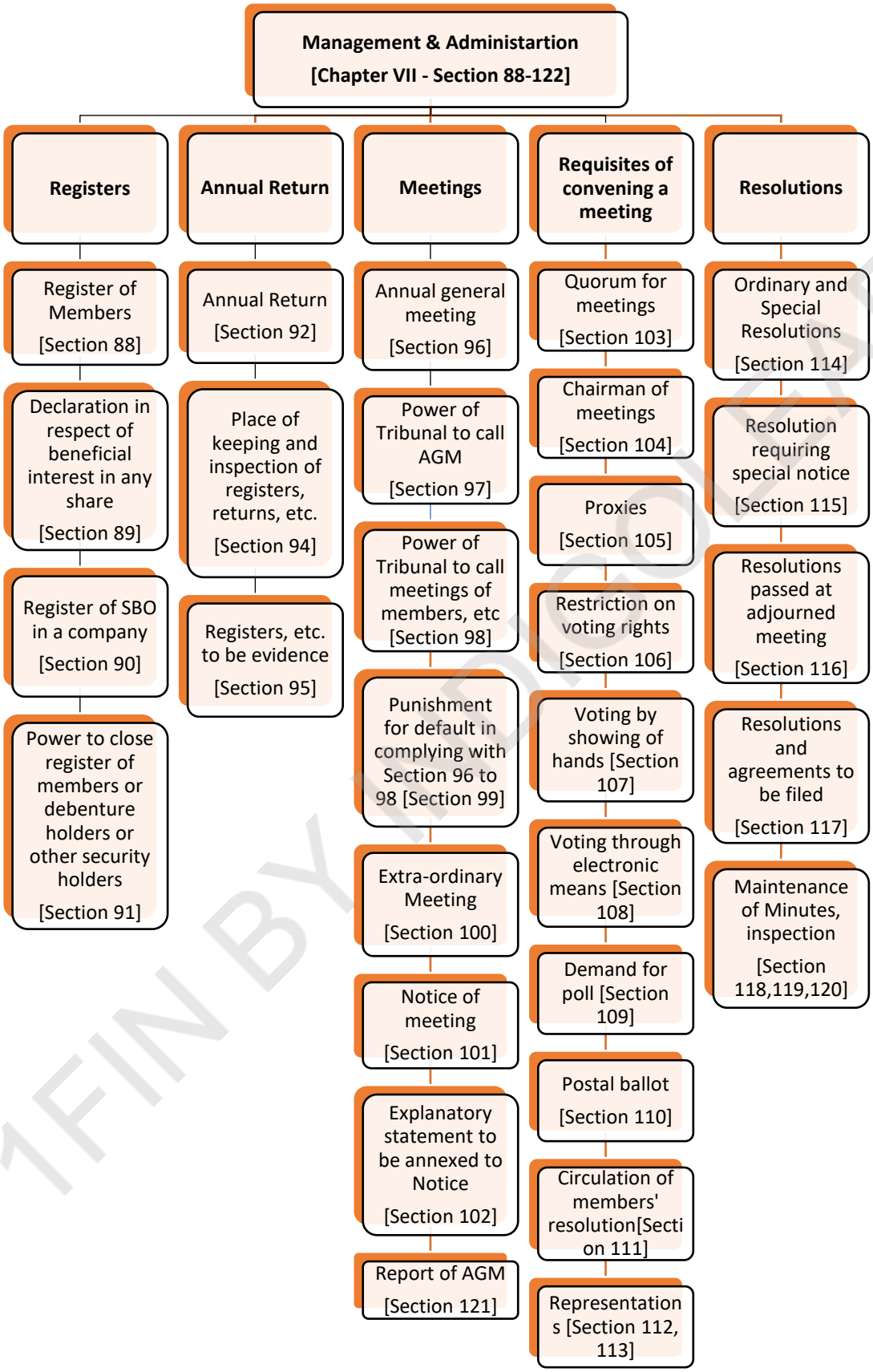
Provisions of section 98 (i.e., power of Tribunal to call EGM)	Not applicable to OPC
Provisions of section 100 to 111 (i.e., relating to EGM, meetings, and voting)	Not applicable to OPC
Business required to be transacted at GM	In case of OPC, it shall be sufficient if the resolution is communicated by the member to the company and entered in the minute book maintained u/s 118 and signed and dated by such member. Such date shall be deemed to be the date of meeting.
Business required to be transacted at Board Meeting	In case of an OPC where there is only one director on the Board, it shall be sufficient if the resolution by such director is entered in the minute book maintained u/s 118 and signed and dated by such director. Such date shall be deemed to be the date of board meeting.

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Penalty

If any default is made in compliance with any of the provisions of this rule, the company and every officer or such other person who is in default shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which such contravention continues. [Rule 30]

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Sec 135 of Companies Act, 2013 lays down provisions requiring corporates to mandatorily spend a prescribed % of their profits on certain specified areas of social upliftment in discharge of their social responsibilities.

9.1 Constitution of CSR Committee [Section 135 (1) r.w. Companies (CSR) Rules, 2014]

Every company having –

(1) **Net worth of ₹ 500 crore or more**, or
(2) **Turnover of ₹ 1000 crore or more**, or
(3) A **net profit of ₹ 5 crore or more**

during the **immediately preceding F.Y.** shall constitute a CSR Committee. *[Sec. 135 (1)]*

1.Net worth as defined in Sec 2(57) will be taken.

2. Net profit shall not include such sums as **may be prescribed***, and shall be calculated as per Sec 198.

Every company **including its holding or subsidiary, and a foreign company#** having its branch office or project office in India, which fulfils the above criteria shall comply with the provisions of Section 135 of the Act.

#Net worth, turnover or net profit of a foreign company shall be computed in accordance with balance sheet and Profit and loss account prepared in accordance with the provisions Sec 381(1)(a) and Sec 198 of Act.

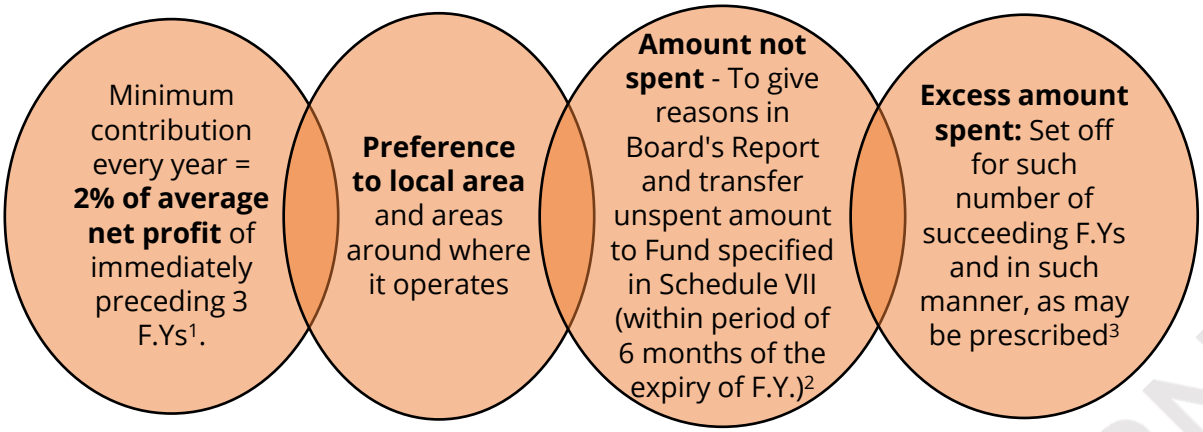
**Net profit means the net profit of company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely: -*

(i) any profit arising from any overseas branch(es) of the company, whether operated as a separate company or otherwise; and
(ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135.

Note: Schedule VII of the Act provides for the list of activities which may be included by Companies in their CSR policies.

9.2 Amount of contribution toward CSR [Sec 135(5)]

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1. Where company has not completed period of 3 F.Y.s since its incorporation, net profits during such immediately preceding financial years shall be considered
2. If unspent amount relates to any ongoing project refer Sec 135(6)
3. To immediate succeeding 3 financial years subject to conditions that –
   (i) excess amount available for set off shall not include surplus arising out of CSR activities,
   (j) Board shall pass a resolution to that effect.

Ongoing Project means a multi-year project undertaken by Company in fulfilment of its CSR obligation having timelines **not exceeding 3 years** excluding financial year in which it was commenced and **shall include** such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification.

9.3 Unspent amount related to ongoing project [Sec 136(6)]

- ✓ **Shall be transferred within a period of thirty days** from end of F.Y. to a **special account**
- ✓ This account is to be opened by company in that behalf for that F.Y. in any scheduled bank to be called **Unspent Corporate Social Responsibility Account**
- ✓ Such **amount shall be spent** by company **within a period of 3 F.Ys** from date of such transfer
- ✓ In case of failure to spend, company shall transfer same to a Fund specified in Schedule VII, within period of 30 days from date of completion of 3rd F.Y.

9.4 Default in compliance of Sec 135(5) and 135(6)

	Penalty
Company	• Twice the amount required to be transferred to Fund specified in Schedule VII or Unspent Corporate Social Responsibility Account, or • ₹1 crore

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	whichever is less
Every officer in default	• One-tenth of the amount required to be transferred to Fund specified in Schedule VII or Unspent Corporate Social Responsibility Account, or • ₹ 2 lakh ***whichever is less***

9.5 Other provisions of Section 135 & Rules

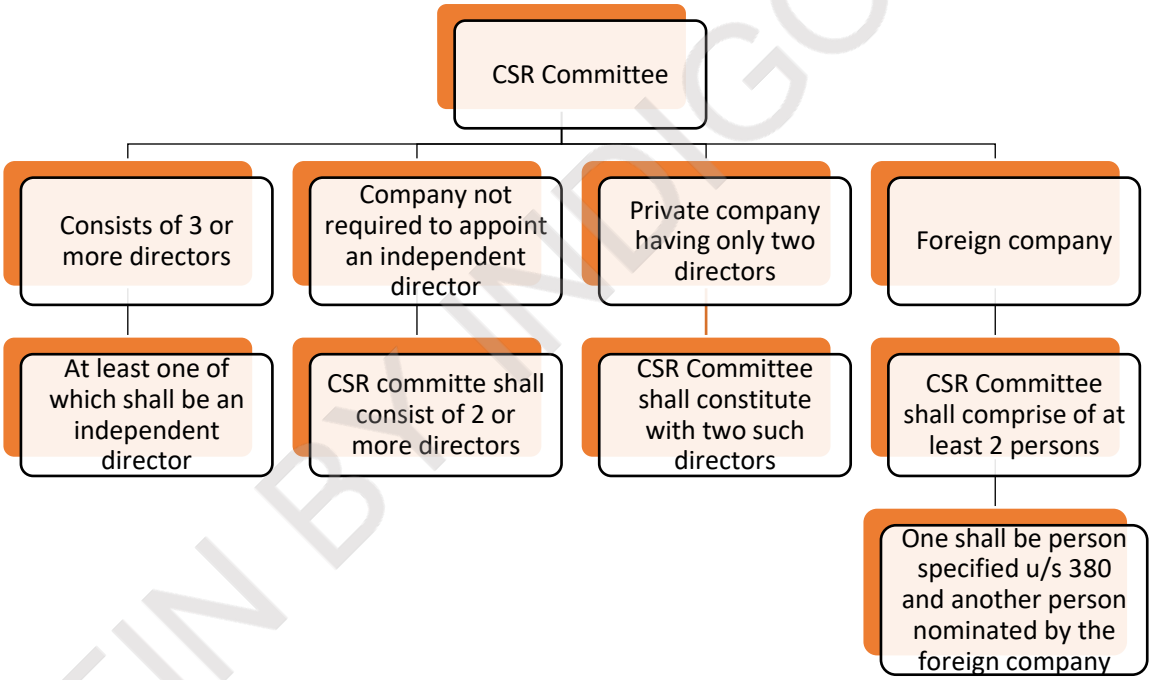
→ CG may give general / special directions to a company or class of companies to ensure compliance of provisions of this section

→ Where amount to be spent on CSR by company does not exceed ₹50L, it is not required to constitute CSR Committee

- Board of Directors of such company shall discharge functions of CSR Committee.

→ A company having any amount in its Unspent Corporate Social Responsibility Account as per section 135(6) shall constitute a CSR Committee and comply with the provisions contained in Sec 135(2) to Sec 135(6)

9.6 Composition of CSR Committee



9.7 Duties of CSR Committee

✓ **Formulate and recommend** to the BOD, a **CSR policy** which shall indicate the activities to be undertaken by the company,
✓ **Recommend the amount of expenditure** to be incurred on the activities, and
✓ **Monitor the CSR policy** of the company from time to time.

9.8 Duties of the Board in relation to CSR

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- ✓ **BOD**, after taking into account recommendations of CSR Committee, **approve CSR Policy** for the company and disclose contents of such Policy in its report and company's website, if any.
    - **Rule 8 –** Board report shall include **annual report on CSR** containing particulars specified in Annexure I or Annexure II
    - **Rule 9 –** BOD shall mandatorily disclose composition of CSR Committee, CSR Policy and Projects approved by it on company website, if any, for public access.
- ✓ **BOD shall ensure** that activities as are included in CSR Policy of the company are undertaken by the company

9.9 Meaning CSR Policy and Annual Action Plan

Rule 2 defines **CSR policy** as a statement containing approach and direction given by Board, after recommendations of its CSR Committee, and includes guiding principles for

- Selection, Implementation and Monitoring of activities as well as formulation of the **annual action plan**.

Rule 5(2): CSR Committee shall formulate and recommend to the Board, an **annual action plan** in pursuance of its CSR policy.

Contents of Annual Action Plan

(a) **list of CSR projects** that are approved to be undertaken in areas or subjects specified in Schedule VII
(b) **manner of execution**
(c) modalities of **utilisation of funds** and **implementation schedules**
(d) **monitoring and reporting mechanism**
(e) details of need and **impact assessment**, if any.

9.10 Impact Assessment – Requirements [Rule 8]

Every company having average CSR obligation of ₹10 crore or more in 3 immediately preceding financial years → Shall undertake impact assessment, through an independent agency → For CSR projects having outlays of ₹1 crore or more, and which have been completed not less than 1 year before undertaking impact study.

→ Impact assessment reports shall be placed before Board and shall be annexed to the annual report on CSR.

→ Impact assessment expenditure may be booked towards CSR, but it shall not exceed 2% of total CSR expenditure for that F.Y. or ₹50 lakh, whichever is higher.

9.11 Meaning of Corporate Social Responsibility (CSR)

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Rule 2 of the Companies (CSR Policy) Rules, 2014 defines **Corporate Social Responsibility (CSR)** which means the **activities undertaken by Company in pursuance of its statutory obligation laid down in section 135** of the Act in accordance with the provisions contained in these rules, but **shall not include the following –**

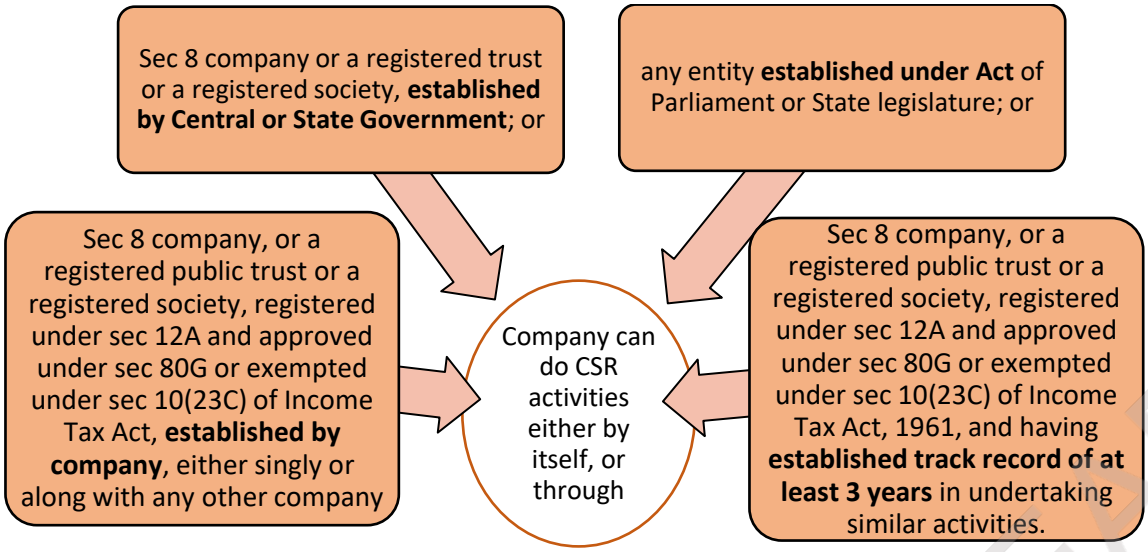
Activities undertaken in **normal course of business** of the company**#**
Activity undertaken by company **outside India** except for training of Indian sports personnel representing any State / UT at national level or India at international level
Contribution of any amount directly or indirectly **to any political party** under section 182
Activities benefitting employees of company as defined in Sec 2(k) of the Code on Wages, 2019
Activities supported by companies on **sponsorship basis** for deriving marketing benefits for its products or services;
Activities carried out for fulfilment of any other **statutory obligations** under any law in force in India

Company engaged in **research and development (R&D)** activity of new vaccine, drugs and medical devices in their normal course of business may undertake R &D activity of new vaccine, drugs and medical devices related to COVID-19 for financial years 2020-21, 2021-22, 2022-23 subject to -

(a) such activities shall be carried out in collaboration with any of the organisations mentioned in item (ix) of Schedule VII to the Act;
(b) details of such activity shall be disclosed separately in the Annual report on CSR included in the Board's Report;

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9.12 CSR Implementation (Rule 4)



→ Every entity, who intends to undertake any CSR activity, shall register itself with Central Government by filing **form CSR-1** with Registrar, with effect from 1st April 2021

- **Form CSR-1** shall be signed and submitted electronically and shall be verified digitally by a CA / CS / Cost Accountant in practice.
- Upon submission, a unique **CSR Registration Number** shall be generated by system automatically.

→ Company may engage **international organisations** for designing, monitoring and evaluation of CSR projects as per its CSR policy as well as for capacity building of their own personnel for CSR.

→ **Company may collaborate with other companies** for undertaking CSR activities in such manner that CSR committees of respective companies can report separately on such projects in accordance with these rules.

9.13 CSR Expenditure [Rule 7]

Administrative overheads	• Shall not exceed 5% of total CSR expenditure for F.Y.
Surplus arising out of CSR activities	• Shall not form part of business profit of • Shall be - Ploughed back into same project or - Transferred to Unspent CSR Account - Transferred to Fund specified in Schedule VII within 6 months of expiry of F.Y.
Capital Asset for CSR	• CSR amount may be spent for creation/ acquisition of a capital asset • Capital asset to be held by – (a) Sec 8 company or a Registered Public Trust or Registered Society; or

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	(b) beneficiaries, in the form of self-help groups, collectives, entities; or (c) public authority

9.14 Activities specified under Schedule VII

Eradicating hunger, poverty and malnutrition, promoting health care and sanitation including contribution to Swach Bharat Kosh
Promoting education, including special education and emplyoment enhancing vocation skills and livelihood enhancement projects
Promoting gender equality, empowering women, setting up homes and hostels for women and orphans, setting up old age homes, day care centres and other facilities for senior citizens and measures for reducing inequalities faced by backward groups
Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources, and maintaining quality of soil, air and water including contribution to Clean Ganga Fund
Protection of national heritage, art & culture including restoration of buildings & sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts
Measures for the benefit of armed forces veterans, war widows and their dependents, Central Armed Police Forces and Central Para Military Forces veterans, and their dependents
Training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports
Contribution to Prime Minister's National Relief fund, PM CARES Fund, any other fund set up by the CG for socio economic development and relief and welfare of SC/ST/OBC, minorities and women.
Contributions to incubators or research development projects funded by CG, SG, or any agency or PSU of CG/SG and contributions to public funded Universities, IITs, National Laboratories & autonomus bodies under DAE; DBT; DST; DoP; AYUSH; MeitY and other research bodies
Rural development projects
Slum area development
Disiater management including relief, rehabilitation, and reconstruction activities

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14.

MCA has made a clarification via circulars that following shall be eligible CSR activity -

1. Spending of CSR funds for carrying out **awareness campaigns/ programmes or public outreach campaigns on COVID-19 Vaccination programme** relating to promotion of health care, including preventive health care and sanitization, promoting education, and, disaster management.
2. **Setting up makeshift hospitals and temporary COVID Care facilities** relating to promotion of health care, including preventive health care, and, disaster management.
3. Spending of CSR funds for '**creating health infrastructure for COVID care'**, '**establishment of medical oxygen generation and storage plants**', '**manufacturing and supply of Oxygen concentrators, ventilators, cylinders and other medical equipment for countering COVID-19**' or similar such activities are eligible CSR activities relating to promotion of health care, including preventive health care, and, disaster management.
4. Reference is also drawn to item no. (ix) of Schedule VII which permits **contribution to specified research and development projects** as well as **contribution to public funded universities and certain Organisations** engaged in conducting research in science, technology, engineering, and medicine as eligible CSR activities
5. Companies including Government companies may undertake activities or projects or programmes using CSR funds, directly by themselves or in collaboration as shared responsibility with other companies, subject to fulfillment of Companies (CSR Policy) Rules, 2014 and the guidelines issued by Ministry from time to time
6. Spending of CSR funds of COVID- 19 **vaccination for persons other than the employees and their families,** is an eligible CSR activity relating to promotion of health care including preventive health care and disaster management.
7. Spending of CSR funds for activities related to **Har Ghar Tiranga campaign**, such as mass scale production and supply of the National Flag, outreach and amplification efforts and other related activities, are eligible CSR activities pertaining to promotion of education relating to culture.

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AUDIT AND AUDITORS

Learning Outcomes – F

- Understand the procedure for appointment of auditors, their removal, resignation, eligibility, qualifications, disqualifications, and remuneration.
- Know the powers and duties of auditors.
- Know about auditing services and certain services which an auditor cannot render.

INTRODUCTION

Large business corporations are managed by the directors who represent the members who are the real owners of the company through BOD. In the absence of any check the directors may mismanage the finances of the organisation. Thus members appoint auditors to look into the true and fair view of the financial affairs of the company.

The provisions relating to audit and auditors of companies have been dealt with under **Chapter X** of the Companies Act, 2013 [**Section 139 to 148**] and the **Companies (Audit and Auditors) Rules, 2014.**

APPOINTMENT OF AUDITOR

Section 139 of the Companies Act, 2013 provides provisions for appointment of auditors.

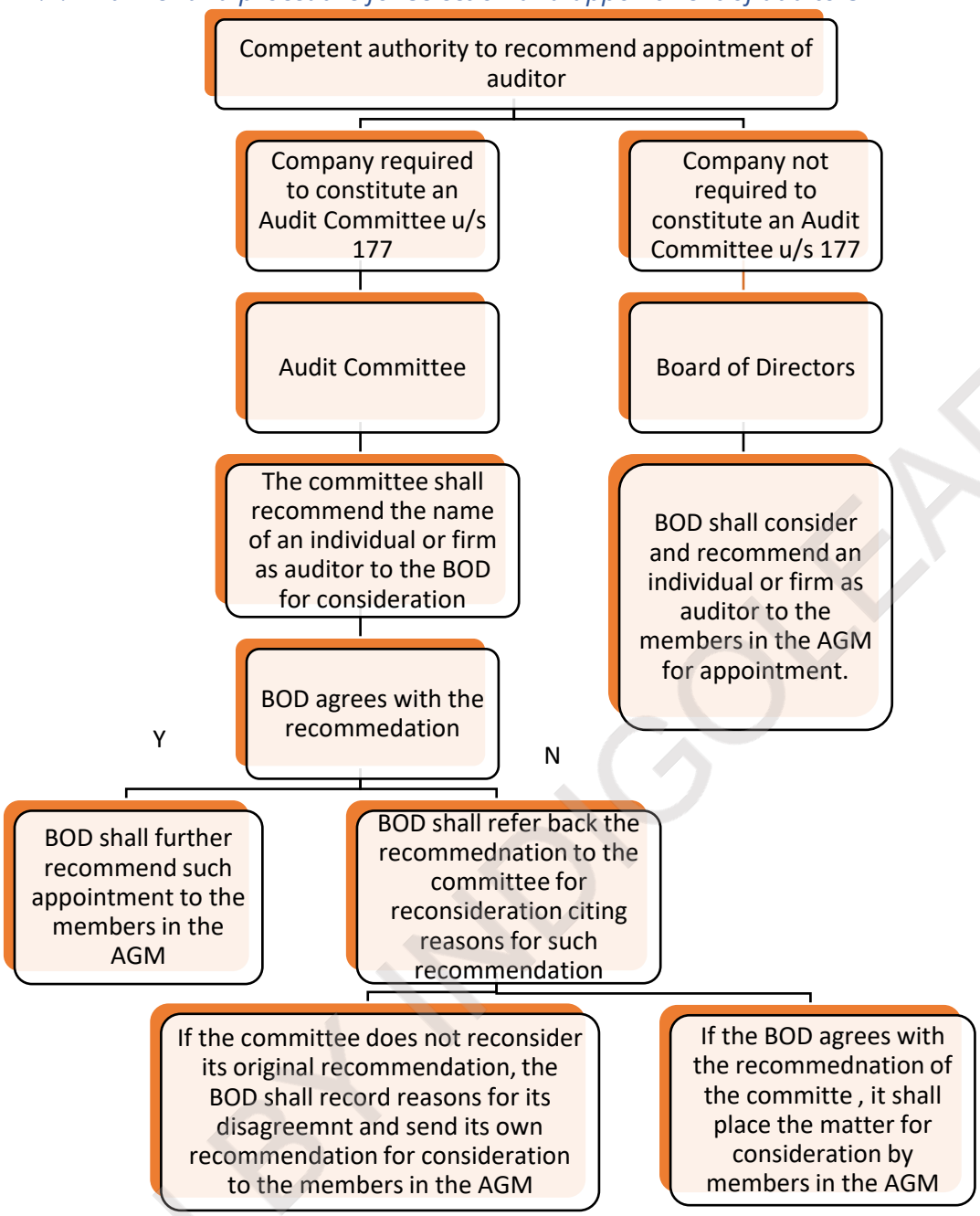
2.1 Appointment of auditor [Sec. 139 (1)]

→ Every company shall **appoint an individual or firm** as an auditor of the company **at the first AGM**.

→ **Tenure**: The auditor shall hold office from the conclusion of 1st AGM till the conclusion of its 6th AGM and thereafter till the conclusion of every 6th AGM.

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2.1.1 Manner and procedure for selection and appointment of auditors



2.1.2 Conditions for appointment and notice to the ROC [Rule 4]

Before the appointment of the auditor, the following shall be obtained:

- ✓ **written consent** of the auditor, and
- ✓ a **certificate** stating that –
  - a) the individual or the firm is **eligible for appointment and is not disqualified** for appointment,
  - b) **The proposed appointment is as per the term** provided under the Act,
  - c) The **proposed appointment is within the limits** laid down by or under the authority of the Act,

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d) The **list of proceedings against the auditor or audit firm or any partner of the audit firm pending** with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

The certificate shall also indicate whether the auditor satisfies the criteria provided in Section 141 of the Act.

The company shall **inform the concerned auditor of his or its appointment** and also **file a notice** (in the form ADT-1) **of such appointment with the ROC within 15 days** of the meeting in which the auditor is appointed.

2.2 Term of Auditor [Sec. 139 (2)]

As on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the F.Y., shall be appointed as auditor of the same company for a period of 5 years.

Note: According to **Rule 3 (3) of the NFRA Rules**, every body corporate, other than a company as defined in section 2(20) of the Act, formed in India, and governed under the NFRA Rules shall, *within 15 days of appointment of an auditor u/s 139 (1), inform the NFRA in Form NFRA-1*, the particulars of the auditor appointed by such body corporate.

Following companies shall not appoint or re-appoint	
an individual as auditor for more than one term of 5 consecutive years, and	an audit firm as auditor for more than two terms of 5 consecutive years.

Section 139 (2) and Rule 5 - Classes of companies (except OPC and small companies)			
Listed companies	all unlisted public companies having paid-up share capital of Rs. 10 crores or more	all private companies having paid up share capital of Rs. 50 crores or more	all companies having paid up share capital of below above threshold limit, but having public borrowings from financial institutions, banks or public deposits of Rs. 50 crores or more.

Cooling period	
An individual auditor who has completed his term shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of his term	An audit firm which has completed his term shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such term

2.3 Rotation of auditor [Sec. 139 (3) and (4)]

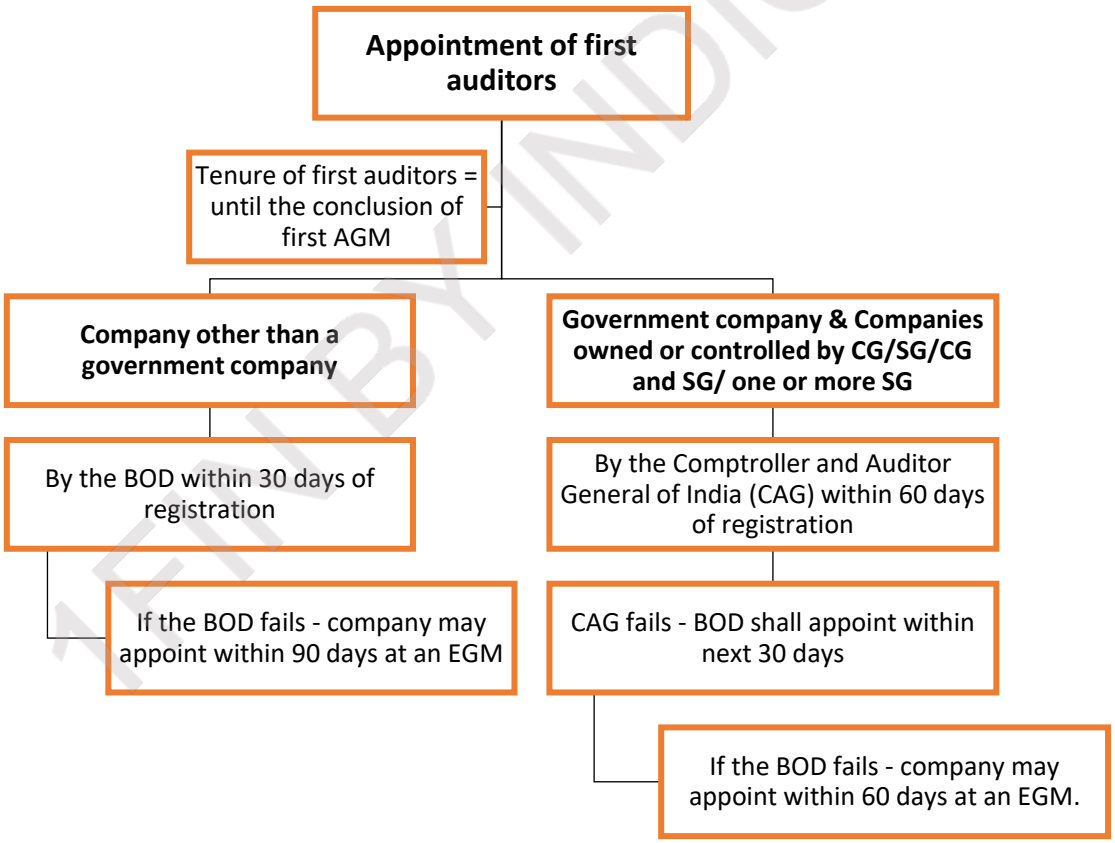
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1) Members of a company may resolve to provide that –
    a. In the audit firm appointed by them, the auditing partner and his team shall be rotated at such intervals as may be resolved by members, or
    b. The audit shall be conducted by more than one auditor.

2) For the purpose of rotation,
    a. The **period for which an individual or firm held the office as auditor before the commencement of the Act** shall be considered for calculating the period of 5/10 consecutive years as the case may be.
    b. The incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the **same network of audit firms**.
    c. A **cool off period of 5 consecutive years** shall be considered as fulfilling the requirement of rotation.
    d. If a partner, who is in charge of an audit firm and also certifies the FS of the company, retires from the said firm, and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for 5 years.

3) **Company which has appointed joint auditors** – the company may follow the rotation of auditors in such a manner that both or all of the joint auditors do not complete their term in the same year.

2.4 First auditors [Sec. 139 (6), (7)]

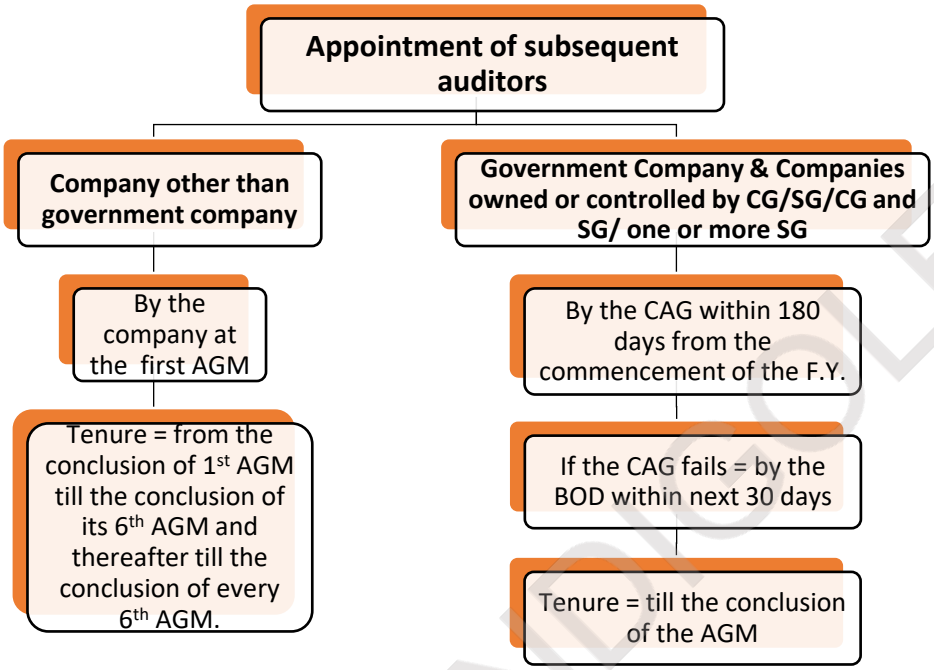


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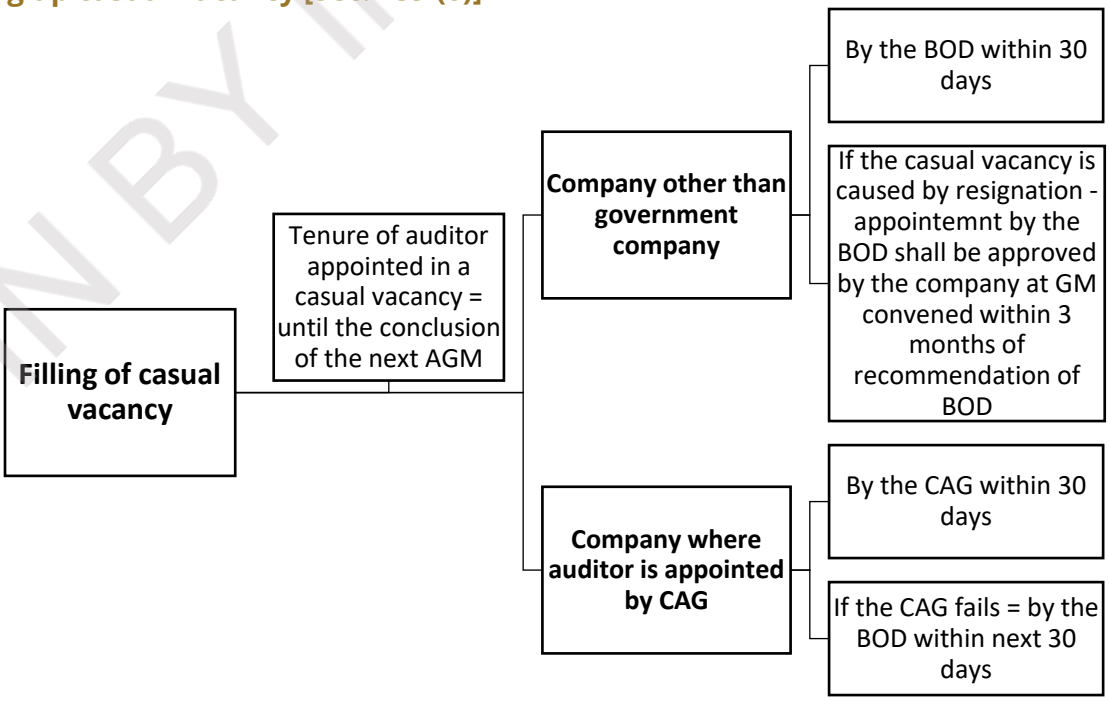
Government company [Sec. 2 (45)] – a company in which not less than 51% of the paid up share capital is held by the CG/any SG/partly by the CG and partly by one or more SG and includes a company which is a subsidiary company of such a government company.

The first auditor shall hold office until the conclusion of the first AGM.

2.5 Subsequent auditors [Sec. 139 (1), (5)]



2.6 Filling up casual vacancy [Sec. 139 (8)]



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2.7 Re-appointment of retiring auditor [Sec. 139 (9), (10), (11)]

A retiring auditor shall be re-appointed at an AGM if-

a) He is **not disqualified** for re-appointment,
b) He has **not given a notice in writing to the company** of his unwillingness to be re-appointed, and
c) A **SR has not been passed at that meeting appointing some othe**r auditor or providing expressly that he shall not be re-appointed.

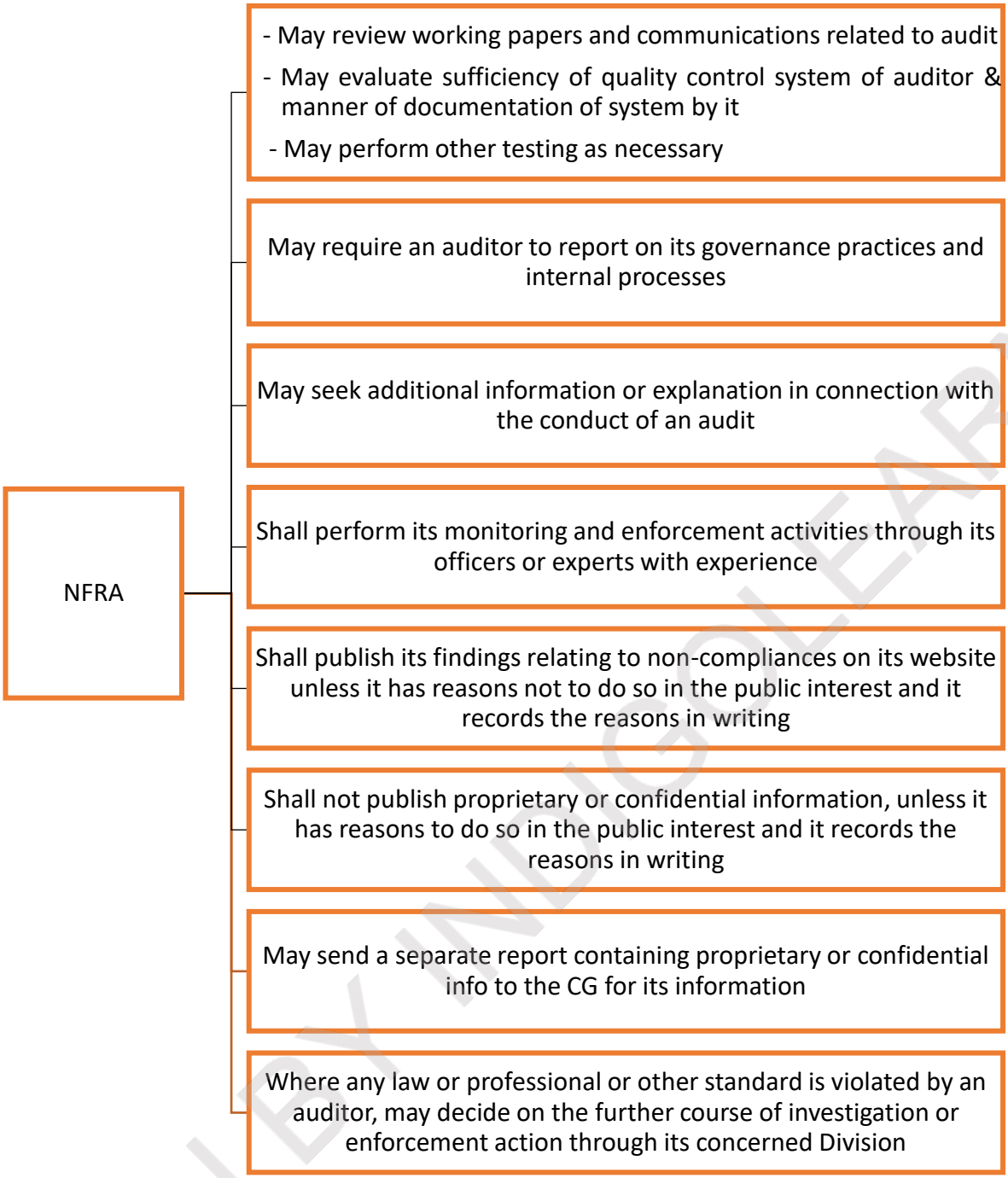
Where at any AGM, no auditor is appointed or re-appointed, the existing director shall continue to be the auditor of the company.

NATIONAL FINANCIAL REPORTING AUTHORITY RULES, 2018

NFRA Rule 8 and Rule 9 are relevant for understanding of the students and included in CA Intermediate Syllabus.

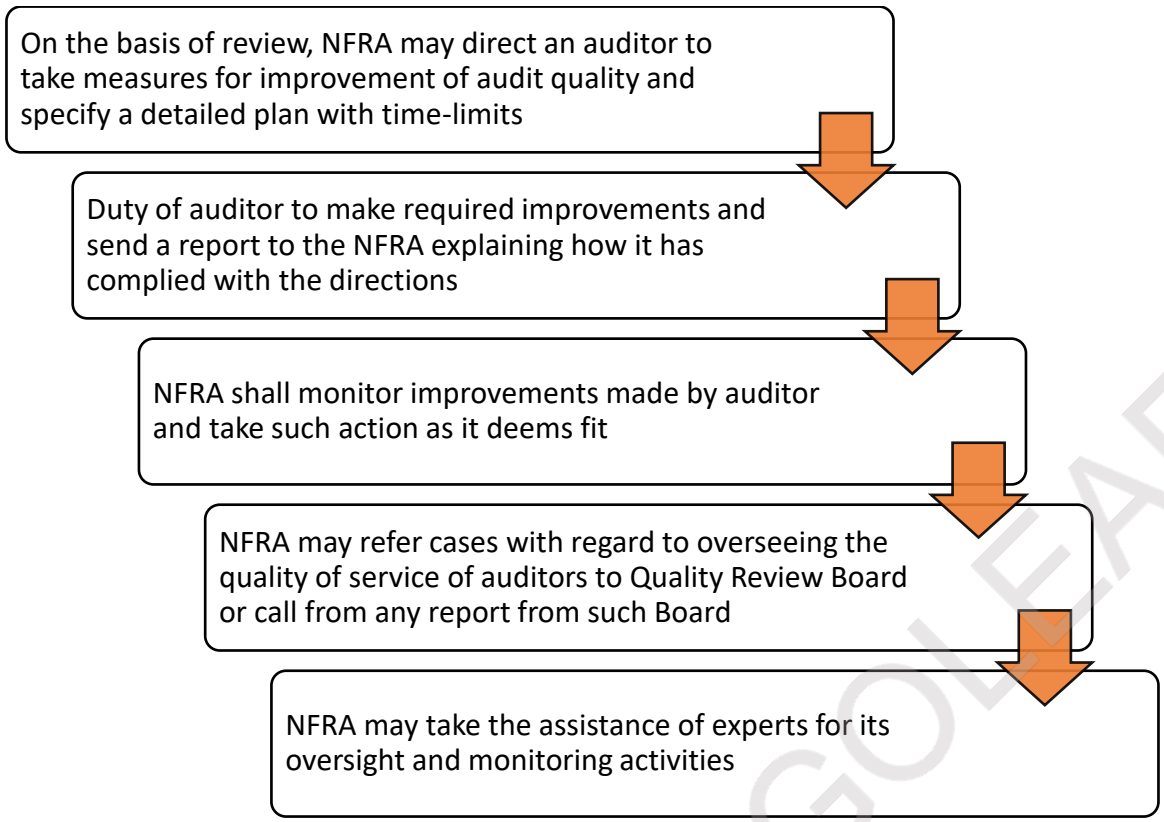
7 3.1 Monitoring and enforcing compliance with auditing standards (Rule 8)

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8 3.2 Overseeing the quality of service and suggesting measures for improvement (Rule 9)



FILLING OF RETURN WITH NFRA

Rule 5 requires every auditor of classes of companies and bodies corporate governed by the NFRA, shall file a return with the Authority i.e. NFRA on or before 30th November every year in Form NFRA-2.

REMOVAL, RESIGNATION OF AUDITOR AND GIVING OF SPECIAL NOTICE

9 4.1 Removal of auditor before the expiry of his term [Section 140 (1)]

- ✓ The auditor may be removed from his office before the expiry of his term only by –

Section 140 of the Companies Act, 2013 provides for removal, resignation of auditor and giving of special notice.

a) A **special resolution** of the company and
b) After obtaining the **previous approval of the CG** by making an *application in* ***Form ADT-2 within 30 days*** of the resolution passed by the BOD.

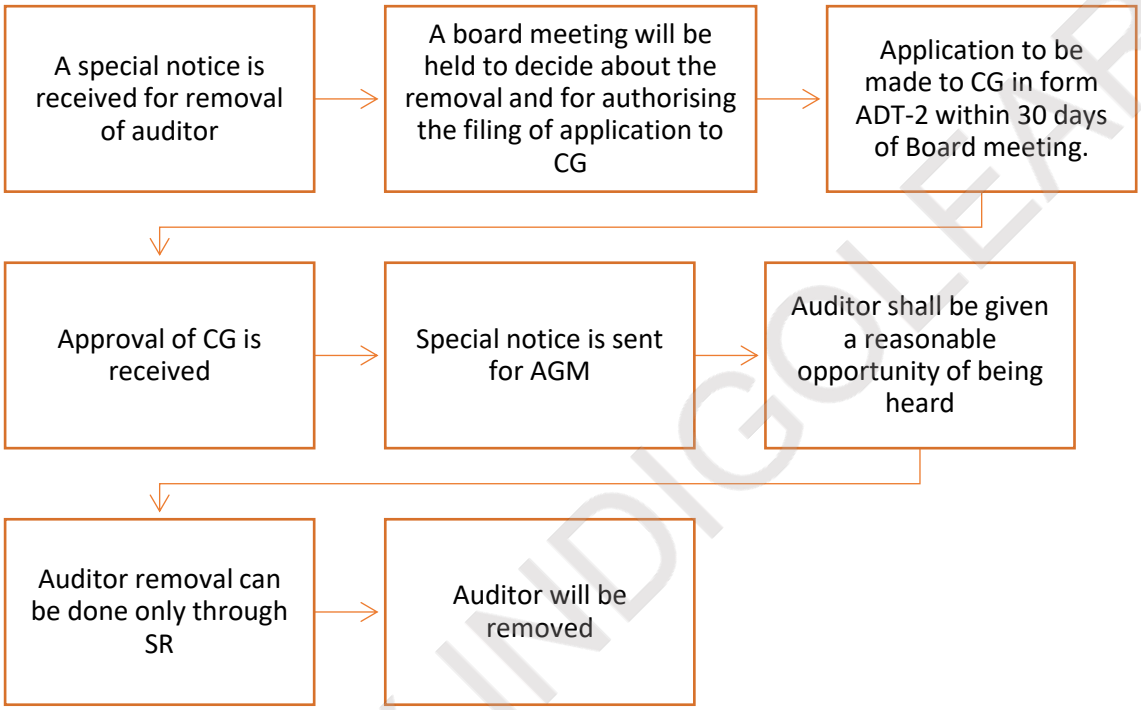
- ✓ **Within 60 days of receipt of appoval of the CG**, the company shall hold the GM for passing the SR.
- ✓ Before taking any action for the removal of auditor before the expiry of his term, the auditor concerned shall be given an **opportunity of being heard**.

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Note:

In case of a Specified IFSC public company5 and Specified IFSC private company , where, within a period of sixty days from the date of submission of the application to the Central Government under this sub-section, no decision is communicated by the Central Government to the company, it would be deemed that the Central Government has approved the application and the company shall appoint new auditor at a general meeting convened within three months from the date of expiry of sixty days period

Steps for removal of auditor



10 4.2 Resignation by auditor [Section 140 (2) & (3)]

If the auditor has resigned from the company, he shall **file a statement in Form ADT-3** with the **company and the ROC** (also with CAG in case of government companies or companies controlled by CG/SG), indicating the reasons and other facts about his resignation, **within 30 days** of resignation.

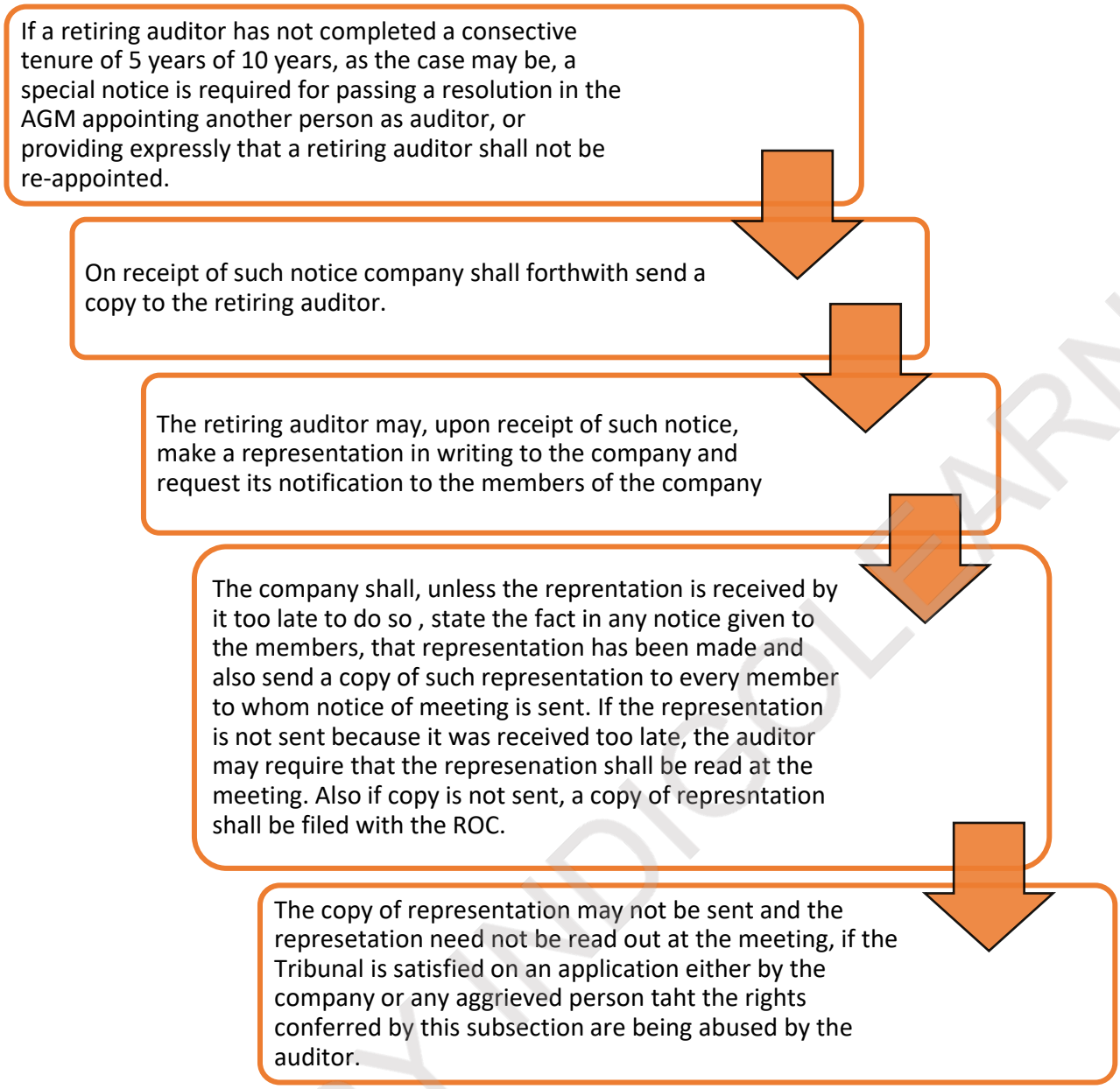
If the **auditor does not comply with these provisions**, he shall be punishable with **penalty of**

→ ₹ 50,000/-, or
→ An amount equal to the remuneration of the auditor,
whichever is less.

→ In case of **continuing failure**, the auditor shall be punishable with a further penalty of ₹ 500/- for each day during which the failure continues, subject to a maximum of ₹2,00,000.

4.3 Appointing auditor other than retiring auditor [Section 140 (4)]

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4.4 Auditor acts in a fraudulent manner or abetted or colluded in any fraud [Section 140 (5)]

The **Tribunal** either –

- Suo moto or
- On an application made to it by –
    - The CG or
    - Any other person,

if it is satisfied that the auditor has, directly or indirectly, acted in a fraudulent manner, or abetted or colluded in any fraud by/ in relation to, the company or its directors or employees, it **may by an order direct the company to change its auditors.**

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In case of an **application made by the CG**, the **order shall be made within 15 days** of receipt of such application, that the auditors shall not function as auditor and the CG may appoint any other person in his place.

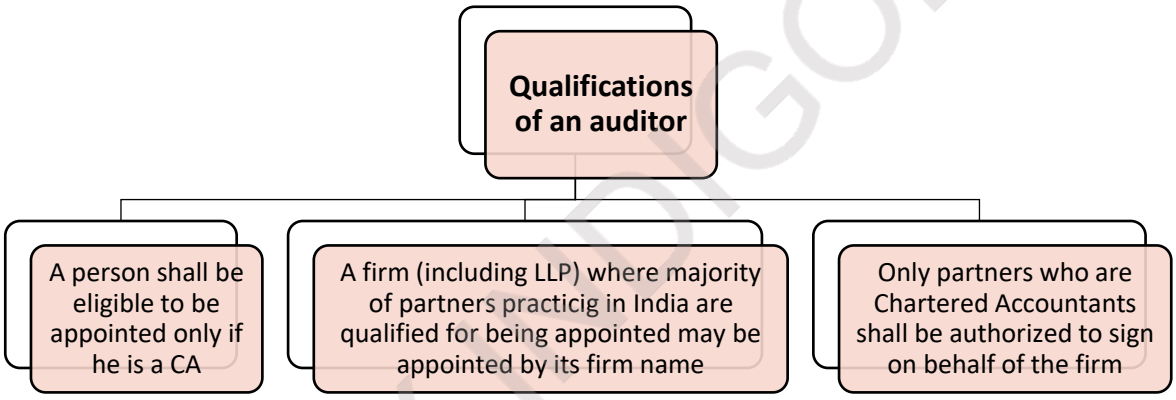
Such an auditor, whether individual or firm, against whom an order has been passed

→ shall **not be eligible to be appointed** as auditor of any company **for 5 years** from the date of passing the order, **and**
→ shall also be liable for **action u/s 447**.

ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITORS

5.1 Qualifications of an Auditor [Section 141 (1) & (2)]

Section 141 of the Companies Act, 2013 provides eligibility, qualifications, and disqualifications of auditors.



5.2 Disqualifications of an Auditor [Section 141 (3)]

The following persons shall **not be qualified for appointment as auditor** of a company-

a) A **body corporate other than LLP** registered under the LLP Act, 2008,

b) An **officer or employee of the company**,

c) A person who is **partner, or who is in employment, of an officer or employee of the company**,

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d) A **person** who, or his **relative** or **partner** –

i. Is **holding any security of or interest** in the company or its subsidiary, or its holding or associate company or subsidiary of such holding company, or

ii. Is **indebted** to the company, or its holding or associate company or subsidiary of such holding company, **in excess of ₹5,00,000**, or

iii. Has **given guarantee or given any security** in connection with the indebtedness of any third person to the company, or its holding or associate company or subsidiary of such holding company, **in excess of ₹ 1,00,000**.

Relative may hold security or interest in the company of face value not exceeding ₹1,00,000. If relative acquires such security or interest above the limit prescribed, the auditor shall take corrective actions to maintain the limits within 60 days.

e) A person or a firm who, directly or indirectly, has **business relationship** with the company, or its holding or associate company or subsidiary of such holding company or associate company.

Business relationship = any transaction entered into for a commercial purpose except transactions which are:

a) In nature of professional services permitted to be rendered by an auditor or audit firm.
b) In the ordinary course of business of the company at arm's length price.

f) A person whose **relative is a director or is in employment** of the company as a director or KMP,

g) A person who is in **full time employment elsewhere or** a person or partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment **holding appointment as auditor of more than 20 companies** other than:

- OPC,
- Small companies and
- Private companies having paid up share capital less than ₹100 crores.

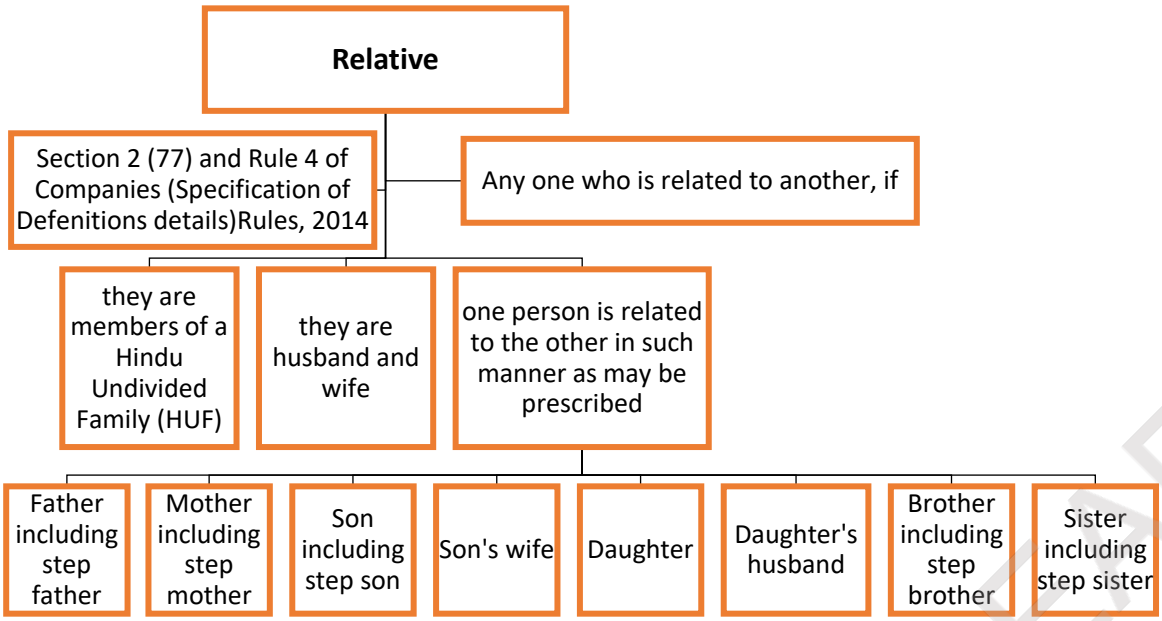
h) A person who has been **convicted by a court of an offence involving fraud** and a period of **10 years has not elapsed** from the date of such conviction,

Before appointment of the auditor, company shall obtain a certificate from him stating that the appointment will not result in an excess holding by the auditor concerned over the limit laid down u/s 141(3)(g).

i) A person who directly or indirectly, **renders any service referred to in section 144** to the company or its holding or its subsidiary company.

5.3 Relative [Section 2 (77)]

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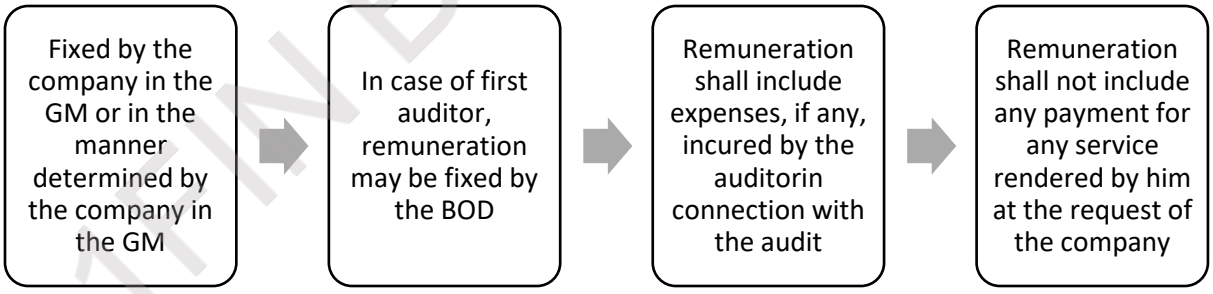


5.4 Vacation of office by an Auditor [Section 141 (4)]

If a person appointed as auditor of a company **incurs any of the disqualifications specified in section 141 (3)**, he shall be **deemed to have vacated his office**. Such vacation shall be **deemed to be a casual vacancy** in the office of the auditor.

REMUNERATION OF AUDITORS

Section 142 of the Companies Act, 2013 provides for remuneration of auditors.



POWERS AND DUTIES OF AUDITORS AND AUDITING STANDARDS

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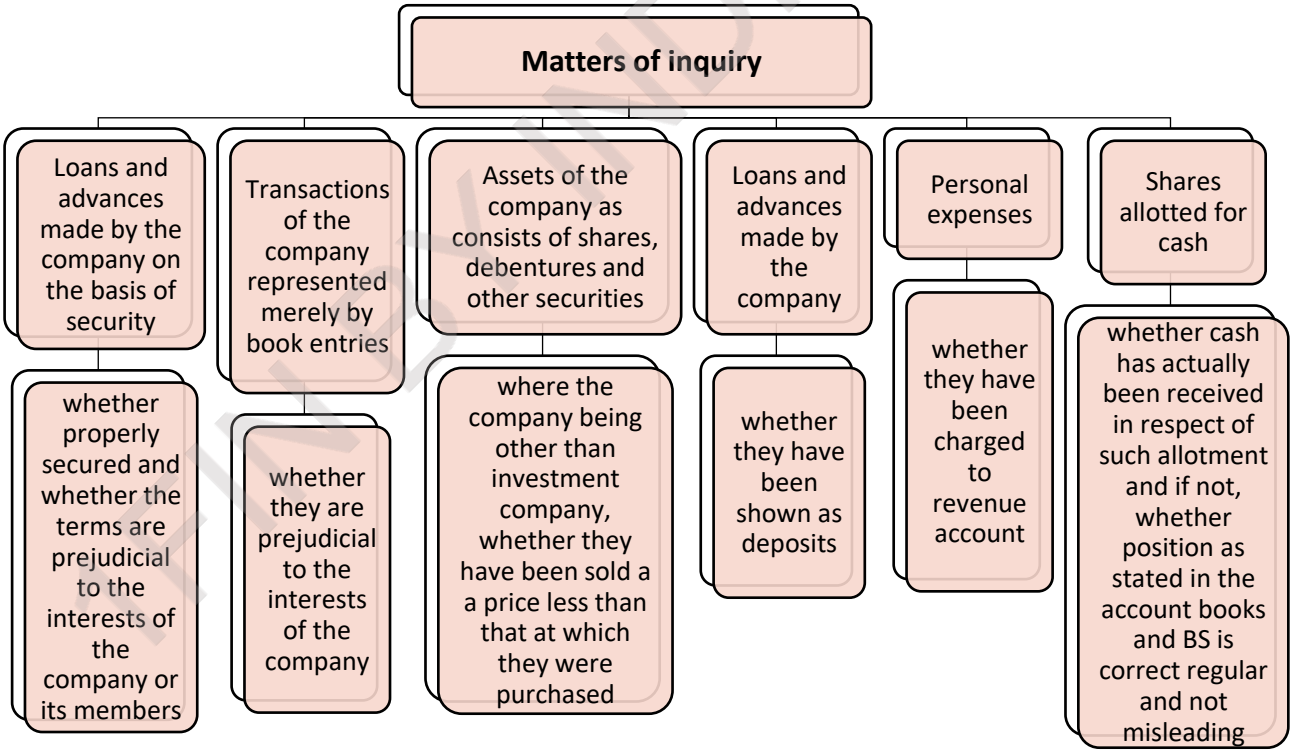
7.1 Powers of Auditors [Section 143 (1)]

Section 143 of the Companies Act, 2013 provides the powers and duties of the auditors and compliance with the auditing standards.

7.2.1 Duties of Auditors

Access to books of accounts and vouchers	• at all times • whether kept at the registered office or at any other place.
Entitled to have necessary information and explanation	• entitled to require from the officers of the company such information and explanations as the auditor may considr necessary.
Access to record of all its subsidiaries	• in so far as it relates to the consolidation of its FS with that of its subsidiaries and associate companies.

7.2.2 To inquire into the following matters –



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7.2.3 To make report to the members –

- ✓ The auditor shall **make a report to the members** of the company on the following:
  - **On accounts examined** by him, and
  - **On every FS** which are required by or under this Act to be laid before the company in the GM.
- ✓ While preparing the report the auditor **shall consider the provisions of the Act**, **the accounting and auditing standards** and matters which are required to be included in the audit report.
- ✓ The auditor shall express an opinion, according to him and to the best of his knowledge, **whether the accounts/ FS give a true and fair view** of the state of affairs as at the end of the F.Y. and profit or loss and cash flow for the year and such matters as may be prescribed.

7.2.4 To report on the following matters –

1) Information and explanations	•Whether he has sought and obtained all the information and explanation which to the best of his knowledge and belief were necessary for the audit and if not, the details thereof and the effect of such information on the FS.
2) Proper books of account	•Whether kept by the company, as appears from his examination. •whether proper returns adequate for audit have been received from the branches not visted by him.
3) Report on the accounts of the branch office audited by other person	•whether it has been sent to him and •the manner in which he has dealt with it in preparing his report.
4) Company's BS and P&L account	•whether in agreement with the books of account and returns
5) Accounting standards	•whether FS comply with it.
6) Financial transactions or matters which have any adverse effect	•the auditor's observations and comments on such matters which have an adverse effect on the functioning of the company.
7) Director	•whether any director is disqualified from being appointed as director u/s 164 (2).
8) Maintenance of accounts and other matters	•any qualification, reservation or adverse remark realting to them
9) Internal Financial controls (IFC) #	•whether company has adequate IFC with reference to FS in place and operating effectiveness of such controls.
10) Other matters as prescribed*	•whether company has disclosed the impact of pending litigations in its FS •whether adequate provisions has been made for material forseeable losses •whether there has been any delay in transferring amounts to IEPF

Where any matter is answered in the negative or with a qualification, the auditor's report shall state the reason for the same.

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Does not apply to Private company which is OPC or Small company or has turnover < ₹50cr per latest audited F.S. and aggregate borrowings at any point < ₹25cr AND has not committed default in filing F.S. u/s 137 or Annual return u/s 92.

Amendment in 'Other matters as prescribed' – Following clauses were inserted by Companies (Audit and Auditors) Amendment Rules. 2021:

→ Whether management has represented that, to best of its knowledge and belief, other than as disclosed in notes to accounts,

i. no funds have been advanced/loaned/invested by company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with understanding, whether recorded in writing or otherwise, that Intermediary shall, whether, directly or indirectly lend/invest in other persons or entities identified in any manner by or on behalf of company ("Ultimate Beneficiaries") or provide any guarantee, security or like on behalf of Ultimate Beneficiaries;

ii. no funds have been received by company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with understanding, whether recorded in writing or otherwise, that company shall, whether, directly or indirectly, lend/invest in other persons or entities identified in any manner by or on behalf of Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or like on behalf of the Ultimate Beneficiaries; and

→ Based on such audit procedures that auditor has considered reasonable and appropriate in circumstances, nothing has come to their notice that has caused them to believe that above representations contain any material mis-statement.

→ Whether dividend declared or paid during the year by company is in compliance with section 123 of the Companies Act, 2013.

→ Whether company, in respect of financial years commencing on or after 1st April, ~~2022~~, 2023 has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and same has been operated throughout the year for all transactions recorded in software and audit trail feature has not been tampered with and audit trail has been preserved by company as per the statutory requirements for record retention.

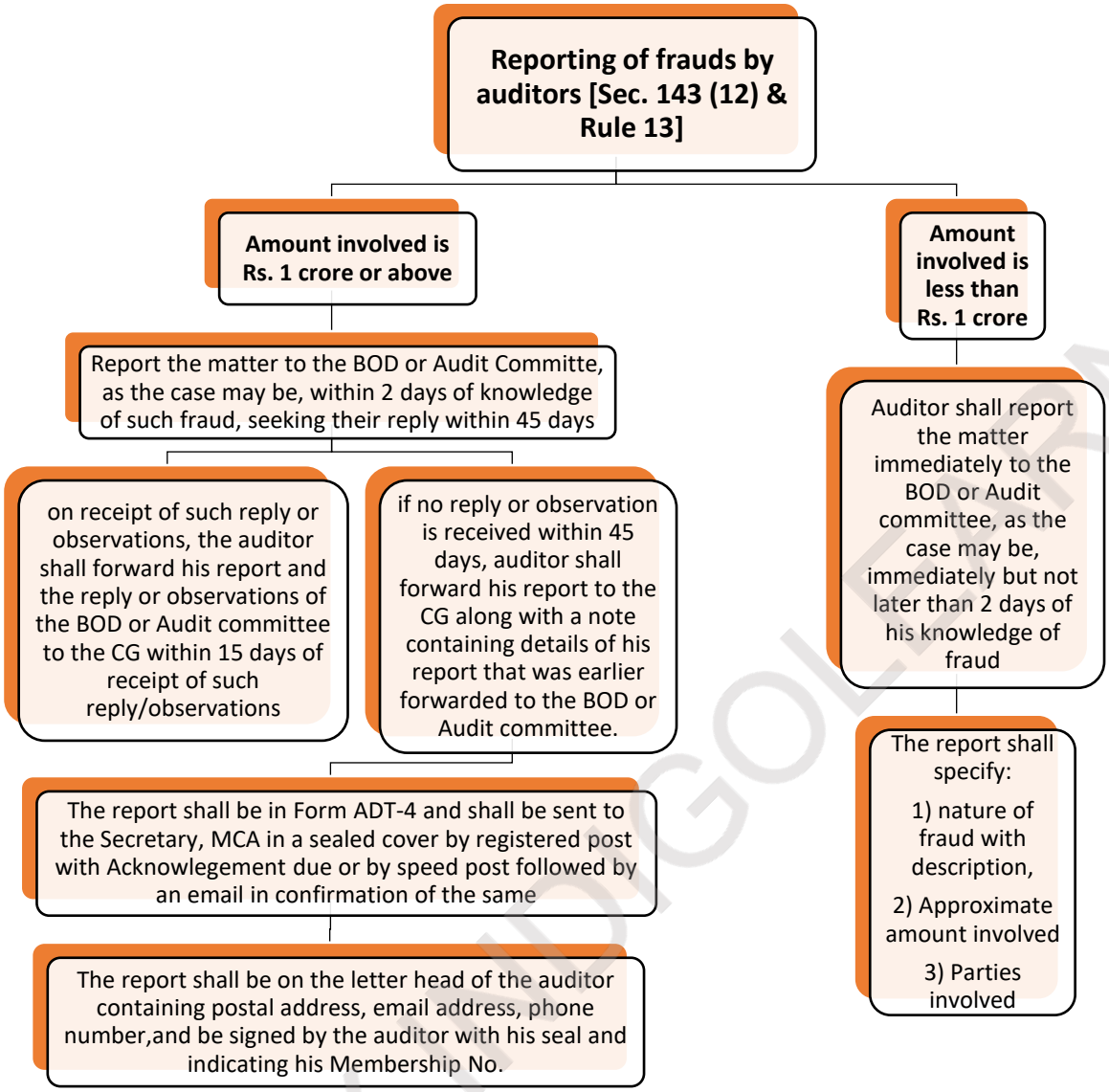
7.2.5 To comply with the auditing standards –

Every auditor shall comply with the auditing standards as prescribed by the CG upon recommendation of the ICAI in consultation with and after examination of the recommendations made by the NFRA. Until they are notified, standards of auditing specified by ICAI are deemed to be the auditing standards.

7.2.6 To report the frauds [Sec. 143 (12)] –

If an auditor of a company, in the course of performance of his duties has reasons to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the CG in such manner and within such time as may be prescribed.

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The Board's report shall disclose:

- Nature of the fraud with description,
- Approximate amount involved,
- Parties involved, if remedial action not taken, and
- Remedial actions taken.

Penalty for non-compliance with Section 143 (12):

→ Auditor, cost accountant, or CS in practice shall be liable to penalty of ₹5,00,000 in case of listed company and ₹1,00,000 in case of another company.

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7.2 Audit of government companies

In case of a government company & Companies owned or controlled by CG/SG/CG and SG/ one or more SG		
CAG shall appoint the auditor u/s 139 (5) and (7) and	shall direct such auditor the manner in which the accounts of the company are required to be audited.	Thereupon, the auditor so appointed shall submit a copy of the audit report to the CAG

The audit report shall include, among other things -		
The directions, if any, issued by the CAG	The action taken thereon	Its impact on the accounts and FS of the company

7.2.1 Supplementary audit-

The CAG shall within 60 days from the date of receipt of the audit report have a right to-

→ **Conduct a supplementary audit** of the FS by such person or persons as he may authorize in this behalf, and
  - for the purpose of such audit, require information or additional information to be furnished to any person or persons, so authorized, on such matters, by such persons, and in such form, as CAG may direct, and

→ **Comment upon or supplement such audit report**.

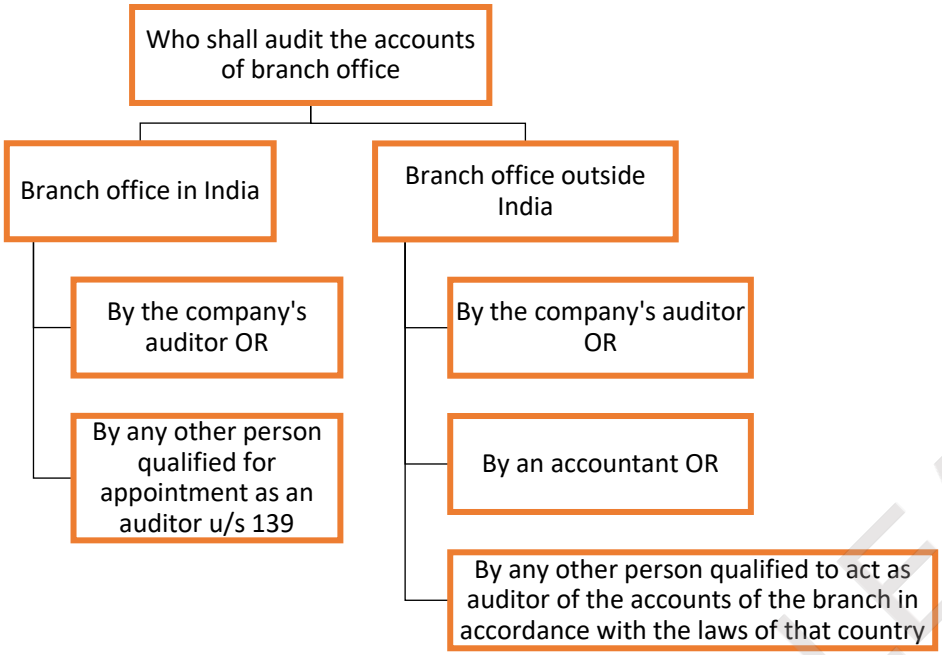
Every **comment given by the CAG** upon, or supplement to, the audit report shall be **sent by the company to every person entitled to copies of audited FS** and also be **placed before the AGM** of the company along with the audit report.

7.2.2 Test audit –

For government company and company controlled by SG/CG, the **CAG may, if he considers necessary, by an order, cause test audit to be conducted** of the accounts of such company.

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7.3 Audit of accounts of branch office of company [Sec. 143 (8)]



→ The branch auditor shall prepare a report on the accounts of the branch examined by him and sent it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

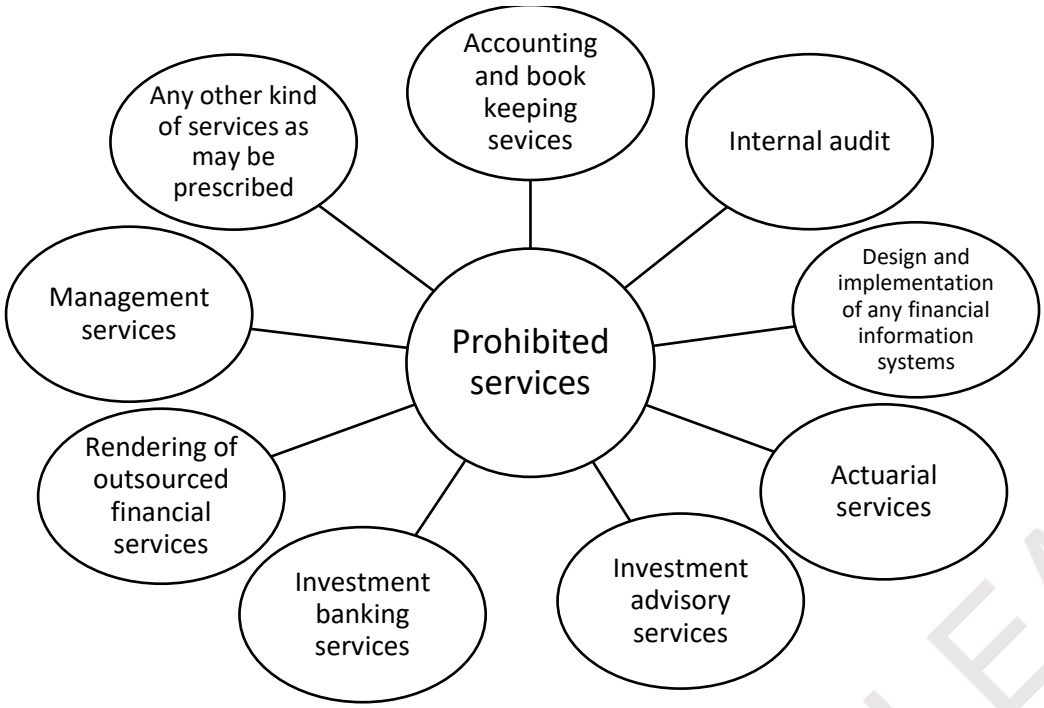
→ Provisions regarding reporting of fraud by the auditor shall also extend to the branch auditor to the extent that it relates to the concerned branch.

Note: The provisions of this section shall apply mutatis mutandis to a Cost Auditor and a Secretarial Auditor during the performance of his duties u/s 148 and 204 respectively.

Section 144 of the Companies Act, 2013 provides for auditor not to render certain services.

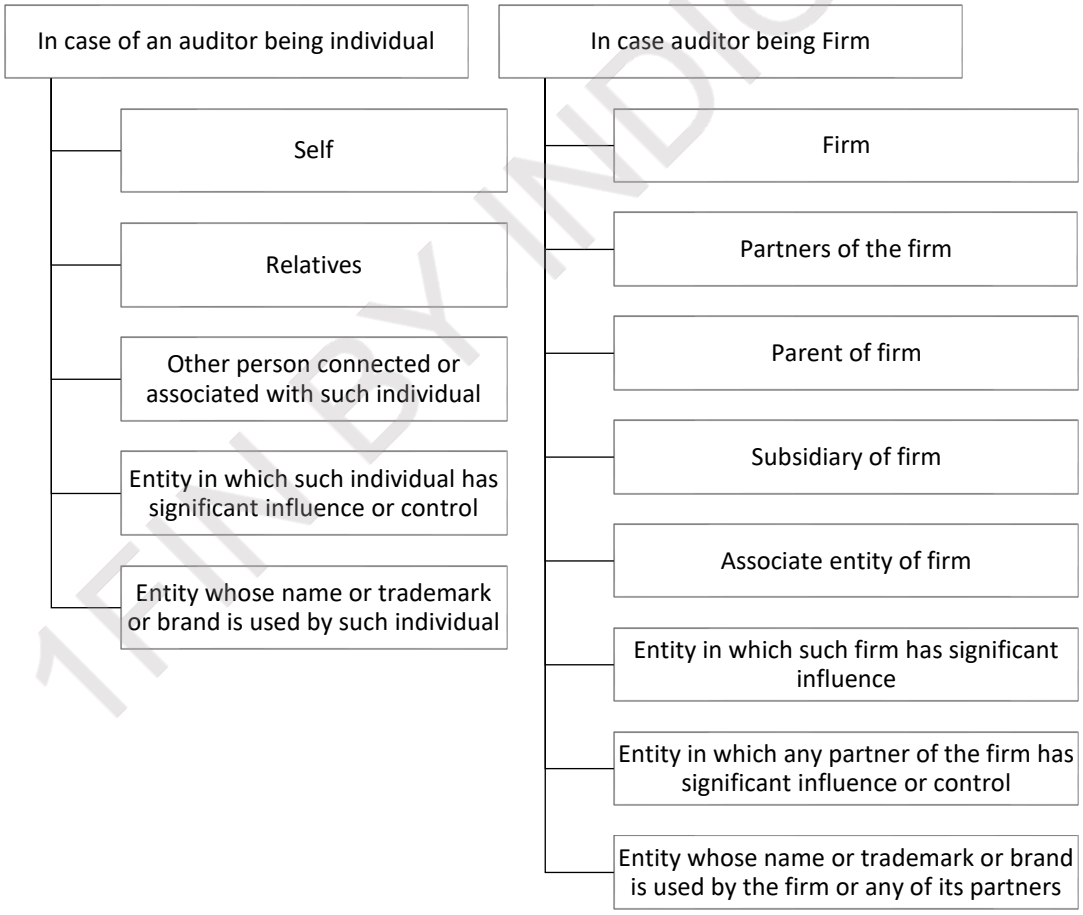
AUDITOR NOT TO RENDER CERTAIN SERVICES

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The auditor shall not, directly or indirectly, render these services to the company or its subsidiary or holding company.

Meaning of the term 'directly or indirectly'



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AUDITORS TO SIGN AUDIT REPORTS, ETC.

Section 145 of the Companies Act, 2013 provides for auditors to sign audit reports, etc.

- ✓ The person appointed as an auditor of the company shall **sign the auditor's report or sign or certify any other document of the company**.
- ✓ The **qualifications, observations or comments** on financial transactions or matters, which have any adverse effect on the functioning of the company **mentioned in the auditor's report shall be read before the company in GM** and shall be open for inspection by any member.

AUDITORS TO ATTEND GENERAL MEETING

Section 146 of the Companies Act, 2013 provides for auditors to attend general meeting.

- All **notices of and other communications** relating to, any GM shall be **forwarded to the auditor** of the company.
- The auditor shall unless otherwise exempted by the company, **attend any GM either by himself or through his authorized representatives**, *who shall also be qualified to be an auditor.*
- The auditor shall have a **right to be heard** on any matter which concerns him as the auditor.

PUNISHMENT FOR CONTRAVENTION

Section 147 of the Companies Act, 2013 provides for punishment for contravention.

Sl. No.	Person liable	Nature of contravention	Punishment

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1.	Company [Sec. 147(1)]	Contravention of any provisions of sections 139 to 146	Minimum fine = ₹25,000/- Maximum fine = ₹5,00,000/-
2.	Officer of the company in default [Sec. 147(1)]	Contravention of any provisions of sections 139 to 146	• Fine not less than ₹10,000/- but which may extend to ₹1,00,000/-
3.	Auditor [Sec. 147(2) & (3)]	Contravention of provisions of section 139, 144 or 145	Minimum fine = ₹25,000/-. Maximum fine = ₹5,00,000/- or 4 times the remuneration of the auditor, whichever is less.
		Contravention of any provisions knowingly or wilfully with the intention to deceive the company or its shareholders or its creditors or tax authorities	• Imprisonment which may extend to 1 year AND • Fine not less than ₹50,000 but which may extend to ₹25,00,000 or 8 times the remuneration of the auditor, whichever is less. • Also the auditor shall – i. Refund the remuneration received by him to the company, and ii. Pay for damages to the company, statutory bodies, or authorities or to members or creditors for the loss arising out incorrect or misleading statements of particulars made in his audit report.
4.	Audit firm [Sec. 147(5)]	The partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers.	The liability for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally and shall also be liable u/s 447. In case of criminal liability of an audit firm, liability other than fine shall be the liability of the concerned partner(s) who acted fraudulently or abetted or colluded in any fraud.

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CG TO SPECIFY AUDIT OF ITEMS OF COST IN RESPECT OF CERTAIN COMPANIES

Section 148 of the Companies Act, 2013 provides the provisions for CG to specify the audit of items of cost in respect of certain companies.

- The CG may, by order, in repsect of **such class or classess of companies engaged in the production of such goods or providing such services as may be prescribed**, direct that particulars relating to the utilisation of material or labour or to other cost items as may be prescribed shall also be included in the books of account kept u/s 128 by that class of companies.

- The CG may, by order, direct that the **audit of cost records** of class of companies, which are covered above and which have a net worth or turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

- Cost Audit shall be **conducted by a Cost Accountant** who shall be **appointed by the BOD** on such remuneration as may be determined by the members. **It shall be in addition to audit conducted under Sec 143.**

Applicability for maintenance of Cost Records

Note:

Clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 defines "Cost Accountant". It means a Cost Accountant who holds a valid certificate of practice under sub-section (1) of section 6 of the Cost and Works Accountants Act, 1959 and is in whole-time practice. Cost Accountant includes a Firm of Cost Accountants and a LLP of cost accountants.

Applicable for a domestic or a foreign company engaged in production of goods or providing services listed in table A (Regulated) or B (Non-regulated) of Rule 3, which have a overall turnover from all of its products and services ≥ 35 crore (immediately preceding financial year).

Case	Turnover (Figures in Crore)					Applicability of Cost Records
	Table A Products	Table B Products	Table A+B Products	Other Products	Total	
1	10	10	20	10	30	No
2	10	10	20	20	40	Yes
3	0	10	10	30	40	Yes
4	10	0	10	30	40	Yes
5	20	20	40	0	40	Yes
6	0*	0*	0	40	40	No

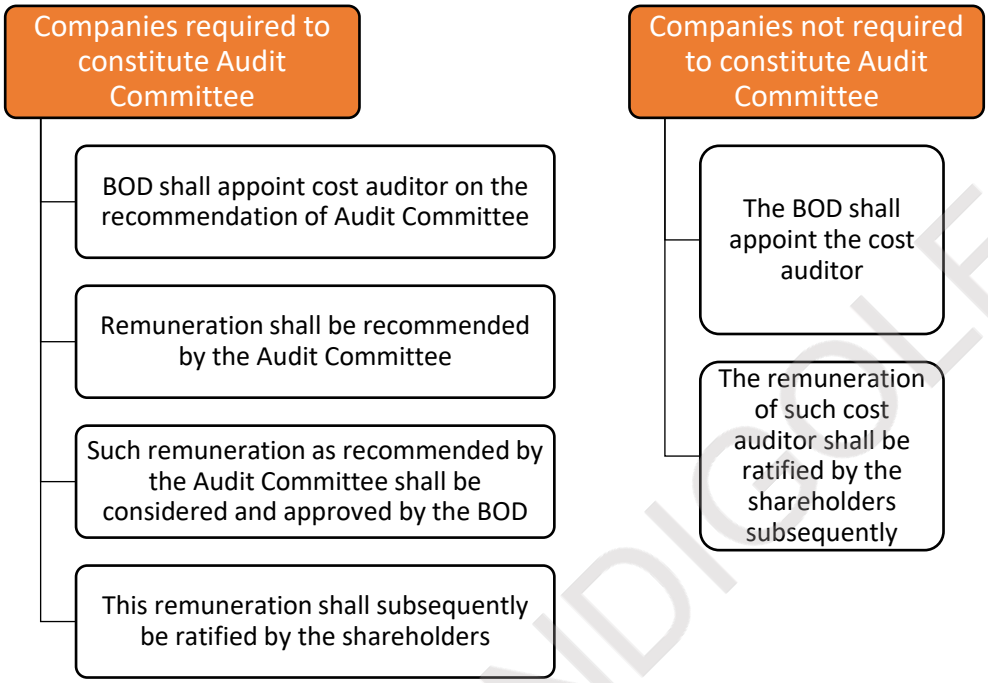
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Not engaged in the production of the goods or providing services, specified inthe Table A (6 Regulated Sectors) and/or Table B (33 Non-Regulated Sector)

Note:

Nothing contained in Rule 3 shall apply to a company which is classified as a micro enterprise or a small enterprise including as per the turnover criteria under sub-section (9) of section 7 of the Micro, Small and Medium Enterprises Development Act, 2006.

12.1 Manner of appointing Cost Auditor [Rule 14]



Form and manner of Cost Records [Rule 5]

Every company covered by rule 3 explained above under these rules including all units and branches thereof, shall, in respect of each of its financial year maintain cost records in form CRA-1.

The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilisation of resources and these records shall also provide necessary data which is required to be furnished under these rules.

12.2 Other conditions

- ✓ **A person appointed as auditor of the company u/s 139 shall not be appointed as cost auditor u/s 148.**
- ✓ The cost auditor shall comply with the **cost auditing standards**.

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- ✓ The qualifications, disqualifications, rights, duties and obligations applicable to a company auditor shall apply to a cost auditor u/s 148.

12.3 Companies that require to constitute an audit committee

Section 177 of the Act, read with Companies (Meetings of Board and its Powers) Rules, 2014 provides Audit Committee shall be constituted by Board of directors in case of;

i. Every listed public companies and
ii. Those public companies which having:
   a. Paid up capital of ten crore rupees or more; or
   b. Turnover of one hundred crore rupees or more; or

c. Aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited financial statements shall be taken into account for the purposes of this rule.

It is also worth noting that where a company ceases to fulfil any of three conditions laid down above for three consecutive years, it shall not be required to comply with the provisions pertaining to audit committee until such time as it meets any of such conditions.

Applicability of Cost Audit

Note: The provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and rule notified thereunder.

Applicability of Cost Audit

Insert Chart on page 10.55 of the new study material

Non applicability of Cost Audit

Further sub-rule 3 to rule 4 provides exception from cost audits. The requirement for cost audit shall not apply to a company which is covered in rule 3, and

a. Whose revenue from exports, in foreign exchange, exceeds seventy five percent of its total revenue; or

b. Which is operating from a special economic zone.

c. Which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term “Captive Generating Plant” shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005.

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Example:

Case	Turnover (Figures in Crore)					Applicability of	
	Table A Products	Table B Products	Table A+B Products	Other Products	Total	Cost Records	Cost Audit
1	10	10	20	10	30	No	No
2	10	10	20	20	40	Yes	No
3	20	20	40	0	40	Yes	No
4	10	20	30	10	40	Yes	No
5	10	20	30	20	50	Yes	Yes, but onlyfor table A
6	0	20	20	20	40	Yes	No
7	20	10	30	80	110	Yes	Only Table A Product
8	20	20	40	70	110	Yes	Both Tables A & B Products
9	10	10	20	80	100	Yes	No
10	15	15	30	10	40	Yes	No
11	20	20	40	8	48	Yes	No

12.4 Manner and Procedure – Appointment, Removal and Resignation [Rule 6 of Companies (Cost Records and Audit) Rules, 2014

The manner and procedure of selection of auditors by the members of the company at AGM has been prescribed under the Rule 3 of the *Companies (Audit and Auditors) Rules, 2014*; tabled and stated below.

Categories of Companies	Competent authority	Responsibility of the competent authority
A company which is required to constitutean Audit Committee under section 177	Audit Committee	The competent authority **shall take into consideration the qualifications and experience** of the individual or the firm proposed to be considered for appointment as auditor and such qualifications and experience are commensurate with the size and requirementsof the company

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A company which is not required to constitutean Audit Committee under section 177	Board of Directors	It shall have regard to any **order or pending proceeding relating to professional matters of conduct** against the proposed auditor before the Institute of Chartered Accountants of India (ICAI) or any competent authority or any Court. It may call for **such other information** from the proposed auditor as it may deem fit.

Where competent authority is audit committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration; the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment.

a. If the **Board agrees** with the recommendation of the Audit Committee - It shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting.

b. If the **Board disagrees** with the recommendation of the Audit Committee - It shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.

Note:

Companies that require to constitute an audit committee

Section 177 of the Act, read with Companies (Meetings of Board and its Powers) Rules, 2014 provides Audit Committee shall be constituted by Board of directors in case of;

i. Every **listed public companies** and

ii. Those **public companies** which having:

a. **Paid up capital** of **ten crore rupees or more**; or

b. **Turnover** of **one hundred crore rupees or more**; or

c. Aggregate, **outstanding loans or borrowings or debentures or deposits** exceeding **fifty crore rupees** or more.

The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited financial statements shall be taken into account for the purposes of this rule.

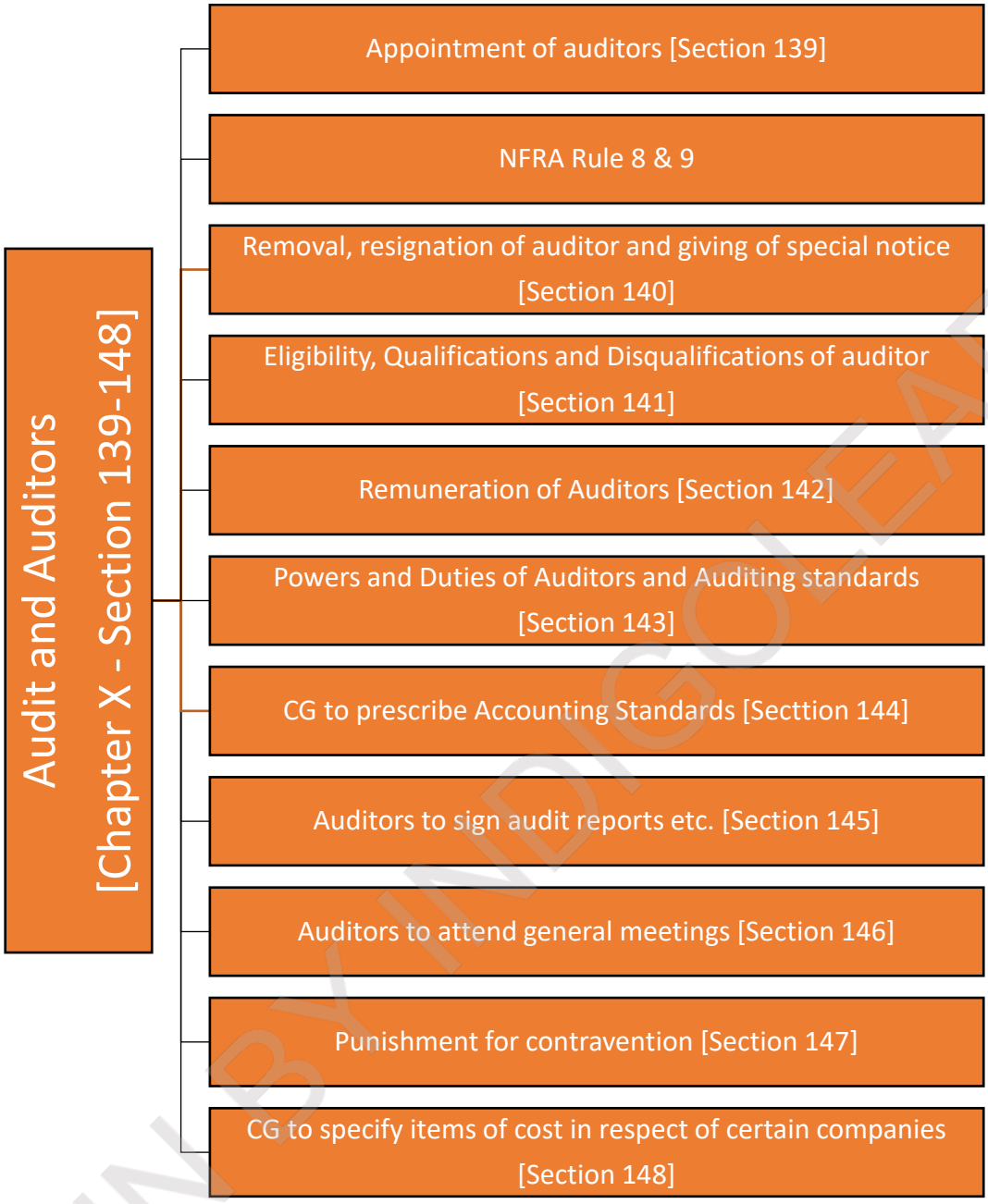
It is also worth noting that where a company ceases to fulfil any of three conditions laid down above for three consecutive years, it shall not be required to comply with the provisions pertaining to audit committee until such time as it meets any of such conditions.

12.5 Punishment for contravention

→ **Company and every officer in default** shall be punishable in the manner as provided in Section 147 (1),

→ **Cost auditor** in default shall be punishable in the manner as provided u/s 147 (2) & (3).

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CH 6 - THE NEGOTIABLE INSTRUMENTS ACT, 1881

Learning Outcomes –

- Understand the meaning, characteristics, and elements of different kinds of negotiable instruments.
- Know the parties to notes, bills and cheques, various ways of negotiation of the instruments and their presentment.
- Know the concepts of noting and protest, and of dishonour of instrument.

INTRODUCTION

The **main objective** of the Negotiable Instruments Act, 1881 is to **legalise the system by which instruments contemplated by it could pass from hand to hand** by negotiation like any other goods.

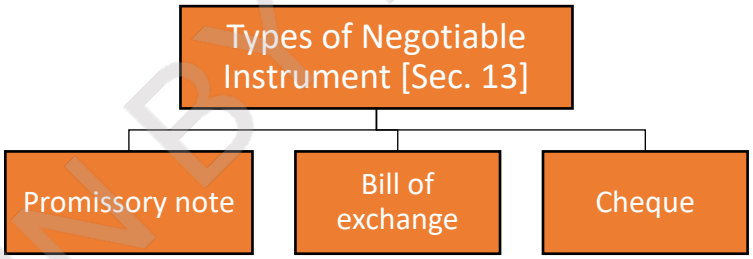
The Act was **introduced on 1st March,1881. The Negotiable Instruments Act, 1881 applies to the whole of India**, but *nothing herein contained affects the Reserve Bank of India Act, 1934*, or affects any local usage relating to any instrument in an oriental language.

The Act was amended several times. Recent three amendments made in this Act were the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002; the Negotiable Instruments (Amendment) Act, 2015 and the Negotiable Instruments (Amendment) Act, 2018. Latter came into effect from **September 1, 2018.**

MEANING OF NEGOTIABLE INSTRUMENTS

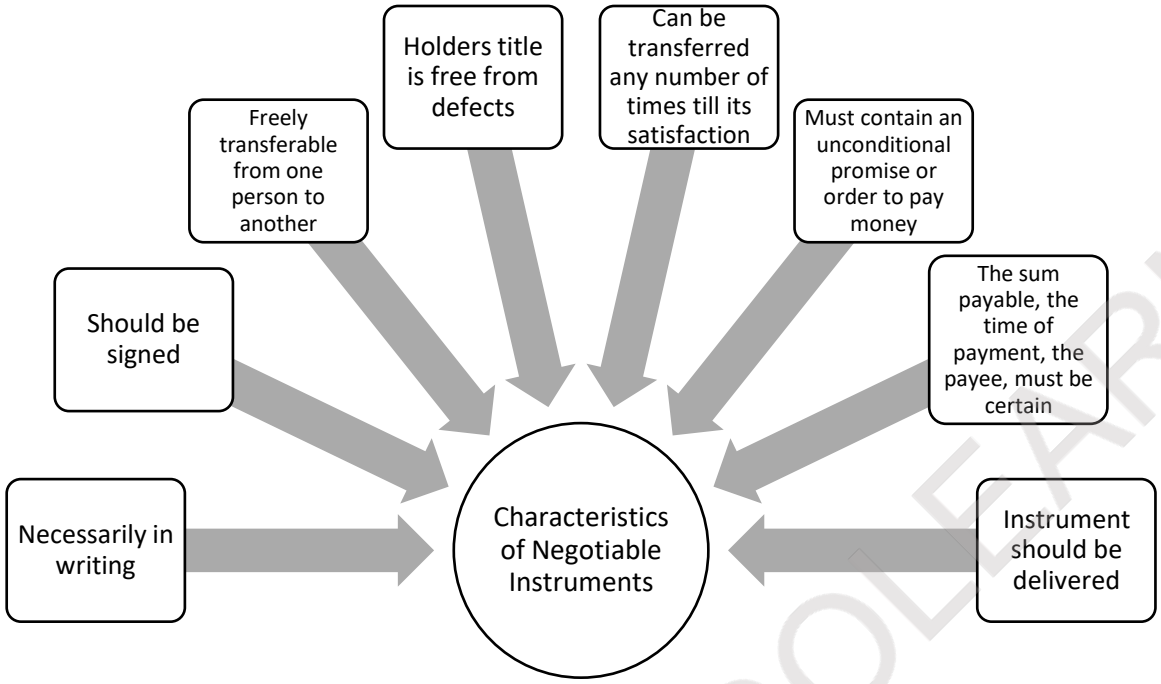
→ Negotiable Instruments is **an instrument which is freely transferable from one person to another by mere delivery or by indorsement and delivery**.

→ The property in such an instrument passes to a bonafide transferee for value.



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2.1 Essential characteristics of Negotiable Instruments



PROMISSORY NOTE

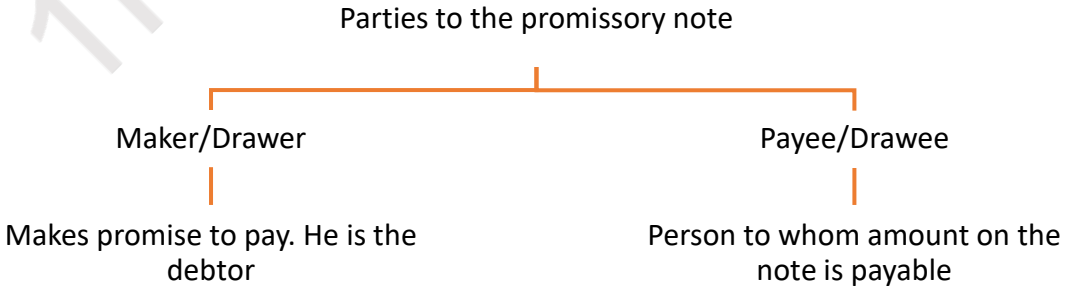
Section 4 of the Negotiable Instruments Act, 1881 provides provisions relating to promissory note.

3.1 Meaning of Promissory note

A promissory note is

→ an **instrument** in **writing** (not being a bank note or a currency note)
→ containing an **unconditional undertaking** signed by the maker,
→ **to pay a certain sum of money** only to, or to the order of, a certain person, or to the bearer of the instrument..

3.2 Parties to Promissory note



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3.3 Essential characteristics of a Promissory note

In writing	An express promise to pay	Promise should be definite and unconditional
Must be signed by the maker	Promise to pay money only	Promise to pay a certain sum
Maker and payee must be certain, definite and different persons	Must be properly stamped and stamp must be duly cancelled by maker's signature or intials or otherwise	

Specimen of Promissory note

10,000

Lucknow April 10, 2017

Three months after date, I promise to pay Shri Ramesh **(Payee)** or to his order the sum of Rupees Ten Thousand, for value received.

Stamp
Sd/- Ram

To, Shri
Ramesh,
B-20, Green Park, Mumbai.
(Maker)

BILLS OF EXCHANGE

Section 5 of the Negotiable Instruments Act, 1881 provides provisions relating to bills of exchange.

4.1 Meaning of Bill of Exchange

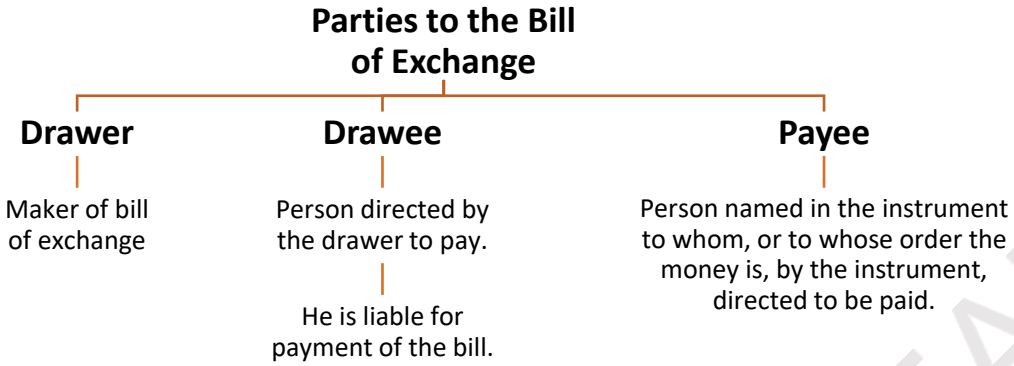
Bill of exchange is

→ an **instrument in writing**
→ containing an **unconditional order**,

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→ **signed** by the maker,
→ **directing a certain person to pay a certain sum of money**
→ only to, or the order of, a certain person or the bearer of the instrument.

4.2 Parties to the Bill of Exchange



4.3 Essential characteristics of Bill of Exchange

(a) Must be in writing

(b) Contain an express order to pay

(c) Order must be definite and unconditional

(d) Drawer, drawee, and payee must be certain.

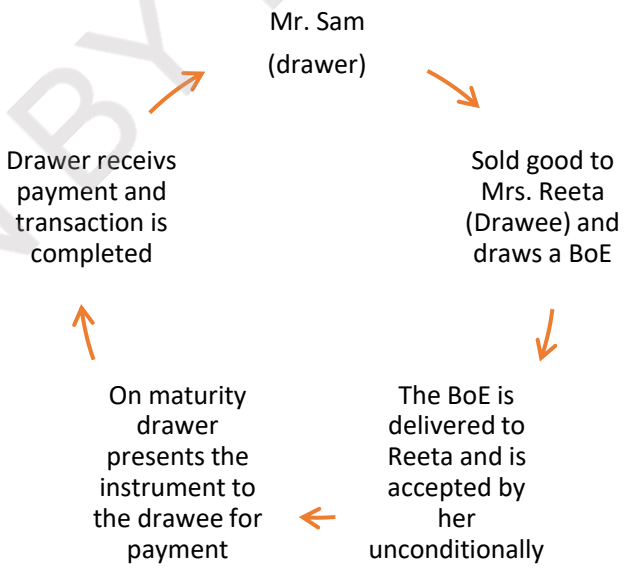
(e) Drawer must sign the instrument

(f) Sum must be certain

(g) Order must be to pay money only

(h) It must be stamped

4.4 Process of Bill of Exchange



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Specimen of Bill of Exchange

Mr. A **(Drawer)**

48, MP Nagar, Bhopal (M.P.)

April 10, 2015

` 10,000/-

Four months after date, pay to Mr. B **(Payee)** a sum of Rupees Ten Thousand, for value received.

To,

Mr. C **(Drawee)**

576, Arera Colony, Bhopal (M.P.)

Signature

Basis	**Promissory Note**	**Bill of Exchange**
1. Definition	A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.	Bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or the order of, a certain person or the bearer of the instrument.
2. Nature of instrument	There is a promise to pay money	There is an order for making payment.
3. Parties	Only 2 parties – Maker and Payee	3 parties – Drawer, drawee, and payee
4. Acceptance	Does not require acceptance	Needs to be accepted by the drawee
5. Payable to bearer	Cannot be made payable to bearer	Can be drawn payable to the bearer. However, it cannot be payable to bearer on demand.

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Section 6 of the Negotiable Instruments Act, 1881 provides provisions relating to bills of exchange.

5.1 Meaning of cheque

A cheque is

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

(a) **Truncated cheque**
It means the cheque whose electronic image has been created during the course of clearing cycle, to substitute

the further physical movement.

(b) **Cheque in electronic form**
The cheque is drawn and signed electronically by the use of digital signature.

5.2 Parties to cheque

Drawer	Person who draws a cheque (Debtor) His liability is primary and unconditional
Drawee	The specific bank on whom cheque is drawn.
Payee	Person named in the cheque to whom or to whose order the money is directed to be paid. Payee may be the drawer himself or a third party.

Drawee in case of need – When in the bill or in any indorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need such person is called a "drawee in case of need".

5.3 Essential characteristics of a cheque

- Fulfills all the characteristics of a bill of exchange
- Must be drawn on a specified banker
- Payable on demand

Note: All cheques are bills but all bills are not cheques.

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Specimen of Cheque

Date :.....

Pay .....

a sum of Rupees..... Rs.

A/c No. .....

ABC Bank
622, Vijay Nagar, Indore (M. P.)

Signature

01212 1125864 000053 38

ACCEPTOR AND ACCEPTOR FOR HONOR

Acceptor [Sec. 7]

- The drawee who has signed his assent upon the bill and delivered it to the holder.

Acceptor for honour [Sec. 7]

- An undertaking by a by a third party to accept and pay a bill of exchange that was dishonoured, either by non-acceptance or by non-payment by the party on whom it was drawn.
- Also called 'acceptance supra protest'.

A **person desiring to accept for honour** must, on **writing on the bill in his own hand**, **declare that he accepts** under protest the protested bill for the honour of the drawer or of a particular indorser in whose names, or generally for honor.

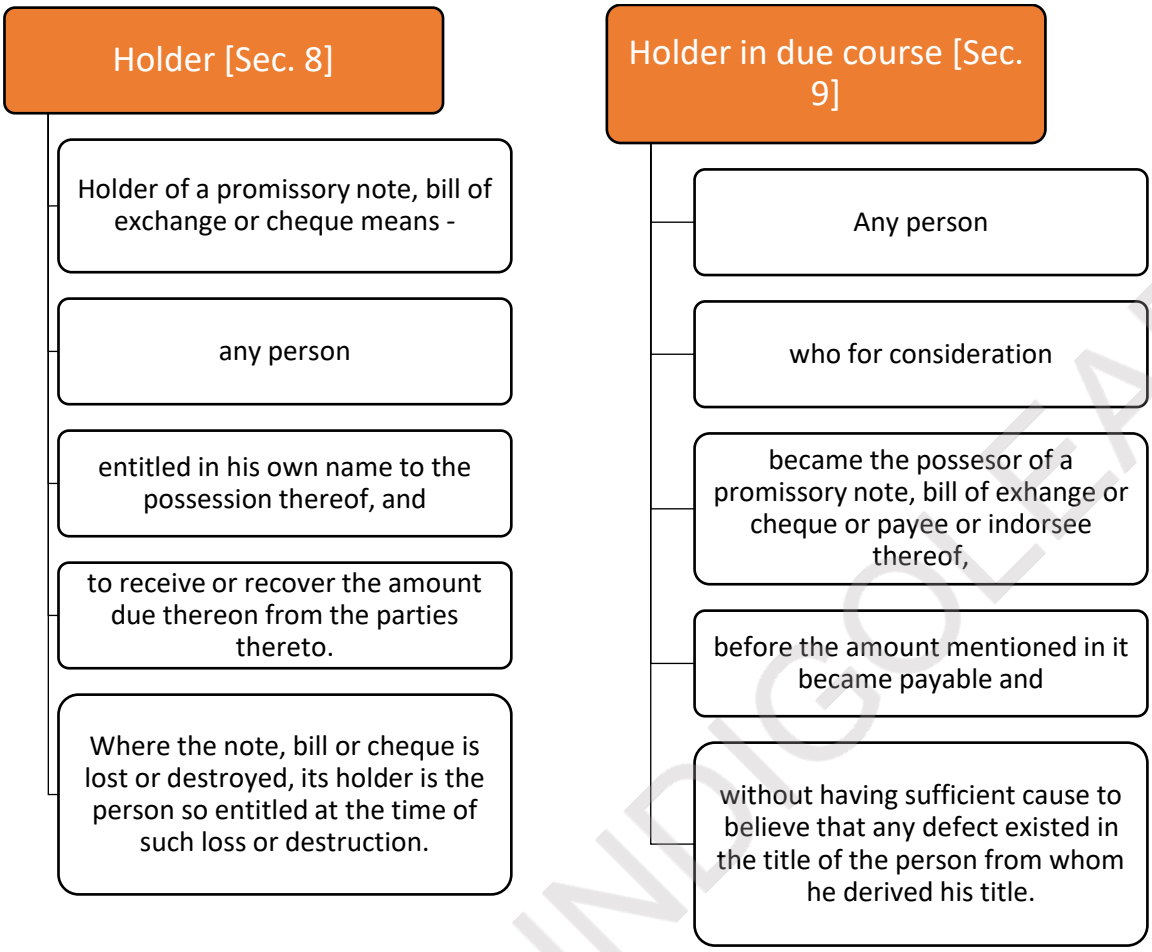
7.1 Essentials of valid acceptance for honor

i. The **holder must consent to acceptance for honor**. The holder cannot be compelled to assent to acceptance for honor.
ii. The **bill must have been noted or protested for the non-acceptance** or for better security.
iii. Acceptance for honor **can be made by a person who is not already liable** on the bill.
iv. It must be **made by writing** on the bill.
v. It **must be for the whole amount due** on the bill.
vi. Acceptance **must be for the honor of any party already able on the bill**.
vii. Acceptance for honor **must be made before to bill is overdue**.

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viii. Stranger paying for honor must, before payment, declare before a Notary Public the party for whose honor he pays, and the **Notary Public must have recorded such a declaration**.

HOLDER AND HOLDER IN DUE COURSE



Example: On a Bill of Exchange for ₹1 lakh, X's acceptance to the Bill is forged. 'A' takes the Bill from his customer for value and in good faith before the Bill becomes payable. As 'A' in this case *prima facie* became a possessor of the bill for value and in good faith before the bill became payable, he can be considered as a holder in due course. But where a signature on the negotiable instrument is forged, it becomes a nullity. The holder of a forged instrument cannot enforce payment thereon.

8.1 Essentials to become holder in due course (HDC)

- ✓ The holder must have **paid valuable consideration**. When given as a gift or has been inherited, the transferee cannot be a holder in due course.
- ✓ The holder must **acquire the instrument before its maturity**.
- ✓ The holder must have **obtained the instrument in good faith**.
- ✓ The **instrument must be complete and regular** on the face of it.

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✓ He must have **received the instrument as a holder**.

CLASSIFICATION OF NEGOTIABLE INSTRUMENT

9.1 Different classifications of Negotiable Instruments

Bearer and Order Instrument [Section 13]	•**Bearer Instrument**: An instrument where the name of the payee is blank or specified with the words "or bearer" or where the last indorsement is blank. Such instrument can be negotiated by mere delivery. •**Order Instrument**: It is an instrument which is payable to a person or his order or where the last indorsement is in full, such instrument can be negotiated by indorsement and delivery.
Inland and Foreign Instrument [Section 11 & 12]	•**Inland Instrument**: A promissory note, BoE or cheque drawn or made in India and made payable in, or drawn upon any person resident in India shall be deemed to be an inland instrument. •**Foreign Instrument**: Instrument which is not an inland instrument
Inchoate and Ambiguous Instruments	•**Inchoate Instrument [Sec. 20]**: It means an Instrument that is incomplete in certain respects. (i) The person gives a blank instrument with authority to the holder to complete it with appropriate amount up to the stamp value of the instrument. (ii) Delivery of such a paper is essential by the signer to the authority/holder. (iii) The person signing and delivering the inchoate instrument is liable both to a holder and holder in due course. However, there is a difference in their respective rights. (a) The holder of such an instrument cannot recover the amount in excess of the amount intended to be paid by the signor. (b) The holder in due course can, however, recover any amount on such instrument provided it is covered by the stamp affixed on the instrument. •**Ambiguous Instrument [Sec. 17]**: An instrument which is vague and cannot be clearly identified either as a bill of exchange, or as a promissory note, is an Ambiguous instrument. In other words, such an instrument may be construed either as promissory note, or as a bill of exchange.

Examples of Inland Instruments

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(i) A promissory note made in Kolkata and payable in Mumbai.

(ii) A bill drawn in Varanasi on a person resident in Jodhpur (although it is stated to be payable in Singapore)

(iii) A, a resident of Agra, drew (i.e., made) a bill of exchange in Agra on B, a merchant in New York. And B accepted the bill of exchange as payable in Delhi. It is an inland bill of exchange. In this case, the bill of exchange was drawn in India and also payable in India.

(iv) A, resident of Mumbai, drew a bill of exchange in Mumbai on B, a merchant in Mathura. And B accepted the bill of exchange as payable in London. It is also an inland bill of exchange. In this case, the bill of exchange was drawn in India on a person resident in India. It is immaterial that the amount is payable in London. An inland instrument remains inland even if it has been endorsed in a foreign country.

(iv) If the bills of exchange mentioned in above two examples, are endorsed in France, they will remain inland bills.

9.2 Maturity of negotiable instrument

9.2.1 Days of grace [Sec. 22]

A note or bill, which is not expressed to be payable on demand, at sight or on presentment is at maturity on the third day after the day on which it is expressed to be payable. Thus, **3 days are allowed as days of grace.**

NEGOTIATION (TRANSFER) OF NEGOTIABLE INSTRUMENTS

When a negotiable instrument is **transferred to any person with a view to constitute the person holder thereof**, the instrument is deemed to have been negotiated **[Section 14]**.

When an instrument is conditionally or for a special purpose only, the property in it does not pass to the transferee, even though it is indorsed to him, unless the instrument is negotiated to a holder in due course [**Section 46**].

Negotiation by delivery [Section 47]

Subject to the provisions of section 58 [Instrument obtained by unlawful means or for unlawful consideration], a promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof.

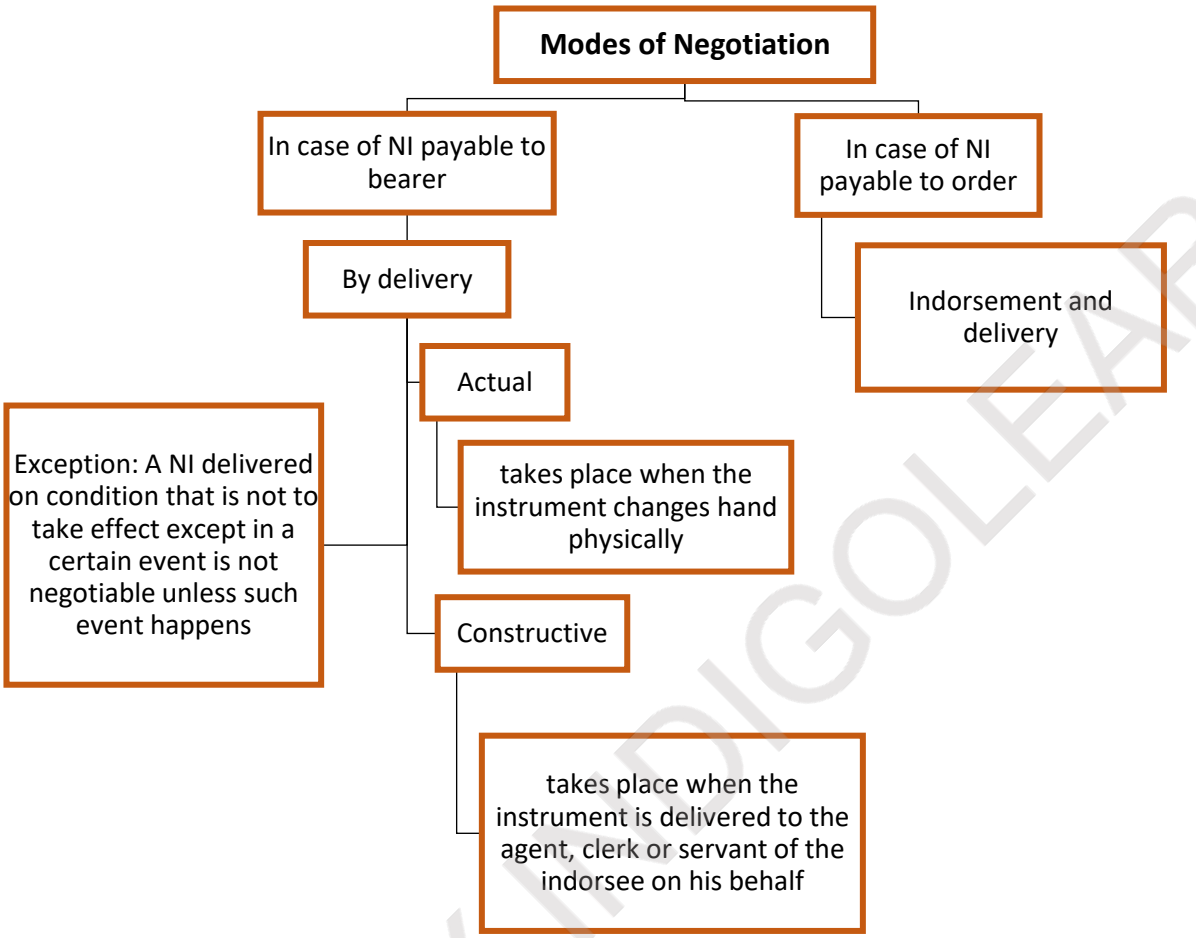
Exception: A promissory note, bill of exchange or cheque delivered on condition that it is not to take effect except in a certain event is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.

"Negotiation by indorsement [Section 48)

Subject to the provisions of section 58, a promissory note, bill of exchange or cheque payable to order, is negotiable by the holder by indorsement and delivery thereof.

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The contract on a NI until delivery remains incomplete and revocable. The delivery is essential not only at the time of negotiation but also at the time of making or drawing of NI. [**Section 57**].



Delivery when effective between the parties

Negotiation of instruments between the parties	How delivery is to be made
As between parties standing in immediate relation	Delivery to be effectual must be made by the party making, accepting, or endorsing the instrument, or by a person authorized by him in that behalf
As between such parties and any holder of the instrument other than a holder in due course	It may be shown that the instrument was delivered conditionally or for a special purpose only, and not for the purpose of transferring absolutely the property therein.

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10.1 Dishonored due to insufficiency of funds [Section 138]

Sections 138 to 142 of the Negotiable Instruments Act, 1881 provides for criminal penalties in the event of dishonour of cheques for insufficiency of funds.

Where any **cheque drawn by a person on an account** maintained by him with a banker,

- for the **payment of any amount of money**
- to another person from that account,
- **for the discharge**, in whole or in part, **of any debt or other liability**,
- is **returned by the bank unpaid**,
- either because of –
  - amount of money standing to the credit of that account is **insufficient**, *or*
  - that it **exceeds the amount arranged to be paid from that account** by an agreement made with that bank,
- **such person shall be deemed to have committed an offence** and
- *shall be **punished with** –*
  - ***imprisonment** for a term which may extend to 2 years, or*
  - ***fine** which may extend to twice the amount of the cheque, or*
  - ***both**.*

A cheque given as a gift or donation, or as a security or in discharge of a mere moral obligation, or for an illegal consideration, would be outside the purview of this section.

Conditions for levy of penalty

- Cheque must be presented within 3 months from the date on which it is drawn or within the period of its validity, whichever is earlier.
- Payee/holder in due courses notifies in writing to the drawer within 30 days of receipt of information by him from the bank regarding dishonour and asks for payment.
- The drawer of such cheque fails to make the payment within 15 days of receipt of such notice.

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10.2 Presumption in favor of holder [Section 139]

When a cheque is dishonored, it shall be presumed, unless the contrary is proved, that the **holder of a cheque received the cheque of the nature referred to in section 138 for the discharge**, in whole or in part, or any debt or other liability.

The effect of this presumption is that the evidential burden rests on the accused.

10.3 Defense which may not be allowed in any prosecution under section 138 [Section 140]

It shall not be a defence in a prosecution of an offence under section 138 that the **drawer had no reason to believe when he issued the cheque that the cheque may be dishonored on presentment for the reasons stated in that section**.

PRESENTMENT OF INSTRUMENTS

11.1 Presentment for acceptance [Section 61]

A bill of exchange payable after sight must [if no time or place is specified therein for presentment] be presented to the drawee thereof for acceptance [if he can, after reasonable search, be found] by a person entitled to demand acceptance, within a reasonable time afterit is drawn, and in business hours on a business day.

In default of such presentment, no party thereto is liable thereon to the person making such default. If the drawee cannot, after reasonable search, be found, the bill is dishonoured.

If the bill is directed to the drawee at a particular place, it must be presented at that place,and if at the due date for presentment he cannot, after reasonable search, be found there,the bill is dishonoured.

Where authorised by agreement or usage, a presentment through the post office by means of a registered letter is sufficient.

11.2 Presentment of promissory note for sight [Section 62]

A promissory note, payable at a certain period after sight, must be presented to the maker thereof for sight (if he can after reasonable search be found) by a person entitled to demand payment, within a reasonable time after it is made and in business hours on a business day.

In default of such presentment, no party thereto is liable thereon to the person making such default.

11.3 Drawee's time for deliberation [Section 63]

The holder must, if so required by the drawee of a bill of exchange presented to him for acceptance, allow the drawee 48 hours (exclusive of public holidays) to consider whether hewill accept it.

11.4 Presentment for payment [Section 64]

Promissory notes, bill of exchange and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively, by or on behalf of the holder as hereinafter provided.

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In default of such presentment, the other parties thereto are not liable thereon to such holder.

Where authorised by agreement or usage, a presentment through the post office by meansof a registered letter is sufficient.

Exception: Where a promissory note is payable on demand and is not payable at a specified place, no presentment is necessary in order to charge the maker thereof.

Notwithstanding anything contained in section 6, where an electronic image of a truncated cheque is presented for payment, the drawee bank is entitled to demand any further information regarding the truncated cheque from the bank holding the truncated cheque incase of any reasonable suspicion about the genuineness of the apparent tenor of instrument, and if the suspicion is that of any fraud, forgery, tampering or destruction of the instrument, it is entitled to further demand the presentment of the truncated cheque itselffor verification:

Provided that the truncated cheque so demanded by the drawee bank shall be retained by it, if the payment is made accordingly.

Hours for presentment (Section 65)

Presentment for payment must be made during the usual hours of business, and, if at a bankers within banking hours.

Presentment for payment of instrument payable after date or sight (Section 66)

A promissory note or bill of exchange, made payable at a specified period after date or sight thereof, must be presented for payment at maturity.

Presentment for payment of promissory note payable by instalments(Section 67)

A promissory note payable by instalments must be presented for payment on the third dayafter the date fixed for payment of each instalment; and non-payment on such presentmenthas the same effect as non-payment of a note at maturity.

Presentment for payment of instrument payable at specified place and not elsewhere (Section 68)

A promissory note, bill of exchange or cheque made, drawn or accepted payable at a specified place and not elsewhere must, in order to charge any party thereto, be presentedfor payment at that place.

Instrument payable at specified place (Section 69)

A promissory note or bill of exchange made, drawn or accepted payable at a specified place must, in order to charge the maker or drawer thereof, be presented for payment at that place.

Presentment where no exclusive place specified (Section 70)

A promissory note or bill of exchange, not made payable as mentioned in sections 68 and69, must be presented for payment at the place of business (if any) or at the usual residence,of the maker, drawee or acceptor thereof, as the case may be.

Presentment when maker, etc., has no known place of business or residence (Section 71)

If the maker, drawee or acceptor of a negotiable instrument has no known place of business or fixed

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residence, and no place is specified in the instrument for presentment for acceptance or payment, such presentment may be made to him in person wherever he canbe found.

Presentment of cheque to charge drawer (Section 72)

Subject to the provisions of section 84, a cheque must, in order to charge the drawer, be presented at the bank upon which it is drawn before the relation between the drawer andhis banker has been altered to the prejudice of the drawer.

Presentment of cheque to charge any other person (Section 73)

A cheque must, in order to charge any person except the drawer, be presented within a reasonable time after delivery thereof by such person.

Presentment of instrument payable on demand (Section 74)

Subject to the provisions of section 31, a negotiable instrument payable on demand must be presented for payment within a reasonable time after it is received by the holder.

Presentment by or to agent, representative of deceased, or assignee ofinsolvent (Section 75)

Presentment for acceptance or payment may be made to the duly authorised agent of the drawee, maker or acceptor, as the case may be, or, where the drawee, maker or acceptor has died, to his legal representative, or, where he has been declared an insolvent, to his assignee.

Excuse for delay in presentment for acceptance or payment (Section 75A)

Delay in presentment for acceptance or payment is excused if the delay is caused by circumstances beyond the control of the holder, and not imputable to his default,misconduct or negligence. When the cause of the delay ceases to operate, presentment must be made within a reasonable time.

When presentment unnecessary (Section 76)

No presentment for payment is necessary, and the instrument is dishonoured at the due date for presentment, in any of the following cases:

(a) (i) If the maker, drawee or acceptor intentionally prevents the presentment of the instrument, or
if the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or

(ii) if the instrument being payable at some other specified place, neither he norany person authorised to pay it attends at such place during the usual business hours, or

(iii) if the instrument not being payable at any specified place, he cannot after due search be found;

(b) as against any party sought to be charged therewith, if he has engaged to pay notwithstanding non-presentment;

(c) as against any party if, after maturity, with knowledge that the instrument has notbeen presented—

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- he makes a part payment on account of the amount due on the instrument,
- or promises to pay the amount due thereon in whole or in part,
- or otherwise waives his right to take advantage of any default in presentmentfor payment;

(d) as against the drawer, if the drawer could not suffer damage from the want of such presentment.

Liability of banker for negligently dealing with bill presented for payment (Section 77)

When a bill of exchange, accepted payable at a specified bank, has been duly presented there for payment and dishonoured, if the banker so negligently or improperly keeps, dealswith or delivers back such bill as to cause loss to the holder, he must compensate the holder for such loss.

15. RULES OF COMPENSATION

Rules as to compensation (Section 117)

The compensation payable in case of dishonour of promissory note, bill of exchange or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules:

(a) the holder is entitled to the amount due upon the instrument, together with the expenses properly incurred in presenting, noting and protesting it;

(b) when the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rateof exchange between the two places;

(c) an endorser who, being liable, has paid the amount due on the same is entitled to the amount so paid with interest at 18% per annum from the date of payment until tender or realisation thereof, together with all expenses caused by the dishonour and payment;

(d) when the person charged and such endorser reside at different places, the endorseris entitled to receive such sum at the current rate of exchange between the two places;

(e) the party entitled to compensation may draw a bill upon the party liable to compensate him, payable at sight or on demand, for the amount due to him, together with all expenses properly incurred by him. Such bill must be accompaniedby the instrument dishonoured and the protest thereof (if any). If such bill is dishonoured, the party dishonouring the same is liable to make compensation thereof in the same manner as in the case of the original bill.

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