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TO
QUESTIONS
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PAPER – 3 : BUSINESS AND CORPORATE LAWS



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CONTENTS

- CHAPTER - 1** The Indian Contract Act, 1872
- CHAPTER - 2** The Sale of Goods Act, 1930
- CHAPTER - 3** The India Partnership Act, 1932
- CHAPTER - 4** The Negotiable Instruments Act, 1881
- CHAPTER - 5** The Payment of Bonus Act, 1965
- CHAPTER - 6** The Employees Provident Fund and
Miscellaneous Provision Act, 1952
- CHAPTER - 7** The Cooperative Societies Act, 1912 Including
the Multi-state Cooperative Societies Act,
2002
- CHAPTER - 8** The Companies Act, 1956

THE INDIAN CONTRACT ACT, 1872

Question 1

What is meant by 'Undue Influence'? 'A' applies to a banker for a loan at a time where there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. Whether the contract is induced by undue influence? Decide. (Nov. 2002)

Answer

Meaning of Undue Influence:

Section 16 of the Indian Contract Act, 1872, states that a contract is said to be induced by undue influence where the relations subsisting between the parties are such that the parties are in a position to dominate the will of the other and used that position to obtain an unfair advantage over the other.

A person is deemed to be in that position:

- (a) where he holds real or apparent authority over the other or stands in a fiduciary relation to him;
- (b) where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of old age, illness or mental or bodily distress.
- (c) where a man who is in position to dominate the will of the other enters into contract with him and the transaction appears to be unconscionable, the burden of proving that it is fair, is on him, who is in such a position.

When one of the parties who has obtained the benefits of a transaction is in a position to dominate the will of the other, and the transaction between the parties appears to be unconscionable, the law raises a presumption of undue influence [section 16(3)]. Every transaction where the terms are to the disadvantage of one of the parties need not necessarily be considered to be unconscionable. If the contract is to the advantage of one of the parties but

the same has been made in the ordinary course of business the presumption of undue influence would not be raised.

In the given problem, A applies to the banker for a loan at a time when there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. This is a transaction in the ordinary course of business, and the contract is not induced by undue influence. As between parties on an equal footing, the court will not hold a bargain to be unconscionable merely on the ground of high interest. Only where the lender is in a position to dominate the will of the borrower, the relief is granted on the ground of undue influence. But this is not the situation in this problem, and therefore, there is no undue influence.

Question 2

'A' stands surety for 'B' for any amount which 'C' may lend to B from time to time during the next three months subject to a maximum of Rs.50,000. One month later A revokes the guarantee, when C had lent to B Rs.5,000. Referring to the provisions of the Indian Contract Act, 1872 decide whether 'A' is discharged from all the liabilities to 'C' for any subsequent loan. What would be your answer in case 'B' makes a default in paying back to 'C' the money already borrowed i.e. Rs.5,000? (Nov. 2002)

Answer

The problem as asked in the question is based on the provisions of the Indian Contract Act 1872, as contained in Section 130 relating to the revocation of a continuing guarantee as to future transactions which can be done mainly in the following two ways:

1. *By Notice* : A continuing guarantee may at any time be revoked by the surety as to future transactions, by notice to the creditor.
2. *By death of surety*: The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions. (Section 131).

The liability of the surety for previous transactions however remains.

Thus applying the above provisions in the given case, A is discharged from all the liabilities to C for any subsequent loan.

Answer in the second case would differ i.e. A is liable to C for Rs. 5,000 on default of B since the loan was taken before the notice of revocation was given to C.

Question 3

State the grounds upon which a contract may be discharged under the provisions of Indian Contract Act, 1872 (Nov. 2002)

Answer

Discharge of a Contract:

A Contract may be discharged either by an act of parties or by an operation of law which may be enumerated as follows :

- (1) *Discharge by performance* which may be actual performance or tender of performance. Actual performance is said to have taken place, when each of the parties has done what he had agreed to do under the agreement. When the promisor offers to perform his obligation, but the promisee refuses to accept the performance. It amounts to attempted performance or tender :
- (2) *Discharge by mutual agreement* : Section 62 of the Indian Contract Act, 1872 provides if the parties to a contract agree to substitute a new contract for it or to refund or remit or alter it, the original contract need not to be performed. Novation, Rescission, Alteration and Remission are also the same ground of this nature.
- (3) *Discharge by impossibility of performance* : The impossibility may exist from its initiation. Alternatively, it may be supervening impossibility which may take place owing to (a). unforeseen change in law (b). The destruction of subject matter (c). The non-existence or non-occurrence of particular state of things d). the declaration of war (Section 56).
- (4) *Discharge by lapse of time* : A contract should be performed within a specific period as prescribed in the Law of Limitation Act, 1963. If it is not performed the party is deprived of remedy at law.
- (5) *Discharge by operation of law* : It may occur by death of the promisor, by insolvency etc.
- (6) *Discharge by breach of contract* : Breach of contract may be actual breach of contract or anticipatory breach of contract. When a person repudiates a contract before the stipulated time, for its performance has

arrived, it is an anticipatory breach. If one of the parties to a contract breaks the contract the party injured thereby has a right of action for damages as well as he is also discharged from performing his part of the contract (Section 64).

- (7) A promise may dispense with or remit the performance of the promise made to him or may accept any satisfaction he thinks fit. In the first case, the contract will be discharged by remission and in the second it is accord and satisfaction (Section 63).
- (8) When a promisee neglects or refuses to afford the promisor reasonable facilities for the performance of the promise, the promisor is excused by such neglect or refusal (Section 67).

Question 4

*What is the status of a "finder of goods" under the Indian Contract Act, 1872?
What are his rights?* (May 2003)

Answer

Status of a Finder of Goods & his Rights:

A person, who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a bailee. He is bound to take as much care of the goods as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value. He must also take all necessary measures to trace its owner. If he does not, he will be guilty of wrongful conversion of the property. Till the owner is found out, the property in goods will vest with the finder and he can retain the goods as his own against the whole world (except the owner, of course).

A finder of goods has the following rights under the Indian Contract Act, 1872

1. *Right of lien:* The finder of goods has a right of lien over the goods for his expenses. As such he can retain the goods against the owner until he receives compensation for trouble and expenses incurred in preserving the goods and finding out the owner. But he has no right to sue the owner for any such compensation (Section 168).
2. *Right to sue for reward.* The finder can sue for any specific reward which the owner has offered for the return of the goods. He may also retain the goods until he receives the reward. (Section 168)

3. *Right or resale*: The finder has a right to sell the goods in the following cases:
- (a) where the goods found is in danger of perishing;
 - (b) where the owner cannot, with reasonable diligence, be found out;
 - (c) where the owner is found out, but he refuses to pay the lawful charges of the finder; and
 - (d) where the lawful charges of the finder, in respect of the goods found, amount to 2/3rd of its value.

Question 5

Explain the general rules of relating to "Acceptance" under the Indian Contract Act, 1872.

(May 2003)

Answer

General Rules of Acceptance: Following are the general rules regarding acceptance under the Indian Contract Act, 1872:

1. Acceptance must be absolute and unqualified [Section 7(1)].
2. Acceptance must be in the prescribed manner. If the offer is not accepted in the prescribed manner, then the offeror may reject the acceptance within a reasonable time.
3. Acceptance must be communicated to the offeree. If acceptance is communicated to the person, other than the offeror, it will not create any legal relationship.
4. Acceptance must be given by the party to whom the offer is made.
5. Acceptance must be given within the prescribed time or within a reasonable time.
6. Acceptance cannot be given before communication of an offer.
7. Acceptance must be made before the offer lapses or is withdrawn.
8. Acceptance must show intention to fulfil the promise.
9. Acceptance can not be presumed from silence.
10. Doing of desired act amounts to acceptance.

Question 6

What tests can be applied in determining whether a person is an agent of another? State any five circumstances whereunder an agent is personally liable to a third party for the acts during the course of agency . (May 2003)

Answer

Determining Agency & Agent

The test for determining whether a person is or is not an agent is whether that person has the capacity to bind the principal and make him answerable to a third person by bringing him (the principal) into legal relations with the third person and thus establish a privity of contract between the party and the principal. If yes, he is agent, otherwise not. This relationship of agency may be created either by express agreement or by implication:

Under the following circumstances an agent is personally liable.

1. When he represents that he has authority to act on behalf of his principal, but who does not actually possess such authority or who has exceeded that authority and the alleged employer does not ratify his acts. Any loss sustained by a third party by the acts of such a person (agent) and who relies upon the representation is to be made good by such an agent.
2. Where a contract is entered into by a person apparently in the character of agent, but in reality on his own account, he is not entitled to required performance of it.
3. Where the contract expressly provides for the personal liability of the agent.
4. When the agent signs a negotiable instrument in his own name without making it clear that he is signing as an agent.
5. Where the agent acts for a principal who cannot be sued on account of his being a foreign Sovereign, Ambassador, etc.
6. Where the agent works for a foreign principal.
7. Where a Government Servant enters into a contract on behalf of the Union of India in disregard of Article 299 (1) of the Constitution of India, In such a case the suit against the agent can be instituted by the third party only and not by the principal (*Chatturbhuj v. Moheshwar*).
8. Where according to the usage of trade in certain kinds of business, agents are personally liable.

Question 7

Explain the concept of 'misrepresentation' in matters of contract. Sohan induced Suraj to buy his motorcycle saying that it was in a very good condition. After taking the motorcycle, Suraj complained that there were many defects in the motorcycle. Sohan proposed to get it repaired and promised to pay 40% cost of repairs. After a few days, the motorcycle did not work at all. Now Suraj wants to rescind the contract. Decide giving reasons. (November 2003)

Answer

Misrepresentation & the Problem: According to Section 18 of the Indian Contract Act, 1872, misrepresentation is there:

1. When a person positively asserts that a fact is true when his information does not warrant it to be so, though he believes it to be true.
2. When there is any breach of duty by a person, which brings an advantage to the person committing it by misleading another to his prejudice.
3. When a party causes, however, innocently, the other party to the agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

Problem:

The aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872]. The aggrieved party loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contract or in some way affirms it. Accordingly in the given case Suraj could not rescind the contract, as his acceptance to the offer of Sohan to bear 40% of the cost of repairs impliedly amount to final acceptance of the sale [Long v. Lloyd, (1958)].

Question 8

Sunil delivered his car to Mahesh for repairs. Mahesh completed the work, but did not return the car to Sunil within reasonable time, though Sunil repeatedly reminded Mahesh for the return of car. In the meantime a big fire occurred in the neighborhood and the car was destroyed. Decide whether Mahesh can be held liable under the provisions of the Indian Contract Act, 1872. (November 2003)

Answer

The problem asked in the question is based on the provisions of section 160 and 161 of the Indian Contract Act 1872. Accordingly, it is the duty of the bailee to return or deliver the goods bailed according to the bailor's directions, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed for any loss, destruction of the goods from that time (Section 161), notwithstanding the exercise of reasonable care on his part.

Therefore, applying the above provisions in the given case, Mahesh is liable for the loss, although he was not negligent, but because of his failure to deliver the car within a reasonable time (*Shaw & Co. v. Symmons & Sons*).

Question 9

What do you understand by "Agency by Ratification"? What is the effect of ratification? Point out any four elements of a valid ratification. (November 2003)

Answer

Agency by Ratification; its effect & essentials of valid ratification:

Meaning: A person may act on behalf of another without his knowledge or consent. Later on such another person may accept the act of the former or reject it. If he accepts the act of the former done without his consent, he is said to have ratified that act and it places the parties in exactly the same position in which they would have been if the former had later's authority at the time he made the contract. Likewise, when an agent exceeds the authority bestowed upon him by the principal, the principal may ratify the unauthorised act.

Effect of Ratification: The effect of ratification is to tender the acts done by one person (agent) on behalf of another (principal), without his (principal's) knowledge or authority, as binding on the other person (principal) as if they had been performed by his authority (Section 196: Indian Contract Act, 1872).

Further, ratification relates back to the date when the act was done by the agent. This means the agency comes into existence from the moment the agent first acted and not from the time when the principal ratified the act.

Essentials of a valid Ratification

1. The agent must purport to act as agent for a principal who is in contemplation and is identifiable at the time of contract.
2. The principal must be in existence at the time of contract.
3. The principal must have contractual capacity both at the time of the contract and at the time of ratification.
4. The principal must have the full knowledge of all the material facts.
5. Ratification must be done within a reasonable time of the act purported to be ratified.
6. The act to be ratified must be lawful and not void or illegal or ultra vires in case of a company.
7. The whole transaction can be ratified.
8. Ratification must be communicated to the party who is sought to be bound by the act done by the agent.
9. Ratification can be of the acts which the principal had the power to do.
10. Ratification should not put a third party to damages.

11. Ratification relates back to the date of the act of the agent.

Question 10

Shambhu Dayal started "self service" system in his shop. Smt. Prakash entered the shop, took a basket and after taking articles of her choice into the basket reached the cashier for payments. The cashier refuses to accept the price. Can Shambhu Dayal be compelled to sell the said articles to Smt. Prakash? Decide. (May 2004)

Answer

Invitation to offer

The offer should be distinguished from an invitation to offer. An offer is the final expression of willingness by the offeror to be bound by his offer should the party chooses to accept it. Where a party, without expressing his final willingness, proposes certain terms on which he is willing to negotiate, he does not make an offer, but invites only the other party to make an offer on those terms. This is the basic distinction between offer and invitation to offer.

The display of articles with a price in it in a self-service shop is merely an invitation to offer. It is in no sense an offer for sale, the acceptance of which constitutes a contract. In this case, Smt. Prakash in selecting some articles and approaching the cashier for payment simply made an offer to buy the articles selected by her. If the cashier does not accept the price, the interested buyer cannot compel him to sell. [*Fisher V. Bell (1961) Q.B. 394 Pharmaceutical society of Great Britain V. Boots Cash Chemists*].

Question 11

Akhilesh entered into an agreement with Shekhar to deliver him (Shekhar) 5,000 bags to be manufactured in his factory. The bags could not be manufactured because of strike by the workers and Akhilesh failed to supply the said bags to Shekhar. Decide whether Akhilesh can be exempted from liability under the provisions of the Indian Contract Act, 1872. (May 2004))

Answer

Delivery of Bags

According to Section 56 (Para 2) of Indian Contract Act, 1872 when the performance of a contract becomes impossible or unlawful subsequent to its formation, the contract becomes void, this is termed as 'supervening

impossibility' (i.e. impossibility which does not exist at the time of making the contract, but which arises subsequently).

But impossibility of performance is, as a rule, not an excuse from performance. It means that when a person has promised to do something, he must perform his promise unless the performance becomes absolutely impossible. Whether a promise becomes absolutely impossible depends upon the facts of each case.

The performance does not become absolutely impossible on account of strikes, lockout and civil disturbances and the contract in such a case is not discharged unless otherwise agreed by the parties to the contract (*Budget V Bennington; Jacobs V Credit Lyonnais*).

In this case Mr. Akhilesh could not deliver the bags as promised because of strike by the workers. This difficulty in performance cannot be considered as impossible of performance attracting Section 56 (Para 2) and hence Mr. Akhilesh is liable to Mr. Shekhar for non-performance of contract.

Question 12

Mr. Seth an industrialist has been fighting a long drawn litigation with Mr. Raman another industrialist. To support his legal campaign Mr. Seth enlists the services of Mr. X a legal expert stating that an amount of Rs. 5 lakhs would be paid, if Mr. X does not take up the brief of Mr. Raman. Mr. X agrees, but at the end of the litigation Mr. Seth refuses to pay. Decide whether Mr. X can recover the amount promised by Mr. Seth under the provisions of the Indian Contract Act, 1872.
(November 2004)

Answer

The problem as asked in the question is based on one of the essentials of a valid contract. Accordingly, one of the essential elements of a valid contract is that the agreement must not be one which the law declares to be either illegal or void. A void agreement is one without any legal effect. Thus any agreement in restraint of trade, marriage, legal proceedings etc., are void agreements. Thus Mr. X cannot recover the amount of Rs. 5 lakhs promised by Mr. Seth because it is an illegal agreement and cannot be enforced by law.

Question 13

What is meant by Anticipatory Breach of Contract?

Mr. Dubious textile enters into a contract with Retail Garments Show Room for supply of 1,000 pieces of Cotton Shirts at Rs.300 per shirt to be supplied on or before 31st December, 2004. However, on 1st November, 2004 Dubious Textiles informs the Retail Garments Show Room that he is not willing to supply the goods as the price of Cotton shirts in the meantime has gone upto Rs. 350 per shirt. Examine the rights of the Retail Garments Show Room in this regard.
(November 2004)

Answer

Anticipatory breach of contract

Anticipatory breach of contract occurs when the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived. In such a situation the promisee can claim compensation by way of loss or damage caused to him by the refusal of the

promisor. For this, the promisee need not wait till the time stipulated in the contract for fulfillment of the promise by the promisor is over.

In the given problem Dubious Textiles has indicated its unwillingness to supply the cotton shirts on 1st November 2004 itself when it has time upto 31st December 2004 for performance of the contract of supply of goods. It is therefore called anticipatory breach of contract. Thus Retail Garments showroom can claim damages from Dubious Textiles immediately after 1st November, 2004, without waiting upto 31st December 2004. The damages will be calculated at the rate of Rs. 50 per shirt i.e. the difference between Rs. 350/- (the price prevailing on 1st November) and Rs. 300/- the contracted price.

Question 14

Distinguish between Contract of Indemnity and Contract of Guarantee. (November 2004)

Answer

Contract of indemnity	Contract of Guarantee
1. There are two parties to the contract viz. indemnifier (promisor) and the Indemnified (promisee).	1. There are three parties to the viz. creditor, principal debtor and the surety
2. Liability of the indemnifier to the indemnified is primary and independent.	2. Liability of the surety to the creditor is collateral or secondary, the primary liability being that of the principal debtor.
3. There is only one contract in case of a contract of indemnity, i.e., between the indemnifier and the indemnified.	3. In a contract of guarantee there are three contracts, between principal Debtor and Creditor; between creditor and the surety and between surety and principal debtor.
4. It is not necessary for the indemnifier to act at the request	4. It is necessary that surety should give the guarantee at the request

of the indemnified.	of the debtor.
5 The liability of the indemnifier arises only on the happening of a contingency.	5. There is usually an existing debt or duty, the performance of which is guaranteed by the surety.
6 An indemnifier cannot sue a third party for loss in his own name, because there is no privity of contract. He can do so only if there is an assignment in his favour.	6. A surety, on discharging the debt due by the principal debtor, steps into the shoes of the creditor. He can proceed against the principal debtor in his own right

Question 15

Father promised to pay his son a sum of Rs. One lakh if the son passed C.A. examination in the first attempt. The son passed the examination in the first attempt, but father failed to pay the amount as promised. Son files a suit for recovery of the amount. State along with reasons whether son can recover the amount under the Indian Contract Act, 1872

(May

2005)

Answer

Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 10. According to the provisions there should be an intention to create legal relationship between the parties. Agreements of a social nature or domestic nature do not contemplate legal relationship and as such are not contracts, which can be enforced. This principle has been laid down in the case of Balfour vs. Balfour (1912 2 KB. 571). Accordingly, applying the above provisions and the case decision, in this case son cannot recover the amount of Rs.1 lakh from father for the reasons explained above.

Question 16

A hire a carriage of B and agrees to pay Rs.500 as hire charges. The carriage is unsafe, though B is unaware of it. A is injured and claims compensation for injuries suffered by him. B refuses to pay. Discuss the liability of B (May 2005)

Answer

Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 150. The section provides that if the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed. Accordingly, applying the above provisions in the given case B is responsible to compensate A for the injuries sustained even if he was not aware of the defect in the carriage.

Question 17

M Ltd., contracts with Shanti Traders to make and deliver certain machinery to them by 30.6.2004 for Rs. 11.50 lakhs. Due to labour strike, M Ltd. could not manufacture and deliver the machinery to Shanti Traders. Later, Shanti Traders procured the machinery from another manufacturer for Rs.12.75 lakhs. Shanti Traders was also prevented from performing a contract which it had made with Zenith Traders at the time of their contract with M Ltd. and were compelled to pay compensation for breach of contract. Advise Shanti Traders the amount of compensation which it can claim from M Ltd., referring to the legal provisions of the Indian Contract Act. (May 2005)

Answer

Section 73 of the Indian Contract Act, 1872 provides for consequences of breach of contract. According to it, when a contract has been broken, the party who suffers by such 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. Such compensation is not given for any remote and indirect loss or damage sustained by reason of the breach. It is further provided in the explanation to the section that in estimating the loss or damage from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken

into account.

Applying the above principle of law to the given case, M Ltd is obliged to compensate for the loss of Rs.1.25 lakhs (i.e. Rs.12.75 minus Rs.11.50 = Rs. 1.25 lakhs) which had naturally arisen due to default in performing the contract by the specified date.

Regarding the amount of compensation which Shanti Traders were compelled to make to Zenith Traders, it depends upon the fact whether M Ltd knew about the contract of Shanti Traders for supply of the contracted machinery to Zenith Traders on the specified date. If so, M Ltd is also obliged to reimburse the compensation which Shanti Traders had to pay to Zenith Traders for breach of contract. Otherwise M Ltd is not liable.

Question 18

Mr. Ahuja of Delhi engaged Mr. Singh as his agent to buy a house in West Extension area. Mr. Singh bought a house for Rs.20 lakhs in the name of a nominee and then purchased it himself for Rs.24 lakhs. He then sold the same house to Mr. Ahuja for Rs.26 lakhs. Mr. Ahuja later comes to know the mischief of Mr. Singh and tries to recover the excess amount paid to Mr. Singh. Is he entitled to recover any amount from Mr. Singh? If so, how much? Explain.

(November

2005)

Answer

The problem in this case, is based on the provisions of the Indian Contract Act, 1872 as contained in Section 215 read with Section 216. The two sections provide, that where an agent without the knowledge of the principal, deals in the business of agency on his own account, the principal may:

- (1) repudiate the transaction, if the case shows, either that the agent has dishonestly concealed any material fact from him, or that the dealings of the agent have been disadvantageous to him.
- (2) claim from the agent any benefit, which may have resulted to him from the transaction.

Therefore, based on the above provisions, Mr. Ahuja is entitled to recover Rs.6 lakhs from Mr. Singh being the amount of profit earned by Mr. Singh out of the transaction.

Question 19

Miss X, a film actress agreed to work exclusively for a period of two years, for a film production company. However, during the said period she enters into a contract to work for another film producer. Discuss the rights of the aggrieved film production company under the Indian Contract Act, 1872. (November 2005)

Answer

Where a party commits a breach of negative term of a contract i.e., where he does something which he promised not to do, the aggrieved party can go to court which may issue an order restraining him from doing what he promised not to do. Such an order of the court is known as injunction. Since Miss X has agreed to work exclusively for the film production company for a period of two years, the aggrieved film production company can go to court and get injunction order restraining Miss X working for another film production company. A similar decision was taken in the case of *Warrior Bros vs. Nelson* (1937) 1 K.B. 209

Question 20

“An agreement made without consideration is void. “With reference to provisions of the Indian Contract Act, 1872 examine the validity of the statement and explain the cases in which the statement does not apply. (November 2005)

Answer

Validity of an Agreement without consideration: The general rule is that an agreement made without consideration is void (Section 25). In every valid contract consideration is very important. A contract may only be enforceable when an adequate consideration is there. However, the Indian Contract Act, 1872 contains certain exceptions to this rule. In the following cases, the agreement though made without consideration, will be valid and enforceable.

1. 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. A contract in writing, registered on account of natural love and affection between parties standing near relation to each other are the essential requirements for valid contract though it is without consideration. (*Rajlukhee Devjee vs. Bhootnath*).

2. 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 under (Section 25(2)). In order that a promise to pay for the past voluntary services is binding, the following essential factors must exist:

- (i) the services should have been rendered voluntarily.
- (ii) the services must have been rendered for the promisor.
- (iii) the promisor must be in existence at the time when services were rendered.
- (iv) the Promisor must have intended to compensate to the promisee.

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

4. Agency: According to Section 185 of the Indian Contract Act, 1872 no consideration is necessary to create an agency.s

5. Completed gift: In case of completed gifts, the rule no consideration no contract does not apply. Explanation (1) to Section 25 of the Act states “Nothing in this section shall affect the validity as between the donor and donee, of any gift actually made.” Thus, gifts do not require any consideration.

Question 21

Examine the validity of a contract when the acceptance from the offeree is obtained under ‘Coercion’ or under ‘Undue influence’. Point out the distinction between ‘Coercion’ and ‘Undue influence’.

(November 2005)

Answer

According to Section 19 of the Indian Contract Act, 1872 when consent to an agreement is given due to coercion or undue influences, such a contract is voidable at the option of the party whose consent was so obtained. The difference between coercion and undue influence is as under:

Coercion	Undue Influence
(a) It involves the physical force or threat. The aggrieved party is complete to make the contract	It involves moral or mental pressure. The aggrieved party believes that he or she would

	against its will.	make the contract.
(b)	It involves committing or threatening to commit an act forbidden by Indian Penal Code for detaining or threatening to detain property of another person.	No such illegal act is committed or a threat is given.
(c)	It is not necessary that there must be some relationship between the parties.	Some sort of relationship between the parties is absolutely necessary.
(d)	Coercion need not proceed from the promisor nor need it be directed against the promisor.	Undue influence is always essential between the parties to the contract.
(e)	The contract is voidable at the option of the party whose consent has been obtained by the coercion.	Where consent is induced by undue influence, the contract is either voidable or the court may set it aside or enforce it in a modified form.
(f)	In case of coercion where the aggrieved party, as per Section 64, rescinds the contract any benefit received has to be restored back to the other party.	The court has the distinction to direct the aggrieved party to return the benefit in whole or in part or not to give any such directions.

Question 22

Ramaswami proposed to sell his house to Ramanathan. Ramanathan sent his acceptance by post. Next day, Ramanathan sends a telegram withdrawing his acceptance. Examine the validity of the acceptance in the light of the following:

- (i) The telegram of revocation of acceptance was received by Ramaswami before the letter of acceptance.*
- (ii) The telegram of revocation and letter of acceptance both reached together.*

(May 2006)

Answer

The problem is related with the communication and time of acceptance and its revocation. As per Section 4 of the Indian Contract Act, 1872, the communication of an acceptance is complete as against the acceptor when it comes to the knowledge of the proposer.

An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

Referring to the above provisions

- (i) Yes, the revocation of acceptance by Ramanathan (the acceptor) is valid.
- (ii) If Ramaswami opens the telegram first (and this would be normally so in case of a rational person) and reads it, the acceptance stands revoked. If he opens the letter first and reads it, revocation of acceptance is not possible as the contract has already been concluded

Question 23

Explain the circumstances whereunder a party to a contract may be exempted from the performance of contract on the ground of 'Supervening impossibility' under the Indian Contract Act, 1872.

(May 2006)

Answer

Supervening impossibility: When performance of a promise becomes impossible or illegal by occurrence of an unexpected, event or a change of circumstances beyond the contemplation of parties, is called supervening impossibility. In case of supervening impossibility the contract becomes void.

Circumstances: A party to a contract may be excused from the performance of his promise on the ground of 'supervening impossibility' under the Indian Contract Act, 1872 in the following circumstances.

- (a) Accidental destruction of the subject matter of the contract: If the subject matter of the contract is destroyed by an accident both the parties are excused from the performance of the contract.
- (b) Non-existence or non occurrence of a particular state of things: Non-existence or non occurrence of a particular state of things of the contract exempts the parties from the performance of the contract.

- (c) Incapacity to perform a contract of personal services: In case of contract of personal service, disability or incapacity to perform, caused by the act of God e.g. illness, constitutes lawful excuse for non-performance of the contract.
- (d) Change in law: Performance of a contract may also become impossible due to a subsequent change in the law. The law passed after the contract may prohibit performance of some act, which may be very basis of the contract. As such the contract is discharged due to subsequent impossibility and the parties become free from their mutual obligations.
- (e) Outbreak of war: Contracts may be affected by war in a variety of ways, viz., (i) by emergency legislation controlling prices or otherwise relating to restriction of trade; (ii) by prohibiting or restraining transaction with alien enemy.

Question 24

Ravi becomes guarantor for Ashok for the amount which may be given to him by Nalin within six months. The maximum limit of the said amount is Rs. 1 lakh. After two months Ravi withdraws his guarantee. Upto the time of revocation of guarantee, Nalin had given to Ashok Rs. 20,000.

(i) Whether Ravi is discharged from his liabilities to Nalin for any subsequent loan.

(ii) Whether Ravi is liable if Ashok fails to pay the amount of Rs. 20,000 to Nalin ?

(May 2006)

Answer

Discharge of Surety by Revocation (Problem): As per section 130 of the India Contract Act, 1872 a specific guarantee cannot be revoked by the surety if the liability has already accrued. A continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor, but the surety remains liable for transactions already entered into.

As per the above provisions (i) Yes, Ravi is discharged from all the subsequent loan because it's a case of continuing guarantee. (ii) Ravi is liable for payment of Rs. 20,000 Nalin because the transaction has already completed

Question 24

X, a minor was studying in M.Com. in a college. On 1st July, 2005 he took a loan of Rs. 10,000 from B for payment of his college fees and to purchase books and agreed to repay by 31st December, 2005. X possesses assets worth Rs. 2 lakhs. On due date X fails to pay back the loan to B. B now wants to recover the loan from X out of his (X's) assets. Referring to the provisions of Indian Contract Act, 1872 decide whether B would succeed. (November 2006)

Answer

Yes, B can proceed against the assets of X. According to section 68 of Indian Contract Act 1872 "If a person, incapable of entering into a contract, or any one 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." Since the loan given to X is for the necessaries suited to the conditions in life of the minor, his assets can be sued to reimburse B.

Question 25

"The relationship of principal and agent (i.e. Agency) may be constituted by Subsequent ratification by the principal." Examine the validity of the statement and state the requisites of a valid ratification in the light of the provisions of the Indian Contract Act, 1872.

(November 2006)

Answer

Where an agent does an act for his principal without his knowledge or authority or where he exceeds the given authority, the principal is not held bound by the transaction so made. However, Section 196 of the Indian Contract Act, 1872, permits the principal to ratify the act of the agent. According to this section "Where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratify them, the same effects will follow as if they had been performed by his authority "Agency in such a case is said to be constituted by ratification.

To be valid, a ratification must fulfill the following conditions:

- (i) The agent must purport to act an agent.

- (ii) The principal must have been in existence at the time the agent originally acted.
- (iii) Ratification may be expressed or implied (Section 197).
- (iv) No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective (Section 198).
- (v) Ratification must be of the entire transaction. A contract cannot be ratified partially (Section 199).
- (vi) Ratification of unauthorized act must not injure third person. (Section 200)
- (vii) An illegal act cannot be ratified.
- (viii) The person ratifying the act must have contractual capacity.

Question 26

Explaining the provisions of the Indian Contract Act, 1872, answer the following:

- (i) *A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability ?*
- (ii) *C, the holder of an over due bill of exchange drawn by A as surety for B, and accepted by B, contracts with X to give time to B. Is A discharged from his liability ?(November 2006)*

Answer

- (i) According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission for the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case the B omits to supply the timber. Hence C is discharged from his liability.
- (ii) According to Section 136 of the Indian Contract Act, 1872, where a contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor, the surety is not discharged. In the given question the contract to give time to the

principal debtor is made by the creditor with X who is a third person. X is not the principal debtor. Hence A is not discharged.

Question 27

Y holds agricultural land in Gujarat on a lease granted by X, the owner. The land revenue payable by X to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue law, the consequence of such sale will be termination of Y's lease. Y, in order to prevent the sale and the consequent termination of his own lease, pays the Government, the sum due from X. Referring to the provisions of the Indian Contract Act, 1872 decide whether X is liable to make good to Y, the amount so paid ?
(May 2007)

Answer

Yes, X is bound to make good to Y the amount so paid. Section 69 of the Indian Contract Act, 1872, provides that "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. In the given case Y has made the payment of lawful dues of X in which Y had an interest. Therefore, Y is entitled to get the reimbursement from X.

Question 28

Examine whether the following constitute a contract of 'Bailment' under the provisions of the Indian Contract Act, 1872:

- (i) *V parks his car at a parking lot, locks it, and keeps the keys with himself.*
- (ii) *Seizure of goods by customs authorities.* (May 2007)

Answer

- (i) No. Mere custody of goods does not mean possession. For a bailment to exist the bailor must give possession of the bailed property and the bailee must accept it (Section 148, Indian Contract Act, 1872 is not applicable).
- (ii) Yes, the possession of the goods is transferred to the custom authorities. Therefore bailment exists and section 148 is applicable.

Question 29

A contracted with B to supply him (B) 500 tons of iron-steel @ Rs. 5,000 per ton, to be delivered at a specified time. Thereafter, A contracts with C for the purchase of 500 tons of iron-steel @ Rs. 4,800 per ton, and at the same time told 'C' that he did so for the purpose of performing his contract entered into with B. C failed to perform his contract in due course. Consequently, A could not procure any iron-steel and B rescinded the contract. What would be the amount of damages which A could claim from C in the circumstances ? Explain with reference to the provisions of the Indian Contract, 1872. (May 2007)

Answer

The problem in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 73. Section 73 provides that when a contract has been broken the party who suffers by such 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. The leading case in this point is *Hadley v Baxendale*.

In "*Hadley vs. Baxendale*" it was decided that if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.

In the instant case 'A' had intimated to 'C' that he was procuring iron steel from him for the purpose of performing his contract with 'B' Thus, C had the knowledge of the special circumstance. Therefore, 'A' is entitled to claim from 'C' Rs. 1,00,000 (difference between the procuring price of iron steel and contracted selling price to 'B') being the amount of profit 'A' would have made by the performance of his contract with 'B'. If A had not told C of B's contract then the amount of damages would have been the difference between the contract price and the market price on the day of default

Question 30

'X' agreed to become an assistant for 5 years to 'Y' who was a Doctor practising at Ludhiana. It was also agreed that during the term of agreement 'X' will not practise on his own account in Ludhiana. At the end of one year, 'X'

left the assistantship of 'Y' and began to practise on his own account. Referring to the provisions of the Indian Contract Act, 1872, decide whether 'X' could be restrained from doing so? (November 2007)

Answer

An agreement in restraint of trade/business/profession is void under Section 27 of the Indian Contract Act, 1872. But an agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else directly or indirectly to promote any business in direct competition with that of his employer is not in restraint of trade. However in the given case X cannot be restrained by an injunction from doing so.

Question 31

X transferred his house to his daughter M by way of gift. The gift deed, executed by X, contained a direction that M shall pay a sum of Rs. 5,000 per month to N (the sister of the executant). Consequently M executed an instrument in favour of N agreeing to pay the said sum. Afterwards, M refused to pay the sum to N saying that she is not liable to N because no consideration had moved from her. Decide with reasons under the provisions of the Indian Contract Act, 1872 whether M is liable to pay the said sum to N. (November 2007)

Answer

As per Section 2 (d) of the Indian Contract Act, 1872, in India, it is not necessary that consideration must be supplied by the party, it may be supplied by any other person including a stranger to the transaction.

The problem is based on a case "*Chinnaya Vs. Ramayya*" in which the Court clearly observed that the consideration need not necessarily move from the party itself, it may move from any person. In the given problem, the same reason applies. Hence, M is liable to pay the said sum to N and cannot deny her liability on the ground that consideration did not move from N.

Question 32

X, Y and Z jointly borrowed Rs.50,000 from A. The whole amount was repaid to A by Y. Decide in the light of the Indian Contract Act, 1872 whether:

- (i) Y can recover the contribution from X and Z,*
- (ii) legal representatives of X are liable in case of death of X,*

- (iii) *Y can recover the contribution from the assets, in case Z becomes insolvent.*

(November 2007)

Answer

Section 42 of the Indian Contract Act, 1872 requires that when two or more persons have made a joint promise, then, unless a contrary intention appears by the contract, all such persons jointly must fulfill the promise. In the event of the death of any of them, his representative jointly with the survivors and in case of the death of all promisees, the representatives of all jointly must fulfill the promise.

Section 43 allows the promisee to seek performance from any of the joint promisors. The liability of the joint promisors has thus been made not only joint but "joint and several". Section 43 provides that in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise.

Section 43 deals with the contribution among joint promisors. The promisors, may compel every joint promisors to contribute equally to the performance of the promise (unless a contrary intention appears from the contracts). If any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

As per the provisions of above sections,

- (i) Y can recover the contribution from X and Z because XYZ are joint promisors.
- (ii) Legal representative of X are liable to pay the contribution to Y. However, a legal representative is liable only to the extent of property of the deceased received by him.
- (iii) 'Y' also can recover the contribution from Z's assets.

Question 33

Point out with reasons whether the following agreements are valid or void:

- (i) *Kamala promises Ramesh to lend Rs. 50,000 in lieu of consideration that Ramesh gets Kamala's marriage dissolved and he himself marries her.*
- (ii) *Sohan agrees with Mohan to sell his black horse. Unknown to both the parties, the horse was dead at the time of agreement.*
- (iii) *Ram sells the goodwill of his shop to Shyam for Rs. 4,00,000 and promises*

- not to carry on such business forever and anywhere in India.*
- (iv) *In an agreement between Prakash and Girish, there is a condition that they will not institute legal proceeding against each other without consent..*
- (v) *Ramamurthy, who is a citizen of India, enters into an agreement with an alien friend.*

(May 2008)

Answer

Validity of agreements

- (i) *Void Agreement:* As per Section 23 of the Indian Contract Act, 1872 an agreement is void if the object or consideration is against the public policy.
- (ii) *Void Agreement:* As per Section 20 of the Indian Contract Act, 1872 the contract caused by mistake of fact are void. There is mistake of fact as to the existence of subject-matter.
- (iii) *Void agreement:* As per Section 27 of the Indian Contract Act, 1872 an agreement in restraint of trade is void. However, a buyer can put such a condition on the seller of good will, not to carry on same business. However, the conditions must be reasonable regarding the duration and the place of the business.
- (iv) *Void agreement:* An agreement in restraint of legal proceedings is void as per Section 28 of the Indian Contract Act, 1872.
- (v) *Valid agreement:* An agreement with alien friend is valid, but an agreement with alien enemy is void.

Question 34

Ravi sent a consignment of goods worth Rs. 60,000 by railway and got railway receipt. He obtained an advance of Rs. 30,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security. The railway failed to deliver the goods at the destination. The bank filed a suit against the railway for Rs. 60,000. Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit?

(May 2008)

Answer

Rights of Bailee

As per Sections 178 and 178A of the Indian Contract Act, 1872 the deposit of title deeds with the bank as security against an advance constitutes a pledge. As a pledge, a banker's rights are not limited to his interest in the goods pledged. In case of injury to the goods or their deprivation by a third party, the pledgee would have all such remedies that the owner of the goods would have against them. In *Morvi Mercantile Bank Ltd. vs. Union of India*, the Supreme Court held that the bank (pledgee) was entitled to recover not only the amount of the advance due to it, but the full value of the consignment. However, the amount over and above his interest is to be held by him in trust for the pledgor. Thus, the bank will succeed in this claim of Rs. 60,000 against Railway.

Question 35

R is the wife of P. She purchased some sarees on Credit from Q. Q demanded the amount from P. P refused. Q filed a suit against P for the said amount. Decide in the light of provisions of the Indian Contract Act, 1872, whether Q would succeed?
(May 2008)

Answer

Problem on Agency

Problem as asked in the question is based on the provisions related with the modes of creation of agency relationship under the Indian Contract Act, 1872. Agency may be created by a legal presumption; in a case of cohabitation by a married woman (i.e. wife is considered as an implied agent, of her husband). If wife lives with her husband, there is a legal presumption that a wife has authority to pledge her husband's credit for necessities. But the legal presumption can be rebutted in the following cases:

- (i) Where the goods purchased on credit are not necessities.
- (ii) Where the wife is given sufficient money for purchasing necessities.
- (iii) Where the wife is forbidden from purchasing anything on credit or contracting debts.
- (iv) Where the trader has been expressly warned not to give credit to his wife.

If the wife lives apart for no fault on her part, wife has authority to pledge her husband's credit for necessities. This legal presumption can be rebutted only in cases (iii) and (iv).

Applying the above conditions in the given case 'Q' will succeed. He can recover the said amount from 'P' if sarees purchased by 'R' are necessities for her.

Question 36

M lends a sum of Rs.5,000 to B, on the security of two shares of a Limited Company on 1st April 2007. On 15th June, 2007, the company issued two bonus shares. B returns the loan amount of Rs.5,000 with interest but M returns only two shares which were pledged and refuses to give the two bonus shares. Advise B in the light of the provisions of the Indian Contract Act, 1872. (November 2008)

Answer

Bailee's duties and Liabilities

The problem as asked in the question is based on the provisions of Section 163(4) of the Indian Contract Act, 1872. As per the section, "in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, any increase or profit which may have accrued from the goods bailed."

Applying the provisions to the given case, the bonus shares are an increase on the shares pledged by B to M. So M is liable to return the shares along with the bonus shares and hence B the bailor, is entitled to them also (*Motilal v Bai Mani*).

Question 37

B owes C a debt guaranteed by A. C does not sue B for a year after the debt has become payable. In the meantime, B becomes insolvent. Is A discharged? Decide with reference to the provisions of the Indian Contract Act, 1872. (November 2008)

Answer

Discharge of surety

The problem is based on the provisions of Section 137 of the Indian Contract Act, 1872 relating to discharge of surety. The section states that mere forbearance on the part of the creditor to sue the principal debtor and/or to enforce any other remedy against him would not, in the absence of any

provision in the guarantee to the contrary, discharge the surety. In view of these provisions, A is not discharged from his liability as a surety.

Question 38

“Good Girl” Soap Co. advertised that it would give a reward of Rs.1,000 who developed skin disease after using, “Good Girl” soap of the company for a certain period according to the printed directions. Miss Rakhi purchased the advertised “Good Girl” and developed skin disease in spite of using this soap according to the printed instructions. She claimed reward of Rs.1,000. The company refused the reward on the ground that offer was not made to her and that in any case she had not communicated her acceptance of the offer. Decide whether Miss Rakhi can claim the reward or not. Refer the relevant case law, if any. (November 2008)

Answer

General offer

Yes, Miss Rakhi can claim the reward of Rs.1,000 because the advertisement issued by the company is an offer made to the public in general and hence any one can accept and do the desired act. Where a general offer is of continuing nature, it will be open for acceptance to any number of persons until it is retracted. The Contract Act posits that performance of the conditions of a proposal is an acceptance of the proposal. So there is no need of actual and formal offer and the communication of an acceptance of an offer. Relevant case law is *Carlill v. Carbolic Smoke Ball Co.*

THE SALE OF GOODS ACT, 1930

Question 1

Explain the provisions of law relating to unpaid seller's 'right of lien' and distinguish it from the "right of stoppage the goods in transit". (Nov. 2002)

Answer

Right of lien of an unpaid seller

The legal provisions regarding the right of lien of an unpaid seller has been stated from Sections 47 to 49 of the Sale of Goods Act, 1930 which may be enumerated as follows :

- (i) According to Section 47 the unpaid seller of the goods who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases namely :
 - (a) where the goods have been sold without any stipulation as to credit.
 - (b) where the goods have been sold on credit, but the term of credit has expired; or
 - (c) where the buyer becomes insolvent.

The seller may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer.

- (ii) Section 48 states that 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.
- (iii) According to Section 49 the unpaid seller loses his lien on goods :
 - (a) 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.

- (b) when the buyer or his agent lawfully obtains possession of the goods ;
- (c) by waiver thereof

The unpaid seller of the goods, having a lien thereon, does not lose his lien by reason only that he has obtained a decree to the price of the goods

Right of lien and Right to stoppage the goods in transit; distinction:

- (i) The essence of a right of lien is to retain possession whereas the right of stoppage in transit is right to regain possession.
- (ii) Seller should be in possession of goods under lien while in stoppage in transit (i) Seller should have parted with the possession (ii) possession should be with the carrier and (iii) Buyer has not acquired the possession.
- (iii) Right of lien can be exercised even when the buyer is not insolvent but it is not the case with right of stoppage in transit.
- (iv) Right of stoppage in transit begins when the right of lien ends. Thus the end of the right of lien is starting point of the right of stoppage the goods in transit.

Question 2

What are the consequences of “destruction of goods” under the Sale of Goods Act, 1930, where the goods have been destroyed after the agreement to sell but before the sale is affected.
(May 2003)

Answer

Destruction of Goods-Consequences:

- (i) In accordance with the provisions of the Sale of Goods Act, 1930 as contained in Section 7, a contract for the sale of specific goods is void if at the time when the contract was made; the goods without the knowledge of the seller, perished or become so damaged as no longer to answer to their description in the contract, then the contract is void ab initio. This section is based on the rule that where both the parties to a contract are under a mistake as to a matter of fact essential to a contract, the contract is void.
- (ii) In a similar way Section 8 provides that an agreement to sell specific goods becomes void if 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 agreement before the risk passes to the buyer. This rule is also based on the ground of impossibility of performance as stated above.

It may, however, be noted that section 7 & 8 apply only to specific goods and not to unascertained goods. If the agreement is to sell a certain quantity of unascertained goods, the perishing of even the whole quantity of such goods in the possession of the seller will not relieve him of his obligation to deliver the goods.

Question 3

What do you understand by "Caveat-Emptor" under the sale of Goods Act, 1930? What are the exceptions to this rule?
(May 2003)

Answer

'Caveat emptor' means "let the buyer beware", i.e. in sale of goods the seller is under no duty to reveal unflattering truths about the goods sold. Therefore, when a person buys some goods, he must examine them thoroughly. If the goods turn out to be defective or do not suit his purpose, or if he depends upon his skill and judgment and makes a bad selection, he cannot blame any body excepting himself.

The rule is enunciated in the opening words of section 16 of the Sale of Goods Act, 1930 which runs thus: "Subject to the provisions of this Act and 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"

The rule of caveat emptor does not apply in the following cases:

1. *Fitness for buyer's purpose*: Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which he requires the goods and relies on the seller's skill or judgment and the goods are of a description which it is in the course of the seller's business to supply, the seller must supply the goods which shall be fit for the buyer's purpose. (Section 16(1)).
2. *Sale under a patent or trade name*: In the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied condition that the goods shall be reasonably fit for any particular purpose (Section 16(1)).
3. *Merchantable quality*: Where goods are bought by description from a seller who deals in goods of that description (whether he is in the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality. But if the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed. (Section 16(2)).
4. *Usage of trade*: An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade. (Section 16(3)).
5. *Consent by fraud*: Where the consent of the buyer, in a contract of sale, is obtained by the seller by fraud or where the seller knowingly conceals a defect which could not be discovered on a reasonable examination, the doctrine of caveat emptor does not apply.

Question 4

In what ways does a "Sale" differ from "Hire-Purchase"? (November 2003)

Answer

Distinction between 'Sale' and 'Hire Purchase'

1. In case of hire purchase, the agreement is that the hirer regularly pays the various installments agreed between the parties. In Sale the payment may be made cash -down or through installments.
2. The subject matter of the hire, on payment of the last installment, shall become the property of the hirer, if such installments are not paid, the article will remain the property of the hire-vendor (seller) and the hire vendor will be entitled to regain possession thereof. In Sale, the property in goods is transferred to the buyer immediately on signing the contract.
3. A hire purchase agreement is both a bailment and an option to buy. In case of Sale it is not so.
4. In case of hire purchase the hirer cannot sell the article to a third party. In Sale the purchaser can do so. This is based on the concept of ownership.

Question 5

What are the implied conditions in a contract of 'Sale by sample' under the Sale of Goods Act, 1930? State also the implied warranties operative under the said Act.

(November 2002, November 2003)

Answer

The following are implied conditions in a contract of sale by sample in accordance with Section 17 of the Sale of Goods Act, 1930;

- (a) that the bulk shall correspond with the sample in quality;
- (b) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample.
- (c) that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on a reasonable examination of the sample [Section 17(2)].

Implied Warrants:

1. *Warranty of quiet possession [Section 14(b)]*: In a contract of sale, unless there is a contrary intention, there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. If the buyer is in any way disturbed in the enjoyment of the goods in consequence of the seller's defective title to sell, he can claim damages from the seller.
2. *Warranty of freedom from encumbrances [Section 14(c)]*: The buyer is entitled to a further warranty that the goods are not subject to any charge or encumbrance in favour of a third party. If his possession is in any way disturbed by reason of the existence of any charge or encumbrances on the goods in favour of any third party, he shall have a right to claim damages for breach of this warranty.
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 by the usage of trade,
4. *Warranty to disclose dangerous nature of goods*: Where a person sells goods, knowing that the goods are inherently dangerous or they are likely to be dangerous to the buyer and that the buyer is ignorant of the danger, he must warn the buyer of the probable danger, otherwise he will be liable in damages.

Question 6

For the purpose of making uniform for the employees, Bansi Bhaiya bought dark blue coloured cloth from Vivek, but did not disclose to the seller the purpose of said purchase. When uniforms were prepared and used by the employees, the cloth was found unfit. However, there was evidence that the cloth was fit for caps, boots and carriage lining. Advise Bansi Bhaiya whether he is entitled to have any remedy under the sale of Goods Act, 1930?

(May 2004)

Answer

Fitness of Cloth

As per the provision of Section 16(1) of the Sale of Goods Act, 1930, an implied condition in a contract of sale that an article is fit for a particular purpose only arises when the purpose for which the goods are supplied is known to the seller, the buyer relied on the seller's skills or judgement and seller deals in the goods in his usual course of business. In this case, the cloth supplied is capable of being applied to a variety of purposes, the buyer should have told the seller the specific purpose for which he required the goods. But

he did not do so. Therefore, the implied condition as to the fitness for the purpose does not apply. Hence, the buyer will not succeed in getting any remedy from the seller under the Sale of Goods Act [Jones v. Padgett. 14 Q.B.D. 650].

Question 7

What do you understand by the term “unpaid seller” under the Sale of Goods Act, 1930? When can an unpaid seller exercise the right of stoppage of goods in transit?
(May 2004)

Answer

Unpaid Seller

According to Section 45 of the Sale of Goods Act, 1930 the seller of goods is deemed to be an 'Unpaid Seller' when-

- (a) the whole of the price has not been paid or tendered.
- (b) a bill of exchange or other negotiable instrument has been received as conditional payment, and it has been dishonoured.

Right of stoppage of goods in transit

When the unpaid seller has parted with the goods to a carrier and the buyer has become insolvent, he can exercise this right by asking the carrier to return the goods back, or not to deliver the goods to the buyer.

However, the right of stoppage in transit is exercised only when the following conditions are fulfilled:

- (a) The seller must be unpaid.
- (b) The seller must have parted with the possession of goods.
- (c) The goods must be in the course of transit.
- (d) The buyer must have become insolvent.
- (e) The right is subject to provisions of the Act.

Question 8

Point out the differences between conditions and warranties under the Sale of Goods Act, 1930.
(May 2004)

Answer

Condition and Warranty

S. No.	Basis of distinction	Condition	Warranty
1.	Nature	A condition is a stipulation which is essential to the main purpose of the contract.	A Warranty is a stipulation which is collateral to the main purpose of the contract.
2.	Rights	The aggrieved party can repudiate the contract of sale in case there is a breach of a condition	The aggrieved party can claim damages only in case of breach of a warranty.
3.	Option	A breach of condition may be treated as a breach of a warranty. This would happen where the aggrieved party is contented with damages only	A breach of a warranty, con not be treated as a breach of a condition.

Question 9

With a view to boost the sales Hanuman Automobiles sells a motorcar to Mr. A on trial basis for a period of three days with a condition that if Mr. A is not satisfied with the performance of the car, he can return back the car. However, the car was destroyed in a fire accident at the place of Mr. A before the expiry of three days. Decide whether Mr. A is liable for the loss suffered. (November 2004)

Answer

The problem as asked in the question is based on the provisions of the Sale of Goods Act, 1930 as contained in Section 8. Accordingly, the contract becomes void if the goods are destroyed or do not answer to the description in the agreement before the risk passes on to the buyer. In the given case that the subject matter of the contract i.e Motorcar was destroyed before the transfer of property from the seller to the buyer. Thus the risk passes only when the ownership is transferred to the buyer. Therefore, in the present case Mr. A is not liable for the loss suffered due to the fire accident over which A has no control. Thus M/s. Hanuman Automobiles will have to bear whatever loss that has taken place due to the fire accident.

Question 10

State briefly the essential element of a contract of sale under the Sale of Goods Act, 1930. Examine whether there should be an agreement between the parties in order to constitute a sale under the said Act. (November 2004)

Answer

Essentials of 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.

- (i) There must be at least two parties
- (ii) The subject matter of the contract must necessarily be goods
- (iii) A price in money (not in kind) should be paid or promised.
- (iv) A transfer of property in goods from seller to the buyer must take place.
- (v) A contract of sale must be absolute or conditional [section 4(2)].

- (vi) All other essential elements of a valid contract must be present in the contract of sale.

The Supreme Court has held in the case of “*Stare of Madras Vs. Gannon Dunkerley and Co. AIR (1858) S (500)*” that according to the law in order to constitute a sale, it is necessary that there should be an agreement between the parties for the purpose of transferring title of goods which of course presupposes capacity to contract, that it must be supported by money consideration that as a result of transaction the property in the goods must actually pass etc.

Question 11

When can an unpaid seller of goods exercise his right of lien over the goods under the Sale of Goods Act? Can he exercise his right of lien even if the property in goods has passed to the buyer? When such a right is terminated? Can he exercise his right even after he has obtained a decree for the price of goods from the court? (May 2005)

Answer

A lien is a right to retain possession of goods until the payment of the price. It is available to the unpaid seller of the goods who is in possession of them where-

- (i) the goods have been sold without any stipulation as to credit;
- (ii) the goods have been sold on credit, but the term of credit has expired;
- (iii) the buyer becomes insolvent.

The unpaid seller can exercise ‘his right of lien even if the property in goods has passed on to the buyer. He can exercise his right even if he is in possession of the goods as agent or bailee for the buyer.

Termination of lien: An unpaid seller loses his right of lien thereon-

- (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) When the buyer or his agent lawfully obtains possession of the goods;

Question 12

“.....there is no implied warranty or condition as to quality or fitness for any particular purpose of goods supplied under a contract of sale....”Discuss the significance and State exceptions, if any. s

(May 2005)

Answer

The statement given in the question is the fundamental principle of law of sale of goods, sometime expressed by the maximum ‘Caveat Emptor’ meaning thereby ‘Let the buyer be aware’. In other words, it is no part of the seller’s duty in a contract of sale of goods to give the buyer an article suitable for a particular purpose, or of particular quality, unless the quality or fitness is made an express terms of the contract. The person who buys goods must keep his eyes open, his mind active and should be cautious while buying the goods. If he makes a bad choice, he must suffer the consequences of lack of skill and judgement in the absence of any misrepresentation or guarantee by the seller.

There are, however, certain exceptions to the rule which are stated as under:

- (i) Where the buyer expressly or by implication, makes known to the seller the particular purpose for which he needs the goods and depends on the skill and judgement of the seller whose business is to supply goods of that description, there is an implied condition that the goods shall be reasonably fit for that purpose;
- (ii) If the buyer purchasing an article for a particular use is suffering from an abnormality and it is made known to the seller at the time of sale, implied condition of fitness will apply.
- (iii) If the buyer purchases an article under its patent or other trade name and relies on seller’s skills and judgement which he makes known to him, the implied condition that are articles are fit for a particular purpose shall apply.
- (iv) If the goods can be used for a number of purposes the buyer must tell the seller the particular purpose for which he required the goods otherwise implied condition of fitness of goods for a particular purpose will not apply.
- (v) Where the 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 are of merchantable quality.

- (vi) An implied condition as to quality or fitness for a particular purpose may be annexed by the usage of trade or custom;

In a sale by sample there is an implied condition that

- (a) The bulk shall correspond with the sample in quality;
 - (b) The buyer shall have reasonable opportunity of comparing the bulk with the sample; and
 - (c) The goods shall be free from any defect, rendering them unmerchantable;
- (viii) In the case of eatables and provisions in addition to the implied condition of merchantability, there is an implied condition that the goods shall be wholesome.

Question 13

J the owner of a Fiat car wants to sell his car. For this purpose he hand over the car to p, a mercantile agent for sale at a price not less than Rs. 50, 000. The agent sells the car for Rs. 40, 000 to A, who buys the car in good faith and without notice of any fraud. P misappropriated the money also. J sues A to recover the Car. Decide given reasons whether J would succeed. (November 2005)

Answer

The problem in this case is based on the provisions of the Sale of Goods Act, 1930 contained in the proviso to Section 27. The proviso provides that a mercantile agent is one who in the customary course of his 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 goods [Section 2(9)]. The buyer of goods from a mercantile agent, who has no authority from the principal to sell, gets a good title to the goods if the following conditions are satisfied:

- (1) The agent should be in possession of the goods or documents of title to the goods with the consent of the owner.
- (2) The agent should sell the goods while acting in the ordinary course of business of a mercantile agent.
- (3) The buyer should act in good faith.
- (4) The buyer should not have at the time of the contract of sale notice that the agent has no authority to sell.

In the instant case, P, the gent, was in the possession of the car with J's consent for the purpose of sale. A, the buyer, therefore obtained a good title to the car. Hence, j in this case, cannot recover the car from A. A similar decision, in analogous circumstances, was taken in *Folkes v. King*.

Question 14

"Nemo Dat Quod Non Habet" – "None can give or transfer goods what he does not himself own."

Explain the rule and state the cases in which the rule does not apply under the provisions of the Sale of Goods Act, 1930. (November 2005)

Answer

Exceptions to the Rule *Nemo dat Quod Non Habet*: The term means, "none can give or transfer goods what he does not himself own". Exceptions to the rule and the cases in which the Rule does not apply under the provisions of the Sale of Goods Act, 1930 are enumerated below:

- (1) **Effect of Estoppel (Section 27):** Where the owner is stopped by the conduct from denying the seller's authority to sell, the transferee will get a good title as against the true owner. But before a good title by estoppel can be made, it must be shown that the true owner had actively suffered or held out the other person in question as the true owner or as a person authorized to sell the goods.
- (2) **Sale by a Mercantile Agent:** A sale made by a mercantile agent of the goods or document of title to goods would pass a good title to the buyer in the following circumstances, namely;
 - (a) if he was in possession of the goods or documents with the consent of the owner;
 - (b) if the sale was made by him when acting in the ordinary course of business as a mercantile agent; and
 - (c) if the buyer had acted in good faith and has at the time of the contract of sale, no notice of the fact that the seller had no authority to sell.(Proviso to Section 27).
- (3) **Sale by one of the joint owners:** If one of the several joint owners of goods has the sole possession of them with the permission of the others the property in the goods may be transferred to any person who buys

them from such a joint owner in good faith and does not at the time of the contract of sale have notice that the seller has no authority to sell. [Section 28].

- (4) Sale by a person in possession under voidable contract:** A buyer would acquire a good title to the goods sold to him by seller who had obtained possession of the goods under a contract voidable on the ground of coercion, fraud, misrepresentation or undue influence provided that the contract had not been rescinded until the time of the sale (Section 29).
- (5) Sale by one who has already sold the goods but continues in possession thereof:** If a person has sold goods but continues to be in possession of them or of the documents of title to them, he may sell them to a third person, and if such person obtains the delivery thereof in good faith without notice of the previous sale, he would have good title to them, although the property in the goods had passed to the first buyer earlier. A pledge or other deposition of the goods or documents of title by the seller in possession are equally valid. [Section 30(1)].
- (6) Sale by buyer obtaining possession before the property in the goods has vested in him:** Where a buyer with the consent of seller obtains possession of the goods before the property in them has passed to him, he may sell, pledge or otherwise dispose of the goods to a third person, and if such person obtains delivery of the goods in good faith and without notice of the lien or other right of the original seller in respect of the goods in good faith and without notice of the lien or other right of the original seller in respect of the goods, he would get a good title to them. [Section 30(2)].
- (7) Sale by an unpaid seller:** Where on 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 [Section 54(3)].
- (8) Sale under the provisions of other Acts:**

 - (i) Sale by an official Receiver or liquidator of the company will give the purchaser a valid title.
 - (ii) Purchase of goods from a finder of goods will get a valid title under circumstances.
 - (iii) Sale by a pawnee under default of pawnor will give valid title to the purchaser.

Question 15

Suraj sold his car to Sohan for Rs. 75,000. After inspection and satisfaction, Sohan paid Rs. 25,000 and took possession of the car and promised to pay the remaining amount within a month. Later on Sohan refuses to give the remaining amount on the ground that the car was not in a good condition. Advise Suraj as to what remedy is available to him against Sohan.

(May

2006)

Answer

As per the section 55 of the Sale of Goods Act, 1930 an unpaid seller has a right to institute a suit for price against the buyer personally. The said Section lays down that

- (i) Where under a contract of sale the property in the goods has passed to buyer and the buyer wrongfully neglects or refuses to pay for the goods, the seller may sue him for the price of the goods [Section 55(1)].
- (ii) 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. It makes no difference even if the property in the goods has not passed and the goods have not been appropriated to the contract [Section 55(2)].

This problem is based on above provisions. Hence, Suraj will succeed against Sohan for recovery of the remaining amount. Apart from this Suraj is also entitled to:-

- (1) Interest on the remaining amount
- (2) Interest during the pendency of the suit.
- (3) Costs of the proceedings.

Question 16

Point out the differences between the transactions of "Sale" and "hire-purchase" in the light of the provisions of the Sale of Goods Act, 1930.
(May 2006)

Answer

Following are the differences between sale and hire purchase:

Sale	Hire Purchase Agreement
1. Ownership is transferred from the seller to the buyer as soon as the contract is entered into.	1. Ownership is transferred from the seller to the hire-purchaser only when a certain agreed number of installments are paid.
2. The position of the buyer is that of the owner	2. The position of the hire-purchaser is that of the bailee.
3. The buyer cannot terminate the contract and as such is bound to pay the price of the goods.	3. The hire-purchaser has an option to terminate the contract at any stage, and cannot be forced to pay the further installments.
4. If the payment is made by the buyer in installments, the amount payable by the buyer to the seller is reduced, for the payment made by the buyer is towards the price of the goods.	4. The installments paid by the hire-purchaser are regarded as hire charges and not as payment towards the price of the goods till option to purchase the goods is exercised.
5. The Sale agreements are governed by the Sales of Goods Act, 1930.	5. The hire-purchase agreements are governed by the Hire-Purchase Act, 1972.

Question 17

A contracts to sell B, by showing sample, certain quantity of rape-seed oil described as 'foreign refined rape-seed-oil'. The oil when delivered matches with the sample, but is not foreign refined rape-seed oil. Referring to the provisions of Sale of Goods Act, 1930 advise the remedy, if any, available to B.
(November 2006)

Answer

B has a remedy to repudiate the contract. According to section 15 of the Sale of Goods Act, 1930, when the goods are sold by sample as well as by

description, there shall be an implied condition that the goods shall correspond to the sample as well as description. In this case, A supplied refined rape oil which did correspond with the sample but was not correspond to the description of foreign refined rape-oil. Hence the B has the right to repudiate the contract.

Question 18

Distinguish between a 'Condition' and a 'Warranty' in a contract of sale. When shall a 'breach of condition' be treated as 'breach of warranty' under the provisions of the Sale of Goods Act, 1930 ? Explain.
(November 2006)

Answer

Difference between Condition and Warranty

- (i) A condition is a stipulation essential to the main purpose of the contract whereas a warranty is a stipulation collateral to the main purpose of the contract.
- (ii) Breach of condition gives rise to a right to treat the contract as repudiated whereas in case of breach of warranty, the aggrieved party can claim damage only.
- (iii) Breach of condition may be treated as breach of warranty whereas a breach of warranty cannot be treated as breach of condition.

According to Section 13 of the Sale of Goods Act, 1930 a breach of condition may be treated as breach of warranty in following circumstances:

- (i) Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition,
- (ii) Where the buyer elects to treat the breach of condition as breach of a warranty.
- (iii) Where the contract of sale is non-severable and the buyer has accepted the whole goods or any part thereof.
- (iv) Where the fulfillment of any condition or warranty is excused by law by reason of impossibility or otherwise.

Question 19

A, an agent of a buyer, had obtained goods from the Railway organization and loaded the goods on his truck. In the meantime, the Railway organization

received a notice from B, a seller, for stopping goods in transit as the buyer had become insolvent. Referring to the provisions of the Sale of Goods Act, 1930 decide whether the Railway organization can stop the goods in transit, as instructed by the seller ?
(May 2007)

Answer

The right of stoppage of goods in transit can be exercised only so long as the goods are in the course of transit. In the given case the transit was at an end as soon as the agent of the buyer obtained goods from the Railway Organisation. Therefore Railway Organisation cannot act as instructed by the seller, who has lost the right of stoppage of the goods in transit as provided in Section 30 of the Sale of Goods Act, 1930.

Question 20

Mr. S agreed to purchase 100 bales of cotton from V, out of his large stock and sent his men to take delivery of the goods. They could pack only 60 bales. Later on, there was an accidental fire and the entire stock was destroyed including 60 bales that were already packed. Referring to the provisions of the Sale of Goods Act, 1930 explain as to who will bear the loss and to what extent?
(May 2007)

Answer

Section 26 of the Sale of Goods Act, 1930 provides that 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 buyer's risk whether delivery has been made or not. Further Section 18 read with Section 23 of the Act provide that in a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer, unless and until the goods are ascertained and where there is contract for the sale of unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be express or implied. Applying the aforesaid law to the facts of the case in hand, it is clear that Mr. S has the right to select the good out of the bulk and he has sent his men for same purpose.

Hence the problem can be answered based on the following two assumptions and the answer will vary accordingly.

Where the bales have been selected with the consent of the buyer's representatives:

- (i) In this case the property in the 60 bales has been transferred to the buyer and goods have been appropriated to the contract. Thus loss arising due to fire in case of 60 bales would be borne by Mr. S. As regards 40 bales, the loss would be borne by Mr. V, since the goods have not been identified and appropriated.
- (ii) Where the bales have not been selected with the consent of buyer's representatives:

In this case the property in the goods has not been transferred at all and hence the loss of 100 bales would be borne by Mr. V completely.

Question 21

Aman contracted to erect machinery on Sapan's premises on the condition that the price shall be paid on completion of work. During the progress of work the premises and machinery were destroyed by an accidental fire. Referring to the provisions of the Sale of Goods Act, 1930, decide whether the parties are bound to perform their promises and can Aman recover the price of the work actually done?
(November 2007)

Answer

Section 8 of the Sale of Goods Act, 1930 states that where there is an agreement to sell specific goods and subsequently the goods without the fault of seller or buyer perish before the risk passes to the buyer, the agreement becomes void. In the given case the premises and machinery get destroyed because of accidental fire before the risk passes to the buyer and therefore both parties were excused from further performance. Aman having contracted for an entire work for a specific price to be paid on completion of work, could not recover any price for the work actually done.

NOTE: The question is on the specific point ie. risk passes on to the buyer with ownership and more specifically based on the Sale of Goods Act, 1930. Yet, the question might be answered in accordance with Section 56 of the Indian Contract, 1872 which states that an agreement to do an impossible act in itself is void. A contract to do an act which, after the contract is made,

becomes impossible, or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

Question 22

Under which circumstances can an unpaid seller exercise his right of lien? Distinguish between right of lien and right of stoppage of goods in transit, under the Sale of Goods Act, 1930. (November 2007)

Answer

Section 47 of the Sale of Goods Act, 1930 lays down cases in which an unpaid seller is entitled to lien. They are as follows:

- (i) Where goods have been sold without any stipulation as to credit.
- (ii) Where goods have been sold on credit but the term of credit expired, or
- (iii) Where the buyer becomes insolvent.

Distinction between right of lien and right of stoppage of goods in transit.:

- (1) The essence of a right of lien is to retain possession whereas the right of stoppage in transit is right to regain possession.
- (2) Seller should be in possession of goods under lien while in stoppage in transit (i) Seller should have parted with the possession (ii) possession should be with a carrier and (iii) buyer has not acquired the possession.
- (3) Right of lien can be exercised even when the buyer is not insolvent but it is not the case with right of stoppage in transit.
- (4) 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.

Question 23

A, B and C were joint owners of a truck and possession of the said truck was with B. X purchased the truck from B without knowing that A and C were also owners of the truck. Decide in the light of provisions of the Sale of Goods Act, 1930, whether the sale between B and X is valid or not ? (May 2008)

Answer

Sale by joint owner

This problem is based on Section 28 of the Sale of Goods Act, 1930 which lays down an exception to the general rule that a person cannot transfer a better title than that he himself possesses. A person who is one of joint owners may transfer a better title than he possesses. Section 28 provides that – “if one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in goods is transferred to any person who buys them of such joint owner in good faith and has not at the time of the contract of sale notice that the seller has not authority to sell”.

The given problem fulfills all such requirements. A, B and C are joint owners of a truck. B had sole possession of it. In such a case if X has purchased the truck from B in good faith without notice at the time of sale that B had no authority to sell, then X acquires good title and becomes full owner although B was not the full owner.

Question 24

Mr. Amit was shopping in a self-service Super market. He picked up a bottle of cold drink from a shelf. While he was examining the bottle, it exploded in his hand and injured him. He files a suit for damages against the owner of the market on the ground of breach of condition. Decide, under the Sale of Goods Act, 1930, whether Mr. Amit would succeed in his claim?

(May 2008)

Answer

Essentials of Sale

The problem as given in the question is based on Section 16(2) of the Sale of Goods Act, 1930, which states that 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. Though the term ‘merchantable quality’ is not defined in the Act, it means that in the present case, the bottle must be properly sealed. In other words, if the goods are purchased for self-use, they should be reasonably fit for the purpose for which it is being used. In the instant case, on an examination of the bottle of cold drink, it exploded and injured the buyer. Applying the provision of Section 16(2), Mr. Amit would succeed in claim for damages from the owner of the shop.

Question 25

Ram sells 200 bales of cloth to Shyam and sends 100 bales by lorry and 100 bales by Railway. Shyam receives delivery of 100 bales sent by lorry, but before he receives the delivery of the bales sent by railway, he becomes bankrupt. Ram being still unpaid, stops the goods in transit. The official receiver, on Shyam's insolvency claims the goods. Decide the case with reference to the provisions of the Sale of Goods Act, 1930. (November 2008)

Answer

Right of stoppage of goods in transit

The problem is based on section 50 of the Sale of Goods Act, 1930 dealing with the right of stoppage of the goods in transit available to an unpaid seller. The section states that the right is exercisable by the seller only if the following conditions are fulfilled.

- (i) The seller must be unpaid
- (ii) He must have parted with the possession of goods
- (iii) The goods must be in transit
- (iv) The buyer must have become insolvent
- (v) The right is subject to the provisions of the Act

Applying the provisions to the given case, Ram being still unpaid, can stop the 100 bales of cloth sent by railway as these goods are still in transit.

Question 26

B buys goods from A on payment but leaves the goods in the possession of A. A then pledges the goods to C who has no notice of the sale to B. State whether the pledge is valid and whether C can enforce it. Decide with reference to the provisions of the Sale of Goods Act, 1930. (November 2008)

Answer

Pledge by a seller in possession after sale

The problem is based on the provisions of Section 30 (1) of the Sale of Goods Act, 1930 which provides an exception to the general rule that no one can give a better title than he himself possesses. As per the provisions of the section, if a person has sold goods but continues to be in possession of them or of the documents of title to them, he may pledge them to a third person and if such person obtains them in good faith without notice of the previous sale, he would have good title to them. Accordingly, C, the pledgee who

obtains the goods in good faith from A without notice of the previous sale, gets a good title. Thus the pledge is valid.

THE INDIAN PARTNERSHIP ACT, 1932

Question 1

What acts do not fall within the implied authority of a partner under the Indian Partnership Act, 1932? (Nov. 2002)

Answer

Implied Authority of a partner :

Section 19(1) and 22 of the Indian Partnership Act, 1932 deal with the implied authority. Accordingly, the act of a partner which is done on, in the usual way, business of the kind carried on by the firm binds the firm, provided that the act is done in the firm name or any manner expressing or implying an intention to bind the firm. Such an authority of a partner binds the firm is called his implied authority.

When implied authority cannot be availed by a partner

Section 19(2) of the Indian Partnership Act, 1932 lays down that, in the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to–

- (a) submit a dispute relating to the business of the firm to arbitration.
- (b) open a bank account on behalf of the firm in his own name.
- (c) compromise or relinquish any claim or portion of a claim by the firm against a third party.
- (d) withdraw a suit or proceeding filed on behalf of the firm.
- (e) admit any liability in a suit or proceeding against the firm.
- (f) acquire immovable property on behalf of the firm;
- (g) transfer immovable property belonging to the firm or
- (h) enter into partnership on behalf of the firm.

Some other instances of implied authority are also noteworthy.

- (i) a partner has no implied authority to bind the firm by giving a guarantee which is apparently unconnected with the partnership trade.
- (j) he cannot accept shares of a company against the debt due to the firm.
- (k) no right of set off his own separate debts against debt due to the firm.

Question 2

Whether a minor may be admitted in the business of a partnership firm? Explain the rights of a minor in the partnership firm. (Nov. 2002)

Answer

Minor as a partner :

A minor is incompetent to do the contract and such contract is void-ab-initio (*Mohiribibi vs. Dharam Das Ghose*). Therefore, a minor cannot be admitted in the business of the partnership firm because the partnership is formed on a contract. Though a minor cannot be a partner in a firm, he can nevertheless be admitted to the benefits of partnership under section 30 of the Partnership Act, 1932. He may be validly have a share in the profit of the firm but this can be done with the consent of all the partners of the firm.

Rights of the minor in the firm :

- (i) a minor 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 payments of his share but only, when severing his connection with the firm, and not otherwise. The amount of share shall be determined by a valuation made in accordance with the rules upon a dissolution.
- (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.

Question 3

Is it possible for the partners in a firm having majority to expel a partner under the provisions of the Indian Partnership Act, 1932? Does the firm get dissolved if the expulsion of a partner is not valid? (May 2003)

Answer

Expulsion of A Partner

According to the provisions of the Indian Partnership Act, 1932 as contained in Section 33, a partner may be expelled from the partnership subject to the following three conditions:

1. The power of expulsion of a partner should be conferred by the contract between the partners.
2. The power should be exercised by a majority of the partners.
3. The power should be exercised in good faith which includes interest of partnership, notice to the partner to be expelled, and an opportunity of being heard. Hence, mere majority is not enough.

Accordingly, it is possible for the majority of partners in a firm to expel a partner but it is subject to fulfillment of other conditions as stated above.

It should be noted that the expulsion of partners does not necessarily result in dissolution of the firm. The invalid expulsion of a partner also does not put an end to the partnership even if the partnership is at will and it will be deemed to continue as before. (*Jiwan Singh v. Lakshmi Chand* AIR (1935) Lh. 332. *Dwaraka Das v. Chuni Lal* (1907).

Question 4

What is the procedure of registration of a partnership firm under the Indian Partnership Act, 1932 ? What are the consequences of non-registration?(May 2003)

Answer

Registration of a Partnership & Consequences of Non-Registration

Procedure: (Section 58 & 59 Indian Partnership Act, 1932)

The registration of a firm may be effected at any time by filing an application in the form of a statement, giving the necessary information, with the Registrar of Firms of the area. The application shall be accompanied by the prescribed fee. It shall also state:

- (a) the name of the firm;
- (b) the place or principal place of business of the firm;
- (c) the names of other places where the firm carries on business;
- (d) the date when each partner joined the firm
- (e) the names in full and permanent address of the partners;
- (t) the duration of the firm.

The statement shall be signed by all the partners or by their agents specially authorized in this behalf Section 58(i). It shall also be verified by them in the prescribed manner (Section 58(2)). When the Registrar is satisfied that the above provisions have been duly complied with, he shall record an entry of the statement in the Register of Firms and file the statement (Section 59). He shall then issue under his hand a certificate of registration.

The non-registration of the firm does not affect the following:

1. The right of a firm or partners of a firm having no place of business in India.
2. The right to file any suit or claim of set off exceeding Rs. 100 in value.
3. The right of a partner to sue for the dissolution of the firm, or for the accounts of the dissolved firm, or for share of the property of the dissolved firm. This disability of a partner to sue disappears with the dissolution of the firm.
4. The powers of an Official Receiver, Assignee, or Court to realize the property of an insolvent partner of an unregistered firm.
5. The right of a third party to proceed against an unregistered firm or any of its partners.
6. The right of an unregistered firm to enforce a right arising otherwise than out of a contract (Section 69(3) and (4)).

Question 5

State the modes by which a partner may transfer his interest in the firm in favour of another person, under the Indian Partnership Act, 1932. What are the rights of such a transferee?

(November 2003)

Answer

Modes by which a partner may transfer his interest entitlements & non entitlements:

According to Section 29 of the Indian Partnership Act, 1932 a partner may transfer his interest in the firm by sale, mortgage or charge. The transfer may be absolute or partial. The transfer does not entitle the transferee, during the continuance of the firm:

- (a) to interfere in the conduct of the business of the firm, or
- (ii) to require accounts of the firm, or

(iii) to inspect the books of the firm

On transfer of interest by a partner, the transferee only becomes entitled to receive share of profit of the transferring partner. But in this case also the transferee has to accept the account of profits agreed to by the partners [Section 29(i)].

If the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled to receive the transferring partner's share in the assets of the firm. For the purpose of ascertaining that share, he is entitled to an account as from the date of the dissolution (Section 29(2)).

Question 6

What do you understand by "Implied Authority" of a partner? Is such authority subject to any condition? Which of the acts of a partner come within the implied authority under the Indian Partnership Act, 1932? (November 2003)

Answer

Implied Authority of a Partner:

Meaning: Where there is no partnership agreement or where the agreement is silent, 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 (Section 19(1) Indian Partnership Act, 1932). This authority of a partner to bind the firm by his acts is called implied authority. It is subject to the following conditions:

1. The act done by the partner must relate to the normal business of the firm.
2. The act must be such as is done within the scope of the business of the firm in the usual way.

The act must be done in the name of the firm, or in any other manner expressing or implying an intention to bind the firm (Section 22).

Acts falling within the Implied Authority of a partner:

1. Purchasing goods on behalf of the firm, in which the firm deals or which are employed in the firm's business.
2. Selling goods of the firm.
3. Receiving payment of the debt due to the firm and giving receipts for them.
4. Settling accounts with the persons dealing with the firm.

5. Engaging servants for the partnership business.
6. Borrowing money on the credit of the firm.
7. Drawing, accepting, indorsing bills and other negotiable instruments in the name of the firm.
8. Pledging any goods of the firm for the purpose of borrowing money.
9. Employing a solicitor to defend an action against the firm for goods supplied.

Question 7

"Mere sharing in the profits of a business is not a conclusive proof of existence of partnership."- Comment. (May 2004)

Answer

Sharing of Profit

According to Section 4 of the Indian Partnership Act, 1932, "Partnership is 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". This clearly reveals that sharing of profits of a business is an important criterion of partnership. But in determining whether it is conclusive evidence of partnership or not, the regard shall be had to the real relations between the parties, as shown by all relevant facts taken together. Section 6 of the Indian Partnership Act, 1932, categorically lays down that receipt by a person of a share of the profits of a business does not by itself make him a partner with the persons carrying on the business as there are number of cases where the persons sharing the profits do not have relationship of partners.

For instance, in the following cases partnership relation does not exist:-

1. Joint owners of some property in sharing of profits or gross returns arising from the property.
2. A leader of the firm who receives a share of profit.
3. A widow or child of a deceased partner who receives a share of profit.
4. A servant or agent who receives a share of profit as part of his remuneration.
5. A person who receives a share of profit in consideration of sale of business or goodwill of the business.

Hence, mere participation in the profits of a trade is not a conclusive evidence of partnership.

Question 8

Ram, Shyam and Gopal are partners in a firm. Ram retires. Shyam and Gopal continue to carry on firm's business in the same "firm name". Do you agree that in this situation change in the relationship between partners is involved, but this is not extinguishment of the existence of the firm itself? Give reasons.
(May 2004)

Answer

Effect of Retirement of Partner

As per the provision of Section 39 of the Indian Partnership Act, 1932, "The dissolution of partnership between all the partners of a firm is called the dissolution of firm." But when one or more partner cease to be a partner in a firm, but other continue the business of partnership, it is called dissolution of partnership. Thus in this case when Ram retires and Shyam and Gopal continue to carry on firm's business in the old firm's name. The firm in such a case is called a reconstituted firm. Re-constitution of a firm involves a change in the relation of partner and not the end of the firm.

Question 9

Explain the provisions of the Indian Partnership Act, 1932 relating to the creation of Partnership by holding out. Upto what extent such partner will be liable to the Partnership firm.
(November 2004)

Answer

Partnership by 'Holding Out'

According to Section 28 of the Indian Partnership Act, 1932 "anyone who by words spoken or written or by conduct represents himself, or knowingly permits himself to be represented, to be a partner in a firm, is liable as a partner". The statement includes with its purview representation by all possible means enumerated in this section. Thus the person sought to be charged with liability by holding out must have done something which amounts to a representation that he was a partner in the business. This is known as creation of partnership by 'holding out'.

Extent of liability of a partner by holding out:

- (i) A partner by holding out is liable as a partner in the firm to anyone who has on the faith of, any such representation gives credit to the firm,

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 [section 28(1)].

- (ii) Provisions of section 28 are also applicable to a former partner who has retired from the firm without giving proper public notice of his retirement. In such case a person, who, even subsequent to the retirement, gives credit to the firm on behalf that he was a partner, will be entitled to hold him liable.
- (iii) Where after a partner's death the business is continued in the old firm name, the continued use of that name or of the deceased partner's name as a part thereof shall not be itself make his legal representative or his estate liable for any act of the firm done after his death [Section 28(2)].
- (iv) If a person holds himself out to be the partner of a firm, he becomes personally liable. He does not become partner of the firm and is not entitled to any rights as against those who in fact are partners in the firm. By holding out he does not become an agent of the firm.

Question 10

Describe the provisions of Indian Partnership Act. 1932 regarding the admission of minor in the partnership firm. State the rights and liabilities of such minor before or after he attains majority. (November 2004)

Answer

Minor's Admission into a Partnership Firm: According to Section 11 of the Indian Contract Act, 1872 an agreement by or with a minor is void (*Mohri Bibi Vs. Dharm Das Ghose*). As such, a minor is incapable of entering into a contract of partnership. But with the consent of all the partners for the time being, a minor may be admitted to the benefits of partnership [Section 30(1)]. This provision is based on the rule that a minor cannot be a promisor, but he can be a promisee or a beneficiary.

Position before and on his attaining the age of majority

Position before attaining majority:

Rights:

1. He has a right to such share of the property and of profits of the firm as may have been agreed upon.
2. He has a right to have access to and inspect and copy any of the accounts of the firm but not books. (Section 30(2)).

3. When he is not given his due share of profit, he has a right to file a suit for his share of the property of the firm. But he can do so only if he wants to sever his connection with the firm. [Section 30(4)].

Liabilities:

1. The liability of the minor partner is confined only to the extent of his share in the profits and property of the firm. Over and above this, he is neither personally liable nor is his private estate liable [Section 30(3)].
2. He cannot be declared insolvent, but if the firm is declared insolvent his share in the firm vests in the Official Receiver or Official Assignee.

Position on attaining majority:

On attaining majority such a minor has to decide within 6 months whether he shall continue in the firm or leave it. These six months run from the date of his attaining majority or from the date when he first comes to know that he had been admitted to the benefits of partnership whichever date is later. Within this period he should give a public notice of his choice: (a) to become, or (b) not to become, a partner in the firm.

If he fails to give a public notice, he is deemed to have become a partner in the firm on the expiry of the said six months. [Section 30(5)].

When such a minor elects to become a partner:

1. He becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.
2. His share in the property and profits of the firm is the share to which he was entitled as a minor partner [Section 30(7)].

When such a minor elects not to become a partner:

1. His rights and liabilities continue to be those of a minor up to the date of the notice.
2. His share is not liable for any acts of the firm done after the date of the public notice.
3. He is entitled to sue the partners for his share or the property and profits in the firm [Section 30(8)].

Question 11

Describe the procedure of registration of firm under the Indian Partnership Act. What is the rule of evidence with regard to entries in the Register of firms?
(May 2005)

Answer

The Indian Partnership Act, 1932 provides that registration of firms may be effected at any time by filing an application in the form of a statement, giving the necessary information, with the Registrar of Firms of the area. Section 57 of the Act empowers the State Government to appoint Registrar of Firms for the purposes of the Partnership Act and defines the areas within which they shall exercise their powers and perform their duties.

Application for registration of a firm shall be accompanied by the prescribed fee. It shall state:

- (a) the name of the firm;
- (b) place or principal place of business of the firm;
- (c) names of other places where the firm carries on business;
- (d) date when each partner joined the firm;
- (e) names in full and permanent addresses of the partners;
- (f) duration of the firm.

The application shall be signed by all the partners or by their agents specially authorized in this behalf. It shall also be certified by them in the prescribed manner.

When the Registrar is satisfied that the above provisions have been complied, he shall record an entry in the Registrar of Firms and issue a certification of registration. Registration takes effect from the date on which the Registrar makes entries in the Register of Firms.

Any statement, notice or intimation recorded with the Registrar by any person shall be a conclusive proof against him of any fact therein stated. The third parties can, however, challenge the fact of statement and prove that it is false and is based on mis-representation or fraud (Section 68).

Question 12

Ram & Co., a firm consists of three partners A, B and C having one third share each in the firm. According to A and B, the activities of C are not in the interest of the partnership and thus want to expel C from the firm. Advise A and B whether they can do so quoting the relevant provisions of the Indian Partnership Act.
(May 2005)

Answer

Normally it is not possible for the majority of partners to expel a partner from

the firm without satisfying the conditions as laid down in Section 33 of the Indian Partnership Act, 1932. The essential conditions before expulsion can be done are:

- (i) power of expulsion should exist in the partnership deed (contract between the partners).
- (ii) power has been exercised by the majority of the partners in good faith.

The test of good faith includes:

- (a) that the expulsion must be in the interest of the partnership;
- (b) that the partner to be expelled is served with a notice; and
- (c) that the partner has been given an opportunity of being heard.

Thus, in the given case A and B the majority partners can expel the partner only if the above conditions are satisfied and procedure as stated above has been followed.

Further the invalid expulsion of a partner does not put an end to the partnership and it will be deemed to continue as before.

Question 13

*State the acts which are considered beyond the implied authority of a partner under the provisions of the Indian Partnership Act, 1932.
(November 2005)*

Answer

According to Section 19 of the Indian Partnership Act, 1932, unless there is usage or custom of trade to the contrary, the following acts of a partner are considered beyond his implied authority.

- (1) Submit a dispute relating to the business of the firm to arbitration.
- (2) Open a bank account on behalf of the firm in his own name.
- (3) Compromise or relinquish any claim or portion of a claim by the firm against a third party (i.e. an outsider).
- (4) Withdraw a suit or proceedings filed on behalf of the firm.
- (5) Admit any liability in a suit or proceedings against the firm.
- (6) Acquire immovable property on behalf of the firm.
- (7) Transfer immovable property belonging to the firm.
- (8) Enter into partnership on behalf of the firm.

Question 14

*When does dissolution of a partnership firm take place under the provisions of the Indian Partnership Act, 1932? Explain.
(November 2005)*

Answer

Dissolution of Firm: The Dissolution of Firm means the discontinuation of the jural relation existing between all the partners of the Firm. But when only one of the 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. The particular partner goes out, but the remaining partners carry on the business of the Firm. In the case of dissolution of the firm, on the other hand, the whole firm is dissolved. The partnership terminates as between each and every partner of the firm.

Dissolution of a Firm may take place (Section 39 - 44)

- (a) as a result of any agreement between all the partners (i.e., dissolution by agreement);
- (b) by the adjudication of all the partners, or of all the partners but one, as insolvent (i.e., compulsory dissolution);
- (c) by the business of the Firm becoming unlawful (i.e., compulsory dissolution);
- (d) subject to agreement between the parties, on the happening of certain contingencies, such as: (i) effluence of time; (ii) completion of the venture for which it was entered into; (iii) death of a partner; (iv) insolvency of a partner. In case of death, it is to be noted that the partners may make a contrary agreement only if their number exceeds two. If there are only two partners the only result of either's death will necessarily be the dissolution of the firm. This was made clear by the Supreme Court in *Commissioner of Income-tax vs. G.S. Mills*.
- (e) by a partner giving notice of his intention to dissolve the firm, in case of partnership at will and the firm being dissolved as from the date mentioned in the notice, or if no date is mentioned, as from the date of the communication of the notice; and
- (f) by intervention of court in case of: (i) a partner becoming the unsound mind; (ii) permanent incapacity of a partner to perform his duties as such; (iii) Misconduct of a partner affecting the business; (iv) willful or persistent breaches of agreement by a partner; (v) transfer or sale of the whole interest of a partner; (vi) improbability of the business being carried on save at a loss; (vii) the court being satisfied on other equitable grounds that the firm should be dissolved.

Question 15

Ram, Mohan and Gopal were partners in a firm. During the course of partnership, the firm ordered Sunrise Ltd. to supply a machine to the firm. Before the machine was delivered, Ram expired. The machine, however, was later delivered to the firm. Thereafter, the remaining partners became insolvent and the firm failed to pay the price of machine to Sunrise Ltd.

Explain with reasons:

- (i) *Whether Ram's private estate is liable for the price of the machine purchased by the firm?*

(ii) *Against whom can the creditor obtain a decree for the recovery of the price?(May 2006)*

Answer

Partnership Liability: The problem in question is based on the provisions of the Indian Partnership Act, 1932 contained in Section 35. The Section provides that 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. Therefore, considering the above provisions, the problem may be answered as follows:

- (i) Ram's estate in this case will not be liable for the price of the Machinery purchased. *[Bagel Vs. Willer]*
- (ii) The creditors in this case can have only a personal decree against the surviving partners and decree against the partnership assets in the hands of those partners. However, since the surviving partners are already insolvent, no suit for recovery of the debt would lie against them. A suit for goods sold and delivered would not lie against the representative of the deceased partner. This is because there was not debt due in respect of the goods in Ram's life time. *[Bagel vs. Willer]*.

Question 16

When is the registration of a Partnership firm deemed to be complete under the Indian Partnership Act, 1932? What are the consequences when a partnership firm is not registered?

(May 2006)

Answer

Registration of firm: Registration of a partnership firm is affected by delivering to the Registrar of Firms, a statement in the prescribed form accompanied by the prescribed fee (Section 58 of the Indian Partnership Act). The act of the party by way of presentation of Statement under Section 58 makes registration effective; whereas the Act of the Registrar in recording an entry of the statement in the Registrar of the Firms is only a clerical act (*Jayalakshmi R&O M vs. Income Tax commissioner*).

The effects of non-registration of a firm as contained in section 69 are as follows:

1. Suits between Partners & Firm [Section 69 (1)] A partner of an unregistered firm cannot sue the firm or any partner of the firm to enforce a right arising from a contract or conferred by the Partnership Act. He can do so if (i) the firm is registered and (ii) the person suing is or has been shown in the Registrar of Firms as a partner in the firm.
2. Suits between Firm and third parties [Section 69(2)] An unregistered firm cannot sue a third party to enforce a right arising from a contract.
3. Claim of set-off [Section 69(3)]: An unregistered firm or any partner thereof cannot claim a set-off in a proceeding instituted against the firm by a third party to enforce a right arising from a contract until the registration of the firm is effected. This right of set-off, however, is not affected if the claim of set-off is less than Rs. 100 in value [Section 69(4)(b)].

Question 17

A, B and C are partners in a firm. A introduces D to X as a partner in business. D, infact, was not a partner in the firm's business. D did not deny this statement. X advanced a loan of Rs. 20 lakhs to the firm. Firm's failure to repay the loan X want to hold D responsible for the repayment of the above loan. Referring to the provisions of the Indian Partnership Act, 1932 decide whether X would succeed in recovering the loan from D. (November 2006)

Answer

Yes, X can hold D responsible for the repayment of loan as he is the partner by Estoppel or by holding out. Section 28(1) Indian Partnership Act, 1932 lays down this principle as follows: "Anyone who by words spoken or written or by conduct represents himself, or knowingly permits himself to be represented, to be a partner in a firm, is liable as a partner in that firm to anyone who has on the faith of any such representation given credit to the firm, whether the person represented to be a partner does or does not know that representation has reached the person so giving credit." Hence D becomes a partner by holding out as he did not deny the statement given by A. Hence D is liable to make repayment of loan.

Question 18

"Sharing of profits is only a prima facie not a conclusive evidence of the existence of partnership." Examine the validity of the statement in the light of

the provisions of the Indian Partnership Act, 1932 and state as to how would you determine whether a group of persons does or does not constitute partnership.
(November 2006)

Answer

It is true that sharing of profits of business is an essential element to constitute a partnership. But it is only a prima facie evidence but not a conclusive evidence of the existence of partnership. It is also true that the partners agree to share the profits of a business which is carried on by all or by one of them acting for all. However, the sharing of profits would not by itself make such person partner with the persons carrying on a business. Sharing of profits by the following person will not make them partners in the partnership firm:

- (i) by a lender of money to persons engaged or about to engage in any business;
- (ii) by a servant or agent as remuneration.
- (iii) by widow or child or a deceased partner as annuity, or
- (iv) by a previous owner or part owner of the business as consideration for the sale of goodwill or share thereof.

To determine whether a group of persons running a business does or does not constitute partnership, Section 6 of the India Partnership Act, 1932 has to be referred. According to Section 6 "In determining whether a group of persons is or is not firm, regard shall be had to the real relation between the parties as shown by all relevant facts taken together. It is very clear from this that in determining relationship between parties and ascertaining the existence of partnership all relevant facts such as follows are to be considered –

- (i) There must be an agreement between two or more persons
- (ii) There must be a business of partnership
- (iii) The partners must have agreed to share the profits of business
- (iv) The business must be carried on by all or any one of them acting for all. In other words there must be mutual agency between the partners. Existence of mutual agency which is the cardinal principle of partnership law, is very much helpful in reaching a conclusion in this regard. In this situation each partner is the principal as well as agent of the other partners.

Hence, in order to determine whether the relation of partnership exists between two or more persons or not, one should examine all the facts and circumstances as cited above.

Question 19

A and B entered into an agreement to carry on a business of manufacturing and selling toys. Each one of them contributed Rs. 35 lacs as their capital with a condition that A and B will share the profits equally, but the loss, if any is to be borne by A alone. Referring to the provisions of the Indian Partnership Act, 1932 decide whether there exists a partnership between A and B. (May 2007)

Answer

Yes, it is a case of partnership between A and B as sharing losses is not an essential condition to create a partnership. Section 13(b) of the Indian Partnership act 1932 provides Subject to the contract between the partners, the partners are entitled to share equally in the profits earned, and shall contribute equally to the losses sustained by the firm.” In the given case the partners make a contract contrary to this provision where A agrees to bear all the losses of the business.

Question 20

A, B and C are partners in a firm called ABC Firm. A, with the intention of deceiving D, a supplier of office stationery, buys certain stationery on behalf of the ABC Firm. The stationery is of use in the ordinary course of the firm's business. A does not give the stationery to the firm, instead brings it to his own use. The supplier D, who is unaware of the private use of stationery by A, claims the price from the firm. The firm refuses to pay for the price, on the ground that the stationery was never received by it (firm). Referring to the provisions of the Indian Partnership Act, 1932 decide:

- (i) Whether the Firm's contention shall be tenable ?*
- (ii) What would be your answer if a part of the stationery so purchased by A was delivered to the firm by him, and the rest of the stationery was used by him for private use, about which neither the firm nor the supplier D was aware?*
(May 2007)

Answer

The problem in the question is based on the 'Implied Authority' of a partner provided in Section 19 of the Indian Partnership Act 1932. The section

provides that subject to the provisions of Section 22 of the Act, 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' [Sub-Section (i) of section 19]. Furthermore, every partner is in contemplation of law the general and accredited agent of the partnership and may consequently bind all the other partners by his acts in all matters which are within the scope and object of the partnership. Hence, if the partnership is of a general commercial nature, he may buy goods on account of the partnership.

Considering the above provisions and explanation, the questions as asked in the problem may be answered as under:

- (i) The firm's contention is not tenable, for the reason that the partner, in the usual course of the business on behalf of the firm has an implied authority to bind the firm. The firm is, therefore, liable for the price of the goods,
- (ii) In the second case also the answer would be the same as above, i.e. the implied authority of the partner binds the firm.

In both the cases, however, the firm ABC can take action against A, the partner but it has to pay the price of stationery to the supplier D.

Question 21

Abhinav buys certain goods worth Rs. 50,000 from an unregistered firm Ram & Sons. Ram & Sons has to pay Rs. 60,000 to Abhinav for the goods purchased by the firm in the past. Referring to the provisions of the Indian Partnership Act, 1932 decide whether Ram & Sons can compel Abhinav to accept Rs. 10,000 i.e. the difference between Rs. 60,000 and 50,000 as the final settlement?

(November 2007)

Answer

Section 69 of the Indian Partnership Act, 1932 provides that an unregistered firm can not claim a set off exceeding Rs. 100 in value. In the given case the difference between Rs. 60,000 and 50,000 is of Rs. 10,000 for which the right of set off is not available. Therefore, Ram & Sons can not compel Abhinav to accept Rs. 10,000 as the final settlement.

Question 22

"Implied authority of a partner can be extended or restricted". Discuss the above statement in the light of the provisions of the Indian Partnership Act, 1932. How far, are third parties affected by restrictions placed on such implied authority? (November 2007)

Answer

Section 19 (2) of the Indian Partnership Act, 1932, provides that the act of a partner which is done to carry on the usual way, business of the kind carried on by the firm bind the firm, provided the act is done in the firm's name or in any manner expressing or implying an intention to bind the firm. The implied authority of a partner extends only to such acts which are common in the type of business carried on by the firm and are done by him in usual way of carrying on the firm's business. Thus, if it is usual to give credit to customers, in a particular business, the giving of credit by a partner to a customer will bind the firm. However, if a usual act is done in an unusual manner, this must raise a suspicion as to the authority of a partner and the protection on the ground of implied authority may not be available.

Question 23

What do you mean by "implied authority" of the partners in a firm? Point out the extent of partner's implied authority in case of emergency, referring to the provisions of the Indian Partnership Act, 1932. (May 2008)

Answer

Implied authority of partner

As per Section 19 of the Indian Partnership Act, 1932 "Subject to the provisions of Section 22, the act of a partner which is done to carry on, in the usual way, the 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 21 of the Act provides that a partner has authority in an emergency to do all such act for the purpose of protecting the firm from the 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. Conditions for the authority of a partner in an emergency:

- (i) The act should be done by the partner in an emergency
- (ii) The act of the partner should be for the purpose of protecting the firm from loss.
- (iii) The act should be, as a person of ordinary prudence would do in his own case.

(iv) Such an act should bind the firm.

To protect the firm, a partner has an authority to do all such acts in emergency to save the firm from loss. It may be noticed that the powers of a partner to act in an emergency are similar to those of an agent in similar circumstances under Section 139 of the Indian Contract Act, 1872.

Question 24

A, B and C are partners in a firm. As per terms of the partnership deed, A is entitled to 20 percent of the partnership property and profits. A retires from the firm and dies after 15 days. B and C continue business of the firm without settling accounts. What are the rights of A's legal representatives against the firm under the Indian Partnership Act, 1932? (May 2008)

Answer

Retirement / Death of Partner

Section 37 of the Indian Partnership Act, 1932 provides that where a partner dies or otherwise ceases to be a partner and there is no final settlement of account between the legal representatives of the deceased partner or the firms with the property of the firm, then, in the absence of a contract to the contrary, the legal representatives of the deceased partner or the retired partner are entitled to claim either.

- (i) Such shares of the profits earned after the death or retirement of the partner which is attributable to the use of his share in the property of the firm; or
- (ii) Interest at the rate of 6 per cent annum on the amount of his share in the property.

Based on the aforesaid provisions of Section 37 of the Indian Partnership Act, 1932 A, in the given problem, A shall be entitled, at his option to:

- (i) the 20% shares of profits (as per the partnership deed); or
- (ii) interest at the rate of 6 per cent per annum on the amount of A's share in the property.

Question 25

Mahesh, Suresh and Dinesh are partners in a trading firm. Mahesh, without the knowledge or consent of Suresh and Dinesh borrows himself Rs. 50,000 from Ramesh, a customer of the firm, in the name of the firm. Mahesh, then buys some goods for his personal use with that borrowed money. Can Mr.

Ramesh hold Mr. Suresh & Mr. Dinesh liable for the loan? Explain the relevant provisions of the Indian Partnership Act,1932. (November 2008)

Answer

Implied authority of a partner

Yes, as per sections 19 and 22 of the Indian Partnership Act,1932 unless otherwise provided in the partnership deed, every partner has an implied authority to bind every other partner for acts done in the name of the firm, provided the same falls within the ordinary course of business and is done in a usual manner. Mahesh has a right to borrow the money of Rs. 50,000/- from Ramesh on behalf of his firm in the usual manner. Since, Ramesh has no knowledge that the amount was borrowed by Mahesh without the consent of the other two partners, Mr. Suresh and Mr. Dinesh, he can hold both of them (Suresh and Dinesh) liable for the re-payment of the loan.

Question 26

Anil and Sunil purchased a lorry to ply it in partnership. They plied the lorry for about two years when Anil, without the consent of Sunil, disposed of the lorry. Sunil brought an action to recover his share in the sale proceeds. Anil resisted Sunil's claim on the plea that the firm was not registered. Will Sunil succeed in his claim? Decide with reference to the provisions of the Indian Partnership Act, 1932. (November 2008)

Answer

Effect of non-registration

The problem is based on the provisions of Section 69 of the Indian Partnership Act. As per this section a partner of an unregistered firm is excluded from bringing legal action against the firm or any person alleged to be or to have been a partner in the firm. But such a person may sue for dissolution of the firm or for accounts and realisation of his share in the firm's property where the firm is dissolved. Applying these provisions, Sunil will succeed in his claim as the business had been closed on the sale of the lorry, and the action now was for the realisation of the assets of a dissolved firm.

THE NEGOTIABLE INSTRUMENTS ACT, 1881*

Question 1

State briefly the rules laid down under the Negotiable Instruments Act for determining the date of maturity of a bill of exchange. Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4th May, 2000. (May 2000)

Answer

Calculation of maturity of a Bill of Exchange: The maturity of a bill, not 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 (Section 22, para 2 of Negotiable Instruments Act, 1881). Three days are allowed as days of grace. No days of grace are allowed in the case of bill payable on demand, at sight, or presentment.

When a bill is made payable at stated no. of months after date, the period stated terminates on the day of the month which corresponds with the day on which the instrument is dated. When it is made payable after a stated number of months after sight the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance. When it is payable a stated no- of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens (Section 23).

When a bill is made payable a stated number of months after sight and has been accepted for honour, the period terminates with the day of the month which corresponds with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month (Section 23).

In calculating the date a bill made payable a certain no. of days after date or

* Updated as per the Negotiable Instruments (Amendments & Miscellaneous Provision) Act, 2002.

after sight or after a certain event is at maturity, the day of the date, or the day of presentment for acceptance or sight or the day of protest for non-accordance, or the day on which the event happens shall be excluded (Section 24).

Three days of grace are allowed to these instruments after the day on which they are expressed to be payable (Section 22).

When the last day of grace falls on a day which is public holiday, the instrument is due and payable on the preceding business day (Section 25).

Answer to Problem: In this case the day of presentment for sight is to be excluded i.e. 4th May, 2000. The period of 100 days ends on 12th August, 2000 (May 27 days + June 30 days + July 31 days + August 12 days). Three days of grace are to be added. It falls due on 15th August, 2000 which happens to be a public holiday. As such it will fall due on 14th August, 2000 i.e. the preceding business day.

Question 2

Distinguish between inland and foreign bills.

(May 2000)

Answer

Inland Bills are drawn in India on a person residing in India, payable anywhere or drawn in India on a person residing outside India payable in India while a foreign bill is a bill which is not inland bill. Foreign bills are drawn and payable outside India or drawn in India and payable outside India or drawn in India upon persons resident outside India and made payable outside India. Foreign bills may be of five kinds: (i) bill drawn in India on a person resident outside India and made payable outside India (ii) bill drawn outside India and made payable in India (iii) bill drawn outside India on any person resident outside India (iv) bill drawn outside India on a person resident in India (v) bill drawn outside India are made payable outside India.

Inland bills are drawn in a single copy but foreign bills are drawn in triplicate.

In Inland bills, dishonour requires noting. Protest is optional, but in foreign bills, dishonour requires protesting, (Section 11 & 12, Negotiable Instruments Act, 1881].

Question 3

X, a major, and M, a minor, executed a promissory note in favour of P.

Examine with reference to the provisions of the Negotiable Instruments Act, the validity of the promissory note and whether it is binding on X and M. (May 2000)

Answer

Minor being a party to negotiable instrument: Every person competent to contract has capacity to incur liability by making, drawing, accepting, endorsing, delivering and negotiating a promissory note, bill of exchange or cheque (Section 26, para 1, Negotiable Instrument Act, 1881).

As a minor's agreement is void, he cannot bind himself by becoming a party to a negotiable instrument. But he may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself (Section 26, para 2).

In view of the provisions of Section 26 explained above, the promissory note executed by X and M is valid even though a minor is a party to it. M, being a minor is not liable; but his immunity from liability does not absolve the other joint promisor, namely X from liability [*Sulochana v. Pandiyan Bank Ltd.*, AIR (1975) Mad. 70].

Question 4

Explain the essential elements of a Promissory note. State, giving reasons, whether the following instruments are valid Promissory notes:

- (i) X promises to pay Y, by a Promissory note, a sum of Rs. 5,000, fifteen days after the death of B.**
- (ii) X promises to pay Y, by a Promissory note, Rs. 5000 and all other sums, which shall be due. (November, 2000)**

Answer

Essential Elements of a Promissory Note:

- 1. must be in writing.**
- 2. Promise to pay:** The instrument must contain an express promise to pay.
- 3. Definite and unconditional:** The promise to pay must be definite and unconditional. If it is uncertain or conditional, the instrument is invalid.
- 4. Signed by the maker:** The instrument must be signed by the maker, otherwise it is incomplete and of no effect. Even if it is written by the maker himself and his name appears in the body of the instrument, his

signature must be there. An agent of a trading firm can sign a promissory note on behalf of the firm- (*Meenakshi v. Chettiar*).

5. ***Certain parties:*** The instrument must point out with certainty as to who the maker is and who the payee is. When the maker and the payee cannot be identified with certainty from the instrument itself, the instrument, even if it contains an unconditional promise to pay, is not a promissory note.
6. ***Certain sum of money:*** The sum payable must be certain and must not be capable of contingent additions or subtractions,
7. ***Promise to pay money only:*** The payment must be in the legal tender money of India.

Answer to Problem: In the case number 1, the payment to be made is fifteen days after the death of B. Though the date of death is uncertain, it is certain that B shall die. Therefore the instrument is valid.

In the second case- the sum payable is not certain within the meaning of Section 4 of the Negotiable Instruments Act, 1881- Hence the Promissory Note is not a valid one.

Question 5

Mr. Clever obtains fraudulently from J a cheque crossed 'Not Negotiable'¹. He later transfers the cheque to D, who gets the cheque encashed from ABC Bank, which is not the Drawee Bank. J, on coming to know about the fraudulent act of Clever, sues ABC Bank for the recovery of money. Examine with reference to the relevant provisions of the Negotiable Instruments Act, 1881, whether J will be successful in his claim. Would your answer be still the same in case Clever does not transfer the cheque and gets the cheque encashed from ABC Bank himself?
(November 2000)

Answer

According to Section 130 of the Negotiable Instrument Act, 1881 a person taking cheque crossed generally or specially bearing in either case the words 'Not Negotiable' shall not have or shall not be able to give a better title to the cheque than the title the person from who he took had. In consequence, if the title of the transferee is defective, the title of the transferee would be vitiated by the defect.

Thus based on the above provisions, it can be concluded that if the holder has

a good title, he can still transfer it with a good title, but if the transferor has a defective title, the transferee is affected by such defects, and he cannot claim the right of a holder in due course by proving that he purchased the instrument in good faith and for value. As Mr. Cleaver in the case in question had obtained the cheque fraudulently, he had no title to it and could not give to the bank any title to the cheque or money; and the bank would be liable for the amount of the cheque for encashment. (Great Western Railway Co. v. London and Country Banking Co.)

The answer in the second case would not change and shall remain the same for the reasons given above.

Thus J in both the cases shall be successful in his claim from ABC bank.

Question 6

In what way 'Discharge of a party' to a negotiable instrument differ from the 'Discharge of instrument'. Explain the different modes of discharge of a negotiable instrument under the Negotiable Instruments Act. 1881.(November 2000)

Answer

Discharge of a Party to a Negotiable Instrument etc: An instrument is said to be discharged only when the party who is ultimately liable thereon is discharged from liability. Therefore, discharge of a party to an instrument does not discharge the instrument itself. Consequently, the holder in due course may proceed against the other parties liable for the instrument. For example; the endorser of a bill may be discharged from his liability, but even then acceptor may be proceeded against. On the other hand, when a bill has been discharged by payment, all rights thereunder are extinguished even a holder in due course cannot claim any amount under the bill.

Discharge of an Instrument:

1. **'By payment in due course:** The instrument is discharged by payment made in due course by the party who is primarily liable to pay, or by a person who is accommodated in case the instrument was made or accepted for his accommodation, The payment must be made at or after the maturity to the holder of the instrument if the maker or acceptor is to be discharged. A payment by a party who is secondarily liable does not discharge the instrument.
2. **By party primarily liable by becoming holder (Section 90):** If the maker of a note or the acceptor of a bill becomes its holder at or after its

maturity in his own right, the instrument is discharged.

3. ***By express waiver:*** When the holder of a negotiable instrument at or after its maturity absolutely and unconditionally renounces in writing or gives up his rights against all the parties to the instrument, the instrument is discharged. The renunciation must be in writing unless the instrument is delivered upto the party primarily liable.
4. ***By Cancellation:*** Where an instrument is intentionally cancelled by the holder or his agent and the cancellation is apprent thereon, the instrument is discharged. Cancellation may take place; by crossing out signatures on the instrument, or by physical destruction of the instrument with the intention of putting an end to the liability of the parties to the instrument.
5. ***By discharge as a simple contract:*** A negotiable instrument may be discharged in rile same way as any other contract for the payment of money. This includes for example, discharge of an instrument by novation or rescission or by expiry of period of limitation.

Question 7

Who is a holder in due course of a Negotiable Instrument? In what respects does he differ from a holder?
(November, 2000)

Answer

Holder In Due Course: It means any person who, for consideration became its possessor before the amount mentioned in it became payable. In the case of an instrument payable to order, 'holder in due course' means any person who became the payee or endorsee of the instrument before the amount mentioned in it became payable. In both the cases, he must receive the instrument without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. In other words, holder in due course means a holder who takes the instrument bona fide for value before it is overdue, and without any notice of defects in the title of the person, who transferred it to him. Thus a person who claims to be 'holder in due course' is required to prove that:

1. **on paying a valuable consideration, he became either the possessor of the instrument if payable to order;**
2. **he had come into the possession of the instrument before the amount due thereunder became actually payable; and**

3. **he had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor's from whom derived his title.**

Distinction between Holder & Holder in Due Course:

1. **A holder may become the-possessor or payee of an instrument even without consideration, whereas a holder in due course is one who acquires possession for consideration.**
2. **A holder in due course as against a holder, must become the possessor payee of the instrument before the amount thereon become payable.**
3. **A holder in due course as against a holder, must have become the payee of the instrument in good faith i.e., without having sufficient cause to believe that any defect existed in-the transferor's title.**

Question 8

*Comment on the following statement with reference to the provisions Negotiable Instruments Act. 1881: "Once a bearer instrument always a bearer instrument."
(May 2001)*

Answer

A bearer instrument is one, which can change hands by mere delivery of the instrument. The instrument may be a promissory note or a bill of exchange, or a cheque. It should be expressed to be so payable or on which the last endorsement is in blank. (Explanation 2 to Section 13 of the Negotiable Instrument Act 1881).

Under Section 46 where an instrument is made payable to bearer, it is transferable merely by delivery, i.e. without any further endorsement thereon. But this character of the Instrument can be subsequently altered. Section 49 provides that a holder of negotiable instrument endorsed in blank (i.e. bearer) may, without signing his own name, by writing above the endorser's signature, direct that the payment of the instrument be made to another person. Thus the character of the instrument is changed and the instrument cannot be negotiated by mere delivery.

But in the case of a Cheque, however, the law is a little different from the one stated above. According to the provisions of Section 85 (2) where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, despite any endorsement

whether in blank or full appearing thereon notwithstanding that any such instrument purported to restrict or exclude further negotiation. In other words, the original character of the cheque is not altered so far as the paying bank is concerned, provided the payment is made in due course. Hence the proposition that once a bearer instrument always a bearer instrument.

Question 9

Promissory note dated 1st February, 2001 payable two months after date was presented to the maker for payment 10 days after maturity. What is the date of Maturity? Explain with reference to the relevant provisions of the 'Negotiable Instruments Act, 1881 whether the endorser and the maker will be discharged by reasons of such delay. (May 2001)

Answer

Delay in presentment for payment of a promissory note: If a promissory note is made payable a stated number of months after date, it becomes payable three days after the corresponding date of months after the stated number of months (Section 23 read with Section 22 Negotiable Instruments Act 1881). Therefore- in this case the date of maturity of the promissory note is 4th April, 2001.

In this case the promissory note was presented for payment 10 days after maturity. According to Section 64 of Negotiable Instruments Act read with Section 66, a promissory note must be presented for payment at maturity by on behalf of the holder. In default of such presentment, the other parties to the instrument (that is, parties other than the parties primarily liable) are not liable to such holder. The indorser is discharged by the delayed presentment for payment. But the maker being the primary party liable on the instrument continues to be liable.

Question 10

X by inducing Y obtains a Bill of Exchange from him fraudulently in his (X) favour. Later, he enters into a commercial deal and endorses the bill to Z towards consideration to him (Z) for the deal. Z takes the bill as a Holder-in-due-course. Z subsequently endorses the bill to X for value, as consideration to X for some other deal. On maturity the bill is dishonoured. X sues Y for the recovery of the money.

With reference to the provisions of the Negotiable Instruments Act, decide

whether X will succeed in the case ?

(May 2001)

Answer

The problem stated in the question is based on the provisions of the Negotiable Instruments Act as contained in Section 53. The section provides: 'Once a negotiable instrument passes through the hands of a holder in due course, it gets cleansed of its defects provided the holder was himself not a party to the fraud or illegality which affected the instrument in some stage of its journey. Thus any defect in the title of the transferor will not affect the rights of the holder in due course even if he had knowledge of the prior defect provided he is himself not a party to the fraud. (Section 53).

Thus applying the above provisions it is quite clear that X who originally induced Y in obtaining the bill of exchange in question fraudulently, cannot succeed in the case. The reason is obvious as X himself was a party to the fraud.

Question 11

Explain clearly the meaning of the term 'Promissory' Note as provided in the Negotiable Instruments Act, 1881. In what way does a 'Promissory Note' differ from a 'Bill of Exchange'?

(November

Answer

Meaning of promissory note & distinction with bill of exchange:

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 the bearer of the instrument. (Section 4: The Negotiable Instruments Act, 1881).

DISTINCTION:

- 1. There are two parties in a Promissory Note – maker and the payee. In a bill there are three parties - the drawer, the drawee and the payee.**
- 2. Promissory Note contains an unconditional promise to pay. A Bill of Exchange contains an unconditional order to pay.**
- 3. Maker of a note is the debtor and he himself undertakes to pay. The**

drawer of a bill is the creditor who directs the drawee (his debtor) to pay.

4. **Maker of a note corresponds in general to the acceptor of a bill. But the maker of the note cannot undertake to pay conditionally whereas the acceptor may accept the bill conditionally because he is not the originator of the bill.**
5. **The liability of a maker of a note is primary and absolute, whereas the liability of the drawer of a bill is secondary and conditional (Section 30 and 32);**
6. **A note cannot be made payable to the maker himself, whereas in a bill the drawer and the payee may be one and the same person.**
7. **A note requires no acceptance and it is signed by the person who is liable to pay. A bill payable after sight or after a certain period must be accepted by the drawee before it is presented for payment.**
8. **A note cannot be drawn payable to bearer. A bill can be so drawn. But in no case can a note or bill be drawn 'payable to bearer on demand'.**
9. **The maker of a note stands in immediate relation with the payee, the drawer of a bill stands in immediate relation with the acceptor and not the payee. (Explanation to Section 44)**
10. **Certain provisions like presentment for acceptance (Section 61), acceptance (Section 75), acceptance for honour (Section 108), and bill in sets (Section 132) apply to bills but not to notes.**

Question 12

What is a 'Sans Recours' indorsement? A bill of exchange is drawn payable to X or order. X indorses it to Y, Y to Z, Z to A. A to B and B to X. State with reasons whether X can recover the amount of the bill from Y, Z, A and B, if he has originally indorsed the bill to Y by adding the words 'Sans Recours'. (November 2001)

Answer

Meaning of Sans Recours Endorsement: It is a type of endorsement on a Negotiable Instrument by which the endorser absolves himself or declines to accept any liability on the instrument of any subsequent party. The endorser signs the endorsement putting his signature along with the words, SANS RECOURS.

In the problem X, the endorser becomes the holder after it is negotiated to

several parties. Normally, in such a case, none of the intermediate parties is liable to X. Tills is to prevent 'circuitry of action'. But in this case X's original endorsement is 'without recourse' and therefore, he is not liable co Y, Z, A and B. But the bill is negotiated back to X, all of them are liable to him and he can recover the amount from all or any of them (Section 52 para 2).

Question 13

Explain the meaning of the term 'Holder' under Negotiable Instruments Act, 1881. State the privileges of a 'Holder in due course'. (November 2001)

Answer

Meaning of holder under the Negotiable Instrument Act, 1881 and the privileges of a holder in due course:

The 'holder' of a negotiable instrument means any person entitled in his own name:

- (i) to the possession thereof, and**
- (ii) to receive or recover the amount due thereon from the parties threat.**

Where the instrument is lost or destroyed, its holder is the person so entitled at the lime of such loss of destruction.

Privileges of a Holder in Due Course:

- 1. A person signing and delivering to another a stamped but otherwise inchoate instrument is debarred from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount, (Section 20).**
- 2. In case of a bill of exchange is drawn payable to the drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for acceptor to allege as against the holder in due course mat such name is fictitious. (Section 42).**
- 3. In case of a bill or note is negotiated to a holder in due course, the other parties to the bill or note cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Section 42 and 47).**
- 4. The person liable in a negotiable instrument cannot set up against the holder in due course the defences that the instrument had been lost or**

obtained from the former by means of an offence or fraud or for an unlawful consideration (Section 58).

- 5. 'No maker of a promissory note, and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originality made or drawn. (Section 120).**

No maker of a promissory note and no acceptor of a bill payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity at the date of the note or bill, to endorse the same (Section 121). In short, a holder in due course gets a good title to the bill.

Question 14

Define a Bill of Exchange as per the Negotiable Instruments Act, 1881 and explain its salient features.
(May, 2002)

Answer

Section 5 of the Negotiable Instruments Act, 1881, defines a Bill of Exchange as under:

"A 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 to the order of a certain person or to the bearer of the instrument.

Example: 'A' wrote and signed an instrument ordering 'B' to pay Rs.500 to 'C' This is a Bill of Exchange.

Another example of a valid Bill of Exchange is :

"On demand pay to 'A' or order the sum of rupees five hundred for value received."

In this case although the bill of exchange is payable on demand, but it is payable to a Specified person (i.e. A) or his order (i.e. to a person to whom 'A' requires to be paid), and, therefore, it is a valid bill of exchange.

Salient features of a Bill of Exchange:

The essential requirements of a Bill of Exchange, may be stated briefly as below

- (1) The bill of exchange must be in writing. It should not be oral one.**
- (2) The bill of exchange must contain an express order to pay.**

- (3) The order to pay must be unconditional. The order to pay must not depend upon a condition or on happening or an uncertain event.**
- (4) It must contain an order to pay in terms of money only.**
- (5) It must contain an order to pay a definite (i.e. certain) amount of money.**
- (6) The parties to a bill of exchange must be certain. Usually there are three parties to a bill of exchange, money drawer, drawee and payee. However, in some cases drawer and drawee may be same persons.**
- (7) It must be signed by the drawer.**
- (8) Intention to make a bill of exchange and its delivery are other additional requirements. It must be delivered to the payee. Otherwise it will be an inchoate instrument.**

Question 15

When is an alteration of an instrument treated as a material alteration under the Negotiable Instruments Act, 1881? What is the effect of such an alteration? (November 2001, May 2002)

Answer

Material alteration: An alteration is material which—

- (i) alters the character or identity of the instrument/or which shakes the very foundation of the instrument, or**
- (ii) changes the rights and liabilities of the parties, any of the parties to the instrument; or**
- (iii) alters the operation of the instrument.**
- (iv) any changes in the instrument which causes it to speak a different language in effect from that which it originally spoke or which changes the legal identity or character of this instrument, either in its terms or the relation of the parties to it, is a material alteration. It makes no difference whether the alteration is beneficial or prejudicial. (Rampadarath v. Hari Narain).**

The following alterations are material and vitiate the instrument, viz alterations of

- (i) Date**
- (ii) Sum payable**

- (iii) Time of payment
- (iv) Place of payment
- (v) Rate of interest
- (vi) Addition of place of payment

The following alterations, though material, are permitted by the Negotiable Instruments Act, 1881 and do not invalidate the instrument:

1. Filling blanks of inchoate instruments. (Section 20)
2. Conversion of a blank indorsement into an indorsement in full (Section 49)
3. Qualified acceptance (Section 86)
4. Crossing of cheques (Section 125)

Effect of material alteration:

The effect of a material alteration of a negotiable instrument is only to discharge those who become parties thereto prior to the alteration; But if an alteration is made in order to carry out the common intention of the original parties, it does not render the instrument void. Any material alteration, if made by an indorsee, discharges his indorser from all liability to him in respect of the consideration thereof. (Section 87).

The alteration must be so material that it alters the character of the instrument to a great extent. In *Hongkong and Shanghai Bank v. Lee Shi* (1928) A.C. 181, it has been held that an accidental alteration will not render the instrument void. It is necessary to show that the alteration has been made improperly and intentionally. The effect of making the material alteration without the consent of the party bound is exactly the same as that of cancelling the deed.

Question 16

What is meant by 'Negotiation'? Distinguish between 'Negotiability' v/s 'Assignability' of an instrument. (May, 2002, November, 2003)

Answer

Meaning of Negotiation: According to Section 14 of the Negotiable Instrument Act, 1881 when a promissory-note, bill of exchange or cheque is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated.

A negotiable instrument may be transferred in either of two ways, viz.

- (i) **by negotiation under this Act (Section 14, 46, 47, 48). A negotiable instrument may be negotiated either by delivery, when it is payable to bearer or by endorsement and delivery when it is payable to order; or**
- (ii) **by assignment of the instrument: When a person transfer his right to receive the payment of a debt, 'assignment of the debt' takes place. Thus where the holder of an instrument transfers it to another so as to confer a right on the transferee to receive the payment of the instrument, transfer by assignment takes place. (The Negotiable Instruments Act does not deal with transfer of negotiable instruments by assignment).**

Differences between negotiability and assignability: The following are the differences between Negotiability and Assignability.

- 1. In negotiation consideration is presumed. In assignment consideration must be proved.**
- 2. In case of transfer by negotiation, the transferee acquires all the rights of a holder in due course; where tile case of transfer by assignment, the assignee does not acquire the rights of a holder in due course, but has only the right of his assignor.**
- 3. Notice of transfer to the debtor by the transferee is not necessary. The acceptor of a bill and the maker of a note are liable on maturity to the holder in due course of the assignment in case of negotiation. In assignment it does not bind the debtor unless notice of the assignment has been given by the assignee to the debtor, and the debtor has, expressly or implied, assented to it.**

In negotiation the instruments payable to bearer are negotiated by mere delivery and instruments payable to order are negotiated by indorsement and delivery. In an assignment it can be made only in writing either on the instrument itself or in a separate document transferring to the assignee the transferor's rights in the instrument.

Question 17

When is presentment of an instrument not necessary under the Negotiable Instruments Act?

(May, 2002)

Answer

According to Section 76 of the Negotiable Instruments Act 1881, no presentment to payment is necessary in any one of the following cases:

- (i) if the maker, drawee or acceptor intentionally prevents the presentment of the instrument, or**
- (ii) if the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or**
- (iii) if the instrument being payable at some other specified place, neither he nor any other person authorised to pay it attends at such place during the usual business hours, or**
- (iv) if the instrument not being payable at any specified place, if he (i.e. maker etc) cannot after due search be found;**
- (v) as against any party sought to be charged therewith, if he (i.e maker, etc.) has engaged to pay notwithstanding non-presentment;**
- (vi) as against any party if after maturity, with knowledge that the instrument has not been presented —**

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 presentment for payment;

as against the drawer, if the drawer could not suffer damage from the of such presentment.

Question 18

Explain the meaning of 'Holder' and 'Holder in due course' of a negotiable instrument. The drawer, 'D' is induced by 'A' to draw a cheque in favour of P, who is an existing person. 'A' instead of sending the cheque to 'P', forgoes his name and pays the cheque into his own bank. Whether 'D' can recover the amount of the cheque from 'A's banker. Decide.

(Nov. 2002)

Answer

Meaning of 'Holder' and the 'Holder in due course' of a negotiable instrument :

'Holder' : Holder of negotiable instrument means as regards all parties prior

to himself, a holder of an instrument for which value has at any time been given.

'Holder in due course' : (i) In the case of an instrument payable to bearer means any person who, for consideration became its possessor before the amount of an instrument payable. (ii) In the case of an instrument payable to order, 'holder in due course' means any person who became the payee or endorsee of the instrument before the amount mentioned in it became payable. (iii) He had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor from whom he derived his title.

The problem is based upon the privileges of a 'holder in due course'. Section 42 of the Negotiable Instrument Act, 1881, states that an acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due cause claiming under an indorsement by the same hand as the drawer's signature, and purporting to be made by the drawer. In this problem, P is not a fictitious payee and D, the drawer can recover the amount of the cheque from A's bankers [*North and South Wales Bank B. Macketh (1908) A.C. 137; Town and Country Advance Co. B, Provincial Bank (1917) 2 Ir. R.421*].

Question 19

When a bill of exchange may be dishonoured by 'non-acceptance' and 'non-payment' under the provisions of Negotiable Instruments Act, 1881? (Nov. 2002)

Answer

A bill of exchange may be dishonoured either by non-acceptance or by non-payment:

Dishonour by non-acceptance :

Section 91 of the Negotiable Instrument Act, 1881 enumerate the following circumstances when a bill will be considered as dishonoured by non-acceptance.

- (i) when the drawee either does not accept the bill within forty eight hours or presentment or refuse to accept it.**
- (ii) when one of several drawees, not being partners, makes default in acceptance.**
- (iii) when the drawee gives a qualified acceptance.**

- (iv) when presentment for acceptance is excused and the bill remains unaccepted;**
- (v) when the drawee is incompetent to contract.**
- (vi) presentment is not necessary where the drawee after diligent search cannot be discovered, or where the drawee is incompetent to contract or the drawee is a fictitious person.**

When a bill has been dishonoured by non-acceptance, it gives the holder an immediate right to have recourse against the drawer or the endorser. Since the dishonour by non-acceptance constitutes a material ground entitling the holder to take action against the drawer, he need not wait till the maturity of the bill for it to be dishonoured on presentment for *payment* (*Ram Ravji Janhekar B. Pruthaddas 20 Bom 133*)

Dishonour by non-payment (Section 92 and 76)

A negotiable instrument is said to be dishonoured by non-payment when the maker, acceptor or drawee, as the case may be, makes default in payment upon being duly required to pay the same (section 92) Also a negotiable instrument is dishonoured by non-payment when presentment for payment is excused and the instrument remains unpaid after maturity (section 76).

Question 20

Referring to the provisions of the Negotiable Instruments Act, 1881, examine the validity of the following Promissory Notes:

- (i) I owe you a sum of Rs.1,000. 'A' tells 'B'.**
- (ii) 'X' promises to pay 'Y' a sum of Rs.10,000, six months after 'Y's marriage with 'Z'**

(Nov. 2002).

Answer

Promissory Note

A Promissory Note is an instrument in writing containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of certain person, or the bearer of the Instrument. (Section 4, The Negotiable Instruments Act, 1881).

Essential elements:

1. **It must be in writing.**
2. ***Promise to pay:* The instrument must contain an express promise to pay.**
3. ***Definite and unconditional:* The promise to pay must be definite and unconditional. If it is uncertain or conditional, the instrument is invalid.**
 - a. *Signed by the maker:* The instrument must be signed by the maker, otherwise it is incomplete and of no effect. Even if it is written by the maker himself and his name appears in the body of the instrument, his signatures must be there. An agent of a trading firm can sign a promissory note on behalf of the firm.
 - b. *Certain parties:* The instrument must point out with certainty as to who the maker is and who the payee is. When the maker and the payee cannot be identified with certainty from the instrument itself, the instrument, even if it contains an unconditional promise to pay, is not a promissory note.
6. ***Certain sum of money:* The sum payable must be certain and must not be capable of contingent additions or subtractions.**
7. ***Promise to pay money only:* The payment must be in the legal tender money of India.**

Based on the above conditions in accordance with the definition of a promissory note, the answers to the two problems is as under:

- (i) **It is not a promissory note in the first case, since there is no promise to pay.**
- (ii) **In the second case also it is not a promissory note since as it is probably that Y may not marry.**

Question 21

Which are the essential elements of a valid acceptance of a Bill of Exchange? An acceptor accepts a "Bill of Exchange" but write on it "Accepted but payment will be made when goods delivered to me is sold." Decide the validity.
(May 2003)

Answer

Essentials of a valid acceptance of a Bill of Exchange:

The essentials of a valid acceptance are as follows:

1. **Acceptance must be written:** The drawee may use any appropriate word to convey his assent. It may be sufficient acceptance even if just signatures are put without additional words. An oral acceptance is not valid in law.
2. **Acceptance must be signed:** A mere signature would be sufficient for the purpose. Alternatively, the words 'accepted' may be written across the face of the bill with a signature underneath; if it is not so signed, it would not be an acceptance.
3. **Acceptance must be on the bill:** The acceptance should be on the face of the bill normally but it is not necessary. An acceptance written on the back of a bill has been held to be sufficient in law. What is essential is that must be written on the bill; else it creates no liability as acceptor on the part of the person who signs it.
4. **Acceptance must be completed by delivery:** Acceptance would not be complete and the drawee would not be bound until the drawee has either actually delivered the accepted bill to the holder or tendered notice of such acceptance to the holder of the bill or some person on his behalf.
5. **Where a bill is drawn in sets, the acceptance should be put on one part only. Where the drawee signs his acceptance on two or more parts, he may become liable on each of them separately.**

Acceptance may be either general or qualified. An acceptance is said to be general when the drawee assents without qualification order of the drawer. The qualification may relate to an event, amount, place, time etc. (Explanation to Section 86 of the Negotiable Instruments Act 1881). In the given case, the acceptance is a qualified acceptance since a condition has been attached declaring the payment to be dependent on the happening of an event therein stated.

As a rule, acceptance must be general acceptance and therefore, the holder is

at liberty to refuse to take a qualified acceptance. Where, he refuse to take it, the bill shall be dishonoured by non-acceptance. But, if he accepts the qualified acceptance, even then it binds only him and the acceptor and not the other parties who do not consent thereto. (Section 86).

Question 22

A issues a cheque for Rs. 25,000/- in favour of B. A has sufficient amount in his account with the Bank. The cheque was not presented within reasonable time to the Bank for payment and the Bank, in the meantime, became bankrupt. Decide under the provisions of the Negotiable Instruments Act, 1881, whether B can recover the money from A? (May 2003)

Answer

Problem on Negotiable Instruments Act, 1881

The problem as asked in the question is based on the provisions of the Negotiable Instruments Act, 1881 as contained in Section 84. The section provides that where a cheque is not presented by the holder for payment within a reasonable time of its issue and the drawer suffers actual damage through the delay because of the failure of the bank, he is discharged from liability to the extent of such damage. In determining what is reasonable time, regard shall be had to the nature of the instrument, the usage of trade and bankers, and the facts of the particular case.

Accordingly, in the given case, the drawer is discharged from the liability to pay the amount of cheque to B. However, B can sue against the bank for the amount of the cheque applying the above provisions.

Question 23

What do you mean by an acceptance of a negotiable instrument? Examine validity of the following in the light of the provisions of the Negotiable Instrument Act, 1881 :

(i) An oral acceptance

(ii) An acceptance by mere signature without writing the word "accepted". (May 2003)

Answer

Meaning of Acceptance

It is only the bill of exchange which requires acceptance. A bill is said to be accepted when the drawee (i.e. the person on whom the bill is drawn), after putting his signature on it, either delivers it or gives notice of such acceptance

to the holder of the bill or to some person on his behalf. After the drawee has accepted the bill he is known as the acceptor (Section 7 para 3 of the Negotiable Instruments Act 1881).

Acceptance may be either general or qualified. The acceptance is qualified when the drawer does not accept it according to the apparent tenor of the bill but attaches some condition or qualification which have the effect of either reducing his (acceptor's) liability or acceptance of his liability subject to certain conditions. A general acceptance is the acceptance where the acceptor assents without qualification to the order of the drawer.

Validity of Acceptance:

Problem (1): It is one of the essential elements of a valid acceptance that the acceptance must be written on the bill and signed by the drawee. An oral acceptance is not sufficient in law. Therefore, an oral acceptance of the bill does not stand to be a valid acceptance.

Problem (2): The usual form in which the drawee accepts the Instrument is by writing the word 'accepted'. Across the face of the bill and signing his name underneath. The mere signature of the drawee without the addition of the words 'accepted' is a valid acceptance. As the law prescribes no particular form for acceptance, there can be no difficulty in construing acknowledgement as an acceptance but it must satisfy the requirements of Section 7 of the Negotiable Instruments Act, 1881 i.e. it must appear on the bill and must be signed by the drawee. (*Manakchand v. Chartered Bank*).

Question 24

What do you understand by "crossing of cheques"? What is the object of crossing? State the implications of the following crossing:

(i) *Restrictive Crossing.*

(ii) *Not-negotiable crossing.*

(November 2003)

Answer

Crossing of Cheques:

Meaning: Crossing of cheque means putting on the cheque two parallel transverse lines with or without the words (& Co.) written between the lines. Therefore, crossing is a direction to the drawee banker to pay the amount of money on the crossed cheque generally to a banker or a particular banker so that the party who obtains the payment of the cheque can be easily traced.

Object: The object of crossing cheque is to provide safety to the cheque. In

order to prevent the losses which might be incurred if a cheque is an open one, (i.e. - without crossing) and going to wrong hands, the crossing has been introduced.

Implications of:

- (i) **Restrictive Crossing:** In this type of crossing the words 'Account Payee' are added to the general or special crossing. Sometime, words like 'Account Payee & Not Negotiable' or 'Bank of India (it could be any Bank) Account Mr. X' may be added. The words 'Account Payee' on a cheque are a direction to the collecting banker that the amount collected on the cheque is to be credited to the account of the payee. Such cheques are negotiable.
- (ii) **Not Negotiable:** The implication of this kind of crossing is that, the title of transferee of such a cheque cannot be better than of its transferor. The use of the words "not negotiable" in a crossed cheque does not render the cheque non-negotiable but only affects one of the main features of negotiability. Cheques with not negotiable crossing are negotiable so long as their title is good. Once the title of the transferor or endorser becomes defective the title of the transferee is also affected by such defect and the transferee cannot claim the right of a holder in due course. In other words, nobody can pass on a title better than what he himself has. Any one who takes a cheque marked "not negotiable" takes at his own risk.

Question 25

State the grounds on the basis of which a cheque may be dishonoured by a banker, inspite of the fact that there is sufficient amount in the account of the drawer.

(November 2003)

Answer

Dishonour of cheque by banker: A banker is justified to dishonour a cheque in the following circumstances:

1. If a cheque is undated.
2. If it is stale - i.e. not been presented within reasonable period.
3. If the instrument is inchoate or not free from reasonable doubt.
4. When cheque presented before ostensible date.
5. When customer's funds are not properly applicable.
6. When customers draws cheque upon another branch of the same bank.

7. If the banker receives notice of customer's insolvency or lunacy.
8. If the customer countermands the payment of cheque.
9. If the court has given order to the Banker not to make payments.
10. If the customer dies and there is notice to the Banker.
11. If notice in respect of closure of the account is served by either party on the other.
12. If it contains material alteration.

Question 26

Describe, in brief, the main amendments incorporated by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 in Sections 138, 141 and 142 of the Principal Act i.e. the Negotiable Instruments Act, 1881.
(May 2004)

Answer

Amendments in the Negotiable Instruments Act, 1881

The main amendments made through the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 in Sections 138, 141 and 142 of the Negotiable Instruments Act, 1881 are as follows:

Section 138

- (i) To increase the punishment as prescribed under the Act from one year to two years.
- (ii) To increase the period for issue of notice by the payee to the drawer from 15 days to 30 days *[Proviso(b) to Section 138]*.

Section 141

To exempt those directors from prosecution under Section 141 of the Act who are nominated as directors of a company by virtue of their holding any office or employment in the Central Government or State Government or a Financial Corporation owned or controlled by the Central Government, or the State Government, as the case may be *[Proviso to Section 141(I)]*.

Section 142

To provide discretion to the court to waive the period of one month, which has been prescribed for taking cognizance of the case under the Act *[Proviso to Section 142(b)]*

Question 27

What is a "Promissory Note" and what are its elements?

S writes "I promise to pay 'B' a sum of Rs.500, seven days after my marriage with 'C'. Is this a promissory note?"
(May 2004)

Answer

According to the Section 4 of the Negotiable Instruments Act, 1881, "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 order of a certain person, or to the bearer of the instrument."

The essential characteristics of a promissory note are as follows:

- (1) It must be in writing. In other words an oral promise does not make a promissory note since it is not an instrument.
- (2) The promise to pay must be unconditional. It may be noted that a promise to pay is not conditional if it depends upon an event, which is certain to happen, but the time of its occurrence may be uncertain.
- (3) The amount promised must be a certain and a definite sum of money.
- (4) The instrument must be signed by the maker.
- (5) The person to whom the promise is made must be a definite person.

Problem

In the given case S promises to pay Rs.500. It is possible that 'S' may never marry 'C' and the sum may never become payable. Hence, the promise to pay is conditional as it depends upon an event, which may not happen. Hence, it is not a promissory note.

Question 28

Describe the circumstances where under notice of dishonour is excused under the Negotiable Instruments Act, 1881.
(May 2004))

Answer

Notice of Dishonour

As per section 98 of the Negotiable Instruments Act, 1881, following are the cases in which the Notice of Dishonour is excused:

- (i) When notice of dishonour is dispensed with by the party entitled thereto;
- (ii) In order to charge the drawer, when he has countermanded payment;
- (iii) When the party charged could not suffer damage for want of notice;
- (iv) When the party entitled to notice cannot after due search be found; or the party bound to give notice is, for any other reason, unable without any fault of his own to give it;
- (v) To charge the drawers, when the acceptor is also a drawer;
- (vi) When the promissory note is not negotiable;
- (vii) When the party entitled to notice of dishonour, knowing the facts unconditionally promises to pay the amount due on instrument.

Question 29

Define the term 'Cheque' as given in the Negotiable Instruments Act, 1881 and amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002.

(November 2004)

Answer

Definition of Cheque:

According to Section 6 of the Negotiable Instruments Act, 1881 as amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 "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 cheque in the electronic form means "a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system, ensuring the minimum safety standards with the use of digital signature (with or without biometrics signatures) and asymmetric crypto system' [Explanation I (a)].

A truncated cheque means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for

transmission, substituting the further physical movement of the cheque in writing [Explanation I (b)].

Clearing house means the clearing house managed by the Reserve Bank of India or a clearing house recognised as such by the Reserve Bank of India [Explanation II].

Question 30

State the privileges of a 'Holder in due course' under the Negotiable Instruments Act, 1881.

A induced B by fraud to draw a cheque payable to C or order. A obtained the cheque, forged C's indorsement and collected proceeds to the cheque through his Bankers. B the drawer wants to recover the amount from C's Bankers. Decide in the light of the provisions of Negotiable Instruments Act, 1881-

- (i) Whether B the drawer, can recover the amount of the cheque from C's Bankers?*
- (ii) Whether C is the Fictitious Payee?*
- (iii) Would your answer be still the same in case C is a fictitious person?*

(November 2004)

Answer

Privileges of a "Holder in Due Course": According to the provisions of the Negotiable Instruments Act, 1881, a holder in due course has the following privileges:

- (i) A person signing and delivering to another a stamped but otherwise inchoate instrument is debarred from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount (Section 20).*
- (ii) In case of bill of exchange is drawn payable to drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature. It is not permissible for acceptor to allege as against the holder in due course that such name is fictitious (Section 42).*
- (iii) In case a bill or note is negotiated to a holder in due course, the other parties to the bill or note cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Section 42 and 47).*

- (iv) The person liable in a negotiable instrument cannot set up against the holder in due course the defences that the instrument had been lost or obtained from the former by means of an offence or fraud or for an unlawful consideration (Section 58).
- (v) No maker of a promissory note, and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally made or drawn (Section 120).
- (vi) No maker of a promissory note and no acceptor of a bill payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the rate of the note or bill, to endorse the same (Section 121).

In brief, it is clear that a holder in due course gets a good title in many respects. Answer to problem

According to Section 42 of the Negotiable Instruments Act, 1881 an acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an instrument by the same hand as the drawer's signature, and purporting to be made by the drawer.

The word "fictitious payee" means a person who is not in existence or being in existence, was never intended by the drawer to have the payment. Where drawer intends the payee to have the payment, then he is not a fictitious payee and the forgery of his signature will affect the validity of the cheque.

Applying the above, answers to the questions asked can be as under:

- I. In this case B, the drawer can recover the amount of the cheque from C's bankers because C's title was derived through forged endorsement.
- II. Here C is not a fictitious payee because the drawer intended him to receive payment.
- III. The result would be different if C is not a real person or is a fictitious person or was not intended to have the payment.

Question 31

A draws a bill on B. B accepts the bill without any consideration. The bill is transferred to C without consideration. C transferred it to D for value. Decide-

- (i) *Whether D can sue the prior parties of the bill, and*
- (ii) *Whether the prior parties other than D have any right of action intense?*

Give your answer in reference to the Provisions of Negotiable Instruments Act, 1881

(November 2004)

Answer

Problem on Negotiable Instrument made without consideration:

Section 43 of the Negotiable Instruments Act, 1881 provides that a negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without endorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

- (i) In the problem, as asked in the question, A has drawn a bill on B and B accepted the bill without consideration and transferred it to C without consideration. Later on in the next transfer by C to D is for value. According to provisions of the aforesaid section 43, the bill ultimately has been transferred to D with consideration. Therefore, D can sue any of the parties i.e. A, B or C, as D arrived a good title on it being taken with consideration.
- (ii) As regards to the second part of the problem, the prior parties before D i.e., A, B, and C have no right of action inter se because first part of Section 43 has clearly lays down that a negotiable instrument, made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction prior to the parties who receive it on consideration.

Question 32

A cheque payable to bearer is crossed generally and marked "not negotiable". The cheque is lost or stolen and comes into possession of B who takes it in good faith and gives value for it. B deposits the cheque into his own bank and his banker presents it and obtains payment for his customer from the bank upon which it is drawn. The true owner of the cheque claims refund of the amount of the cheque from B.

(May 2005)

Answers

The cheque in the given case was crossed generally and marked 'Not Negotiable'. Thereafter, the cheque was lost or stolen and came into the possession of B, who takes it in good faith and gives value for it. Section 130 of the Negotiable Instruments Act, 1881 provides that a person taking a cheque crossed generally or specially, bearing in either case the words 'not negotiable', shall not have, and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had. In view of these provisions, B, even though he was a holder in due course, did not acquire any title to the cheque as against its true owner. The addition of the words 'not negotiable' entirely takes away the main feature of negotiability, which is, that a holder with a defective title can give a good title to a subsequent holder in due course. B did not obtain any better title than his immediate transferor, who had either stolen or found the cheque and was not the true owner of the cheque. Therefore, as regards the true owner, B was in no better position than the transferor. B is also liable to repay the amount of the cheque to the true owner. He can, however, proceed against the person from whom he took the cheque.

In the given case, both the collecting banker and the paying bankers would be exonerated. Since the collecting banker, in good faith and without negligence, had received payment for B, who was its customer of the cheque which was crossed generally, the banker would not be liable, in case the title proved to be defective, to the true owner by reason only of having received the payment of the cheque for his customer (Section 131). Since the paying banker on whom the crossed cheque was drawn, had paid the same in due course, the banker would also not be liable to the true owner. (Section 128).

Question 33

'A' draws a cheque for Rs.50,000. When the cheque ought to be presented to the drawee bank, the drawer has sufficient funds to make payment of the cheque. The bank fails before the cheque is presented. The payee demands payment from the drawer. What is the liability of the drawer.

(May 2005)

Answer

Section 84 of the Negotiable Instruments Act, 1881 provides that where a cheque is not presented for payment within a reasonable time of its issue and the drawer or person on whose account it is drawn had the right at the time

when presentation ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage through the delay, he is discharged from the liability, that is to say, to the extent to which such drawer or person is a creditor of the banker to a larger amount than would have been if such cheque had been paid. In determining what is a reasonable time, regard shall be had to the nature of the instrument, the usage of trade and of banker, and the facts of the particular case.

Applying the above provisions to the given problem since the payee has not presented the cheque to the drawer's bank within a reasonable time when the drawer had funds to pay the cheque, and the drawer has suffered actual damage, the drawer is discharged from the liability.

Question 34

*State the cases in which a banker is justified or bound to dishonour cheques.
(May 2005)*

Answer

In the following cases in which a banker is bound or justified to dishonour cheques:

- (i) A banker is justified to dishonour a cheque in reference to payment of a post-dated cheque presented for payment before its ostensible date;
- (ii) The banker is bound to pay a cheque only when it has 'sufficient funds of the drawer in his hands' otherwise not.
- (iii) The banker is bound to honour his customer's cheque only when the funds of the customers in his hands are 'properly applicable to the payment of such cheques' otherwise not.
- (iv) A banker is justified in refusing to honour a cheque which is irregular, or ambiguous, or drawn in a form of doubtful legality;
- (v) A banker is justified in refusing payment of a cheque drawn by a customer having credit with one branch of the bank, where the cheque is drawn upon another branch in which he has no account or in which his account is overdrawn.
- (vi) When the customer becomes insolvent, or an order of adjudication has been made against him, all his assets vest in the official assignee, and the banker should thereafter refuse to pay his customer's cheques.

- (vii) The duty and authority of a banker to pay a cheque drawn on him by his customer is determined by the customer countermending payment;
- (viii) Notice of death of the customer determines the authority of the banker to dishonour a cheque, but if the banker pays a cheque before he receives notice of his customer's death, payment is valid.
- (ix) If garnishee or other legal order from a court attaching or otherwise dealing with money in the hands of the banker, is served on the banker.
- (x) If it contains material alterations, irregular signature or irregular endorsement.
- (xi) If it is stale, that is if it has not been presented within reasonable period.

Question 35

A, a major, and B, a minor, executed a Promissory Note in favour of C. Examine with reference to the provisions of the negotiable Instruments Act, 1881 the validity of the Promissory Note and state whether it is binding on A and B. (November 2005)

Answer

Minor being a party to Negotiable Instrument: Every person competent to enter into contract has capacity to incur liability by making, drawing, accepting, endorsing, delivering and negotiating a Promissory Note, Bill of Exchange or clearance (Section 26, Para 1, Negotiable Instrument Act, 1881).

As a Minor's agreement is void, he cannot bind himself by becoming a party to a Negotiable Instrument. But he may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself (Section 26, para 2).

In view of the provisions of Section 26 explained above, the promissory note executed by A and B is valid even though a minor is a party to it. B, being a minor is not liable; but his immunity from liability does not absolve the other joint promissory, viz., A from liability [*Sulochona v. Pondiyan Bank Ltd.*].

Question 36

In what way does the Negotiable Instruments Act, 1881 regulate the determination of the 'Date of maturity' of a Bill of Exchange. Ascertain the 'Date of maturity' of a bill payable 120 days after the date. The Bill of exchange was drawn on 1st June, 2005. (November 2005)

Answer

Calculation of maturity of a Bill of Exchange: The maturity of a bill, not 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 (Section 22, para 2 of Negotiable Instruments Act, 1881). Three days are allowed as days of grace. No days of grace are allowed in the case of a bill payable on demand, at sight, or presentment.

When a bill is made payable as stated number of months after date, the period stated terminates on the day of the month, which corresponds with the day on which the instrument is dated. When it is made payable after a stated number of months after sight the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance on protested for Non-acceptance when it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens. (Section 23).

When a bill is made payable a stated number of months after sight and has been accepted for honour, the period terminates which the day of the month which corresponds with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month (Section 23).

In calculating the date a bill made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or the day of protest for non-accordance, or the day on which the event happens shall be excluded (Section 24).

Three days of grace are allowed to these instruments after the day on which they are expressed to be payable. (Section 22).

When the last day of grace falls on a day, which is public holiday, the instrument is due and payable on the preceding business day (Section 25).

Answer to Problem: In this case the day of presentment for sight is to be excluded i.e. 1st June, 2005. The period of 120 days ends on 21st September, 2005 (June 29 days + July 31 days + August 31 Days + September 29 days = 120 days). Three days of grace are to be added. It falls due on 2nd October, 2005, which happens to be a public holiday. As such it will fall due on 1st October, 2005 i.e., the preceding Business Day.

Question 37

Examine when shall a holder of a negotiable instrument be considered as a holder in due course under the provisions of the Negotiable Instruments Act, 1881. (November 2005)

Answer

According to Section 9 of the Negotiable Instruments Act, 1881, a holder of a negotiable instrument will be considered as holder in due course if he fulfills the following conditions.

- (i) that for consideration he became the possessor of the negotiable instrument of payable to bearer or the payee or endorsee thereof if payable to order.
- (ii) that he became the holder of the instrument before maturity.
that he became the holder of the instrument in good faith i.e., without sufficient cause to believe that any infirmity or defect existed in the title of the person from whom he derived the title.

Question 38

Point out the differences between “transfer by negotiation” and “transfer by assignment” under the provisions of the Negotiable Instruments Act, 1881. (May 2006)

Answer

Negotiation and Assignment: The essential distinction between transfer by negotiation and transfer by agreement are as under as provisions of the Negotiable Instrument Act, 1881.

- (i) In the latter case the assignee does not acquire the right of a holder in due course but has only the right, title and interest of his assignor; on the other hand in the former case he acquires all the rights of a holder in due course i.e., right from equities (*Mohammad Khuerail vs. Ranga Rao*, 24 M. 654).
- (ii) In the case of negotiable instrument, notice of transfer is not necessary while in the case of assignment of chose in action, notice or assignment must be served by the assignee on his debtor.

- (iii) Again, in the case of transfer of negotiable instrument, consideration is presumed, but in the case of transfer by assignment, consideration must be proved as in the case of any other contract.
- (iv) Negotiation requires either delivery only in the case of “bearer” instrument, or endorsement and delivery only in the case of “order instrument”. But in the case of an assignment, Section 130 of the Transfer of Property Act requires a document to be reduced into writing and signed by the transferor.
- (v) Endorsement does not require payment of stamp duty whereas negotiation requires payment of stamps duty

Question 39

When is an alteration in a negotiable instrument is deemed to be a “material alternation” under the Negotiable Instruments Act, 1881? What are the consequences of material alternation in a negotiable instrument? (May 2006)

Answer

Material alternation and its effect: As per the negotiable Instrument Act, 1881, an alteration is material which

- (a) alters the character or identity of the instrument or which shakes the very foundation of the instrument.
- (b) changes the rights and, liabilities of the parties or any of the parties to the instrument or
- (c) alters the operation of the instrument.

Any change in an instrument which causes it to speak a difference language in effect from that which it originally spoke, or which changes the legal identity or character of the instrument either in its terms or the relation of the parties to it is a material alteration. It makes no difference whether the alteration is beneficial or prejudicial.

Instances of material alteration. The following alterations are material i.e. the alteration of the date, the sum payable, the time of payment, the place of payment, additional of place of payment, and

the rate of interest.

These alterations vitiate the instrument.

Effect of material alteration – As per Section 87 of the Negotiable Instrument Act, 1881, a material alteration of a negotiable instrument renders the same void against persons who were parties thereto before such alteration unless they have consented to the alteration.

But if an alteration is made in order to carry out the common intention of the original parties, it does not render the instrument void. Any material alteration if made by an indorsee, discharges his indorser from all liability to him in 'respect of the consideration thereof.

Question 40

J. a shareholder of a Company purchased for his personal use certain goods from a Mall (Departmental Store) on credit. He sent a cheque drawn on the Company's account to the Mall (Departmental Store) towards the full payment of the bills. The cheque was dishonoured by the Company's Bank. J, the shareholder of the company was neither a Director nor a person in-charge of the company. Examining the provisions of the Negotiable Instruments Act, 1881 state whether J has committed an offence under Section 138 of the Act and decide whether he (J) can be held liable for the payment, for the goods purchase from the Mall (Departmental Store).

(November 2006)

Answer

The facts of the problem are identical with the facts of a case known as H.N.D. Mulla Feroze Vs. C.Y. Somaya Julu, J(2004) 55 SCL (AP) wherein the Andhra Pradesh High Court held that although the petitioner has a legal liability to refund the amount to the appellant, petitioner is not the drawer of the cheque, which was dishonoured and the cheque was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Hence, it was held that the petitioner J could not be said to have committed the offence under Section 138 of the Negotiable Instrument Act, 1881. Therefore X also is not liable for the cheque but legally liable for the payments for the goods.

Question 41

B obtains A's acceptance to a bill of exchange by fraud. B endorses it to C

who is a holder in due course. C endorses the bill to D who knows of the fraud. Referring to the provisions of the Negotiable Instruments Act, 1882, decide whether D can recover the money from A in the given case.

(November 2006)

Answer

Section 53 of the Negotiable Instrument Act, 1881 provides that a holder of negotiable instrument who derives title from a holder in due course has the right thereon of that holder in due course. Such holder of the bill who is not himself a party to any fraud or illegality affecting it, has all the rights of that holder in due course as regards to the acceptor and all parties to the bill prior to that holder. In this case, it is clear that though D was aware of the fraud, he was himself not a party to it. He obtained the instrument from C who was a holder in due course. So D gets a good title and can recover from A.

Question 42

A owes a certain sum of money to B. A does not know the exact amount and hence he makes out a blank cheque in favour of B, signs and delivers it to B with a request to fill up the amount due, payable by him. B fills up fraudulently the amount larger than the amount due, payable by A and endorses the cheque to C in full payment of dues of B. Cheque of A is dishonoured. Referring to the provisions of the Negotiable Instruments Act, 1881, discuss the rights of B and C. (May 2007)

Answer

Section 44 of the Negotiable Instruments Act 1881 is applicable in this case. According to Section 44 of this Act, B who is a party in immediate relation with the drawer of the cheque is entitled to recover from A only the exact amount due from A and not the amount entered in the cheque. However the right of C, who is a holder for value, is not adversely affected and he can claim the full amount of the cheque from B.

Question 43

Referring to the provisions of the Negotiable Instruments Act, 1881, examine the validity of the following:

- (i) A bill of Exchange originally drawn by M for a sum of Rs. 10,000, but accepted by R only for Rs.7,000.*
- (ii) A cheque marked 'Not Negotiable' is not transferable. (May 2007)*

Answer

- (i) As per the provisions of the Negotiable Instruments Act 1881, acceptance may be either general or qualified. It is qualified when the drawee does not accept the bill according to the apparent tenor of the bill but attaches some condition or qualification which have the effect of either reducing his (acceptor's) liability or acceptance of this liability is subject to certain condition. The holder of the bill is entitled to require an absolute and unconditional acceptance, otherwise he will treat it as dishonoured however, he may agree to qualified acceptance but he does so at his own peril, since he discharges all parties prior to himself, unless he has obtained their consent.

Thus in this given case in accordance with the Explanation to Section 86 of the Act, when the drawee undertakes the payment of part only of the sum ordered to be paid, it is a qualified acceptance and the drawer may treat it as dishonoured unless agreed by him. If the Drawer (M) agrees to acceptance, the drawee (R) is responsible for a sum of Rs. 7000 only.

- (ii) It is wrong statement. A cheque marked "not negotiable" is a transferable instrument. The inclusion of the words 'not negotiable' however makes a significant difference in the transferability of the cheques. The holder of such a cheque cannot acquire title better than that of the transferor.

Question 44

What are the essential elements of a "Promissory note" under the Negotiable Instruments Act, 1881? Whether the following notes may be considered as valid Promissory notes:

- (i) *"I promise to pay Rs. 5,000 or 7,000 to Mr. Ram."*
- (ii) *I promise to pay to Mohan Rs. 500, if he secures 60% marks in the examination.*
- (iii) *I promise to pay Rs. 3,000 to Ravi after 15 days of the death of A. (November 2007)*

Answer

A promissory note is an instrument (not being a bank note or currency note) in writing containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to or the holder of, a certain person or to the bearer of the instrument, (Section 4 of the Negotiable Instruments Act, 1881).

In view of the above provision of the said Act, following are the essential elements of a promissory note-

1. It must be in writing.
2. The promise to pay must be unconditional.
3. The amount promised must be a certain and a definite sum of money.
4. The instrument must be signed by the maker.
5. The person to whom the promise is made must be a definite person.

Thus:

- (i) In case (i), it is not a valid promissory note because the amount is not certain.
- (ii) In case (ii), it is not a valid promissory note because it is conditional.
- (iii) In case (iii), it is a valid promissory note because death of A is a certainty even if time of death is not certain.

Question 45

What do you understand by "Material alteration" under the Negotiable Instruments Act, 1881? State whether the following alterations are material alterations under the Negotiable Instruments Act, 1881?

- (i) *The holder of the bill inserts the word "or order" in the bill,*
- (ii) *The holder of the bearer cheque converts it into account payee cheque,*
- (iii) *A bill payable to ' ' is converted into a bill payable to X and Y. (November 2007)*

Answer

As per the Negotiable Instrument Act, 1881, an alteration can be called a material alteration if it alters or attempts to alters the character of the instrument and affects or is likely to affect the contract which the instrument contains or is evidence of. Thus, it totally alters the business effect of the instrument. It makes the instrument speak a language other than that was intended.

The following materials alterations have been authorised by the Act and do not require any authentication:

- (a) filling blanks of inchoate instruments [Section 20]
- (b) Conversion of a blank endorsement into an endorsement in full [Section 49]

(c) Crossing of cheque [Section 125]

The important material and non-material alteration are:

Material alteration	Non-material alteration
1. Alteration of date of instrument (e.g. if a bill dated 1st may, 1998) is changed to a bill dated 1st June, 1998.	1. Conversion of instrument payable to bearer.
2. Alteration of time of payment (e.g. if a bill payable three months after date is changed to bill payable four months payable after date).	2. Conversion of instrument payable to bearer into order.
3. Alteration of place of payment (e.g., if a bill payable at Delhi is changed to bill payable at Mumbai).	3. Elimination of the words 'or order' from an endorsement.
4. Alteration of amount payable (e.g., if bill for Rs. 1,000 is changed to a bill for Rs. 2000	4. Addition of the words 'or demand' to a note in which no time or payment is expressed.
5. Conversion of blank endorsement into special endorsement.	
6. Addition of a new party to an instrument.	
7. Alteration of one of the clauses of the instrument containing a penal action	

As per the above sections the changes of serial numbers (i) is non-material and changes of serial numbers (ii) (iii) are material changes in the given problem.

Question 46

Bharat executed a promissory note in favour of Bhushan for Rs. 5 crores. The said amount was payable three days after sight. Bhushan, on maturity,

presented the promissory note on 1st January, 2008 to Bharat. Bharat made the payments on 4th January, 2008. Bhushan wants to recover interest for one day from Bharat. Advise Bharat, in the light of provisions of the Negotiable Instruments Act, 1881, whether he is liable to pay the interest for one day? (May 2008)

Answer

Claim of Interest

Section 24 of the Negotiable Instruments Act, 1881 states that where a bill or note is payable after date or after sight or after happening of a specified event, the time of payment is determined by excluding the day from which the time begins to run.

Therefore, in the given case, Bharat will succeed in objecting to Bhushan's claim. Bharat paid rightly "three days after sight". Since the bill was presented on 1st January, Bharat was required to pay only on the 4th and not on 3rd April, as contended by Bharat.

Question 47

X draws a cheque in favour of Y. After having issued the cheque he informs Y not to present the cheque for payment. He also informs the bank to stop payment. Decide, under provisions of the Negotiable Instruments Act, 1881, whether the said acts of X constitute an offence against him ? (May 2008)

Answer

Problem: Offence under the Negotiable Instruments Act, 1881

This problem is based on the case of *Modi Cements Ltd. Vs. Kuchil Kumar Nandi, 1998*. In this case the Supreme Court held that once a cheque is issued by the drawer, a presumption under Section 139 of the Negotiable Instruments Act, 1881 follows and merely because the drawer issues a notice thereafter to the drawee or to the bank for stoppage of payment, it will not preclude an action under Section 138. The object of Sections 138 to 142 of the Act is to promote the efficacy of the banking operations and to ensure credibility in transacting business through cheques. Section 138 is a penal provision in the sense that once a cheque is drawn on an account maintained by the drawer with his banker for payment of any amount of money to another person from out of that account for the discharge in whole or in part of any debt or other liability, is informed by the bank unpaid either because of insufficiency of amount to honour the cheques or the amount exceeding

the arrangement made with the bank, such a person shall be deemed to have committed an offence.

Question 48

Discuss with reasons, whether the following persons can be called as a 'holder' under the Negotiable Instruments Act, 1881:

- (i) X who obtains a cheque drawn by Y by way of gift.*
- (ii) A, the payee of the cheque, who is prohibited by a court order from receiving the amount of the cheque.*
- (iii) M, who finds a cheque payable to bearer, on the road and retains it.*
- (iv) B, the agent of C, is entrusted with an instrument without endorsement by C, who is the payee.*
- (v) B, who steals a blank cheque of A and forges A's signature. (November 2008)*

Answer

Person to be called as a holder

As per section 8 of the Negotiable Instruments Act, 1881 'holder' of a Negotiable Instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto.

On applying the above provision in the given cases-

- (i) Yes, X can be termed as a holder because he has a right to possession and to receive the amount due in his own name.
- (ii) No, he is not a 'holder' because to be called as a 'holder' he must be entitled not only to the possession of the instrument but also to receive the amount mentioned therein.
- (iii) No, M is not a holder of the Instrument though he is in possession of the cheque, so is not entitled to the possession of it in his own name.
- (iv) No, B is not a holder. While the agent may receive payment of the amount mentioned in the cheque, yet he cannot be called the holder thereof because he has no right to sue on the instrument in his own name.
- (v) No, B is not a holder because he is in wrongful possession of the instrument.

Question 49

X draws a bill on Y but signs it in the fictitious name of Z. The bill is payable to the order of Z. The bill is duly accepted by Y. M obtains the bill from X thus becoming its holder in due course. Can Y avoid payment of the bill? Decide in the light of the provisions of the Negotiable Instruments Act, 1881. (November 2008)

Answer

Bill drawn in fictitious name

The problem is based on the provision of Section 42 of the Negotiable Instruments Act, 1881. In case a bill of exchange is drawn payable to the drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for the acceptor to allege as against the holder in due course that such name is fictitious. Accordingly, in the instant case, Y cannot avoid payment by raising the plea that the drawer (Z) is fictitious. The only condition is that the signature of Z as drawer and as endorser must be in the same handwriting.

THE PAYMENT OF BONUS ACT, 1965

Question 1

Explain with reference to the provisions of the Payment of Bonus Act the possibility of a non-banking company relying on its Balance Sheet and Profit and Loss Account in the case of a dispute with its employees relating to bonus payable under the Act and the limitations, if any, in this regard. (May, 2000)

Answer

Presumptions about the accuracy of balance sheet and profit and loss account of a company: Dispute between an employer and his employees regarding bonus payable under the Payment of Bonus Act, 1965 shall be deemed to be an industrial dispute within the meaning of the Industrial Disputes Act, 1947 or any corresponding law relating to investigation and settlement of industrial disputes in force in a state and the provisions of that Act or as the case may be such law shall, save and otherwise expressly provided, apply accordingly (Section 22).

Proceeding may be lying before any arbitrator or tribunal under the Industrial Disputes Act or under any corresponding law relating to investigation and settlement of industrial disputes in force in the state (herein referred to as the 'said authority') to which any dispute of the nature specified in Section 22 has been referred. During the course of such proceeding the balance sheet and the profit and loss account of an employer, being a corporation or a company other than a banking company may be produced. If these statements of accounts are audited by the Comptroller and Auditor General of India or by auditors qualified under Section 226(1) of the Companies Act, then as specifically provided in Section 23 of the Payment of Bonus Act, the said authority may presume that those are accurate. In view of this presumption corporation or company need not prove the accuracy of such statements by affidavit or any other mode.

But there are certain limitations. If the said authority is satisfied that those statements are not accurate, it may take such steps as it thinks necessary to find out the accuracy thereof.

Further, the trade union and if there is no trade union, employees being a party to the dispute may apply to the specified authority seeking clarification relating to any item in the balance sheet or profit and loss account. On receipt of such application the specified authority is to satisfy itself as to the necessity of such clarification. On being thus satisfied, the specified authority may direct the corporation or the company to furnish to the trade union or the employees such clarifications within such time as may be specified in the direction. Thereupon, the company or the corporation must comply with such direction [Section 23(2)].

Question 2

State the deductions which are allowed under the third schedule of the Payment of Bonus Act, 1965 for the purpose of computation of 'Available surplus' in the case of a Banking Company, which is not a Foreign Company. (November 2000)

Answer

Deductions that are allowed under the Third Schedule of the Payment of Bonus Act, 1965 are:

- (i) the dividends payable on its preference shares capital for the accounting year calculated at the rate at which such dividends are payable;
- (ii) 7.5 per cent of its paid up equity capital as at the commencement of the accounting year;
- (iii) 5 per cent of its reserves shown in its balance sheet at the commencement of the accounting year, including any profits carried forward from the previous account year;
- (iv) any sum which in respect of the accounting year, is transferred by it.
 - (a) to a reserve fund under sub-section (1) of Section 17 of the Banking Regulation
 - (b) to any reserve in India in pursuance or any direction or advice given by the Reserve Bank of India, whichever is higher;

Question 3

In what way does the Payment of Bonus Act, 1965 regulate the payment of bonus to employees linked with productivity? What restrictions apply in such cases on payment of bonus to an employee?
(May 2001)

Answer

The Payment of Bonus Act, 1965 by virtue of provisions as contained in Section 31A regulate and restrict the payment of bonus to an employee linked with productivity. Accordingly, there may be agreement or settlement by the employees with their employer for payment of an annual bonus linked with production or productivity in lieu of bonus based on profits, as is payable under the Act. Section 31A allows such an agreement/settlement. Therefore when such an agreement has been entered into, the employees are entitled to receive bonus as per terms of the agreement/settlement, subject to the following restrictions by the section:

1. any such agreement/settlement whereby the employees relinquish their right to receive minimum bonus under Section 10 shall, be null and void in so far as it purports to deprive the employees of the right of receiving minimum bonus.
2. if the bonus payable under such agreement exceeds 20% of the salary/wages earned by the employees during the relevant accounting year, such employees are not entitled to the excess over 20% of salary/wages.
3. Further provisions of Section 31 A shall have effect notwithstanding inconsistent therewith contained in any other law for the time being in force or in the terms of any award, agreement or contract of service. (Section 34)
4. Furthermore, provisions of the Coal Mines Provident Fund, Family Pension and Bonus Scheme Act, 1948 or of any scheme made thereunder shall not be affected by the provisions of Section 31A of the Payment of Bonus Act, 1965. (Section 35).

Question 4

Explain the provisions of the Payment of Bonus Act, 1965 relating to the following:

- (i) *Adjustment of customary bonus against bonus payable under the Act.*

- (ii) *Application of the Act to the establishments in public sector. What is the lime limit within which payment of bonus due to an employee under the Act, be paid ? (May 2001)*

Answer

- (i) **Adjustment of coustomary bonus againts bonus payable:** The Payment of Bonus Act, 1965 provides that if in any accounting year, an employer has paid any customary bonus to an employee, then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to employee under the Act in respect of that accounting year. The employee shall be entitled to receive only the balance. The employer can do the same thing even in a case where he has paid off the bonus payable under the Act to an employee before the date on which such bonus payable becomes payable. (Section 17)
- (ii) **Application of the Act to the establishment in public sector:** Section 20 of the Payment of Bonus Act, 1965 provides that if in any accounting year, an establishment in public sector may sell any goods produced or manufactured by it or it may render any services in competition with an establishment in private sector. And if the income from such sale or service or both is not less than 20% of the gross income of establishment in public sector, then the provisions of Bonus Act shall apply in relation to establishment in private Sector (Sub-section 1) Save as otherwise provided in Subsection (1), nothing in this Act shal apply to the employees employed by any establishment in the public sector (Sub-section2).

The limit for a payment of bonus: The employer is bound to pay his employee bonus within one month from the date on which the award becomes enforceable or the settlement comes into operation, if a dispute regarding payment of bonus is pending before any authority under Section 22 of the Act. In other cases, however, the payment of the bonus is to be made within a period of 8 months from closing of the accounting. But this period of 8 months may be extended upto a maximum of 2 years by the appropriate Government or by any authority specified; by the appropriate Government. This extension is to be granted on the application of the employer and only for sufficient reasons.

Question 5

In what way does the Payment of Bonus, 1965 Act regulate the payment of 'Minimum and 'Maximum' Bonus payable to an employee under the Act? (Nov. 2001, May 2004)

Answer

Minimum and maximum bonus payable to an employee under the Payment of Bonus Act, 1965.

Payment of bonus to an employee—minimum and maximum is regulated by the provisions of the Payment of Bonus Act, 1963 as contained in Sections 10 and 11 of the Act.

Minimum Bonus

According to Section 10 subject to the other provisions of the Act, every employer shall be bound to pay to every employee in respect of every accounting year, minimum bonus which shall be 8.33% of the salary or wage earned by the employee during the accounting year or Rs.100, whichever is higher, whether or not the employer has any allocable surplus in the accounting year. But if the employee has not completed 15 years of age at the beginning of the accounting year he will be entitled to a minimum bonus which shall be 8.33% of the salary or wage during the accounting year Rs.60, whichever is higher. Even if the employer suffers losses during the accounting year he is bound to pay minimum bonus as prescribed by Section 10- (*State v. Sardar Dalip Singh Majilhia*).

Maximum Bonus

According to Section 11 where, in respect of any accounting year referred to in Section 10, the allocable surplus exceeds the amount of minimum bonus payable to the employees under that section, The employer shall, in lieu of such minimum bonus, be bound to pay to every employee in respect of that accounting year bonus which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year subject to a maximum 20% of such salary or wage.

Question 6

Explain the meaning of "Salary or Wage" under the Payment of Bonus Act, 1965.

(May 2002, May 2003)

Answer

Meaning of Salary or Wages: According to Section 2(21) of the Payment of Bonus Act, 1965, the term 'salary or wage' means all remuneration other than remuneration in respect of overtime work, capable of being expressed in terms of money, which would, if the terms of employment, express or implied, were fulfilled, be payable to an employee in respect of his employment or of work done in such employment and includes dearness allowance; i.e. all cash payments by whatever name called, paid to an employee on account of a rise in the cost of living. But the term excludes:

- (i) any other allowance which the employee is for the time being entitled to;
- (ii) the value of any house accommodation or of supply of light, water, medical attendance or other amenities or of any service or of any concessional supply of foodgrains or other articles;
- (iii) any travelling concession;
- (iv) any bonus including incentive, production and attendance bonus;
- (v) any contribution paid or payable by the employer to any pension fund or provident fund or for the benefit of the employee under any law for the time being in force;
- (vi) any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex gratia payment made to him;
- (vii) any commission payable to the employee.

Where an employee is given in lieu of the whole or part of the salary or wage payable to him, free food allowance or free food by his employer, such food allowance or the value of such food shall be deemed to form part of the salary or wage of such employee.

Question 7

Specify any six kinds of establishments which are not covered under the Payment of Bonus Act, 1965. (May, 2002)

Answer

Kinds of establishment not covered under the payment of Bonus Act, 1965:

The payment of Bonus Act, 1965 does not cover under its purview the following categories of employees (Section 32):

- (i) Employees employed by the Life Insurance Corporation of India.

- (ii) Seamen as defined under Section 3(42) of the Merchant Shipping Act, 1958.
- (iii) Employees registered or listed under any scheme made under the Dock Workers (Regulation of Employment) Act, 1948 and employed by the registered or listed employers.
- (iv) Employees employed by an establishment engaged in any industry carried on by or under the authority of any department of the Central Government or a State Government or a local authority.
- (v) Employees employed by :
 - (a) the Indian Red Cross Society or any other institution of a like nature (including its branches),
 - (b) Universities and other educational institutions;
Institutions including hospitals, chambers of commerce and social welfare institutions established not for purposes of profit.
- (vi) Employees employed through contractors on building-operations.
 - (i) Employees employed by Reserve Bank of India.
 - (ii) Employees employed by :
 - (a) The Industrial Finance Corporation of India;
 - (b) Any financial corporation established under section 3 or any joint financial corporation established under section 3A of the State Financial Corporation Act 1951;
 - (c) The Deposit insurance Corporation;
 - (d) The Agricultural Refinance Corporation;
 - (e) The Unit Trust of India;
 - (f) The Industrial Development Bank of India;
 - (g) Any other Financial Institution (other than a banking company) being an establishment in Public Sector, which the Central Government 'may be notification in the Official Gazette, specify; while so specifying the Central Government shall have regard to its capital structure, its objectives and the nature and extent of financial assistance or any concessions given to it by the Government and any other relevant factor.
 - (h) Employees employed by inland water transport establishment operating on routes passing through any other country.

Besides the above, if the appropriate government is of the opinion that it will be in the public interest, having regard to the financial position and other relevant circumstances of any establishment or class of establishment, it may, by notification in the Official Gazette, exempt for such periods as may be specified therein and subject to such conditions as it may think fit to impose, such establishments from all any of the provisions of this Act.

Question 8

Who is entitled to bonus under the Payment of Bonus Act, 1965? Does this Act prescribe any disqualifications also for claiming bonus? Explain. (May, 2002 & 2004)

Answer

Every employee of an establishment covered under the Payment of Bonus Act, 1965 is entitled to bonus from his employer in an accounting year, provided he has worked in that establishment for not less than 30 working days in the year on a salary less than Rs.3,500 per month (Section 2 (13) read with Section. 8). **(This ceiling of Rs. 3,500 has been now revised to Rs. 10,000, with effect from Nov 2007)**

If an employee is prevented from working and subsequently re-instated in service, employee's statutory liability for bonus cannot be said to have been lost. "Nor can the employer refuse such bonus. [(ONGC vs Sham Kumar Sahegal (1995)].

An employee in the following cases is entitled to bonus:

- (1) A temporary workman on the basis of total number of days worked by him.
- (2) An employee of a seasonal factory is entitled to proportionate bonus and not minimum bonus, as prescribed by the Act.
- (3) A part-time employee, as a sweeper engaged on a regular basis. (*Automobile Karmachari Sangh vs. Industrial Tribunal* (1970) 38 FJR/268.
- (4) A retrenched employee, provided he has worked for minimum qualifying period (*East Asiatic C. (P) Ltd. Vs. Industrial Tribunal* (1961) LIJ 720).
- (5) A probationer is an employee and as such is entitled to bonus. (*Bank of Mudra Ltd. Vs. Employee's Union*, 1970 (2) US (21)).

- (6) A dismissed employee re-instated with back wages is entitled to bonus (*Gammon India Ltd Vs. Nirnjan Das (1984) 2 LJ 223*)
- (7) A piece rated worker is entitled to bonus (*Mathuradas Kani Vs. L.A. Tribunal AIR (1958) SC. 899*).

Disqualifications:

There are, however, certain disqualifications of an employee to claim bonus in an account year. An employee who has been dismissed from service for a) fraud; or b) riotous or violent behaviour while on the premises of the establishment; or c) theft, misappropriation or sabotage of any property of the establishment is not entitled, for bonus (Section 9). Further an employee in the following cases is not entitled to bonus:

- 1. An apprentice is not entitled to bonus (*Wheel & RIM Co. Vs. Govt. of T.N.*)
- 2. An employee employed through contractors on building operation, is not entitled to - bonus (Section 32).
- 3. An employee who is dismissed from service on the ground of misconduct as mention in Section 9 (*Pandian Roadways Corporation Ltd. Vs. Presiding officer*).

Regarding a probationer, in case of *Bank of Madwa Ltd. Vs. Employee's Union*, it has been held that a probationer is an employee and as such he is entitled to bonus.

Question 9

Explain the meaning of 'Allocable Surplus' and 'Available Surplus' stated in the Payment of Bonus Act, 1965
(Nov. 2002).

Answer**Allocable Surplus :**

According to Section 2(4) of the Payment of Bonus Act, 1965 the expression allocable surplus means 67% of the available surplus in an accounting year, in relation to an employer, being a company, other than a banking company, which has not made the arrangements prescribed under the Income Tax Act, for the declaration and payment within India of the dividends payable out of its profits in accordance with the provisions of Section 194 of that Act. In any other case, the allocable surplus means 60% of such available surplus.

Available Surplus :

According to Section 2 (6) of the Payment of Bonus Act, 1965, available surplus means the available surplus computed under Section 5 of the payment of Bonus Act, 1965. As per Section 5, the available surplus in respect of any accounting year means the gross profits for that year after deducting therefrom the sums referred to in Section 6, viz, depreciation, development rebate or investment allowance or development allowance, income tax payable during the year, and such further sums as are specified in Third Schedule.

To the amount of Gross Profit, so arrived it should be added an amount equal to the saving in income tax in the preceding accounting in year because of the payment of bonus.

Question 10

X, a temporary employee drawing a salary of Rs.3,000 per month, in an establishment to which the Payment of Bonus Act, 1965 applies was prevented by the employers from working in the establishment for two months during the financial year 2001-2002, pending certain inquiry. Since there were no adverse findings 'X' was re-instated in service, later, when the bonus was to be paid to other employees, the employers refuse to pay bonus to 'X', even though he has worked for the remaining ten months in the year. Referring to the provisions of the Payment of Bonus Act, 1965 examine the validity of employer's refusal to pay bonus to 'X'

(Nov. 2002)

Answer**Entitlement for bonus under the Payment of Bonus Act, 1965**

Every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than 30 working days in the year on a salary less than Rs. 3,500 per month. [Section 2(13) read with Section 8] **(This ceiling of Rs. 3,500 has been now revised to Rs. 10,000, with effect from Nov 2007).**

If an employee is prevented from working subsequently reinstated in service, employer's statutory liability for bonus cannot be said to have been lost and the employee concerned shall be entitled to the bonus. (ONGC v. Sham Kumar Sahegal).

Thus based on the above ruling and the provisions of the Act as contained in Section 8, the refusal by the employers to pay bonus to X is not valid and he (X) is entitled to get bonus in the given case for the reasons given above in the provisions, i.e. he has worked for more than 30 days in a year, drawing salary of less than Rs. 3500 **(from November 2007, this amount has been revised to Rs. 10,000)** and not disqualified for any other reason.

Question 11

In an accounting year, a company to which the payment of Bonus Act, 1965 applies, suffered heavy losses. The Board of Directors of the said company decided not to give bonus to the employees. The employees of the company move to the Court for relief. Decide in the light of the provisions of the said Act whether the employees will get relief? (May 2003)

Answer

Problem on Payment of Bonus.

Section 10 of the Payment of Bonus Act, 1965 provides that subject to the other provisions of the Act, every employer shall be bound to pay to employee in respect of the accounting year commencing on any day in 1979 and in respect of any subsequent year, a minimum bonus which shall be 8.33 per cent of the salary or wage earned by the employee during the accounting year or Rs. 100 (Rs. 60 in case of employees below 15 years of age), whichever is higher. The minimum bonus is payable whether or not employer has any allocable surplus in the accounting year.

Therefore based on the above provision (Section 10) the question asked in the problem can be answered as under:

Yes, applying the provisions as contained in Section 10 the employees shall succeed and they are entitled to be paid minimum bonus at rate 8.33% of the

salary or wage earn during the accounting year or Rs. 100 (Rs. 60 in case of employees below 15 Years of age), whichever is higher.

Question 12

The employer is a banking company. Point out so as to what items are required to be added to the "Net Profit" by the employer for calculating the "Gross Profit" in accordance with the First Schedule of the Payment of Bonus Act, 1965.
(November 2003)

Answer

Calculation of gross profit in case of banking company as per the first schedule of the Payment of Bonus Act, 1965;

The following are to be added to the Net Profit as shown in the Profit and Loss Account after making usual and necessary provisions:

1. Provision for Bonus to employees, Depreciation, Development Rebate Reserve, and any other Reserve.
2. Bonus paid to employees in respect of previous year, amount debited in respect of gratuity paid or payable to employees in excess of the aggregate of:
 - (a) the amount, if any, paid or provided for payment, to an approved gratuity fund; and
 - (b) the amount actually paid to employees on their retirement or on termination of their employees for any reason.
3. Donation in excess of the amount admissible for income tax.
4. Capital expenditure (other than capital expenditure on scientific research which is allowed as deduction under any law for the time being in force relating to direct taxes) and capital losses both other than losses on sale of capital assets on which depreciation has been allowed for income tax).
5. Any amount certified by the Reserve Bank in terms of Section 34A(2) of the Banking Regulation Act, 1949.
6. Losses of, or expenditure relating to any business situated outside India.
7. Add also income, profit or gains (if any) credited directly to published or disclosed reserves other than:

- (i) capital receipts and capital profits (including profits on the sale of capital assets on which depreciation has not been allowed for income tax).
- (ii) profits of, and receipts relating to any business situated outside India.
- (iii) income of foreign companies from investment outside India.

Question 13

Describe the procedure provided under the Payment of Bonus Act, 1965 for computing the number of days for determining the amount of minimum bonus payable to an employee. How is proportionate reduction in bonus made? (November 2003)

Answer

Computation of number of working days for determining the minimum bonus etc.

Section 14 of the Payment of Bonus Act, 1965 provides how to compute the number of working days for purposes of Section 13. Section 13 in turn prescribes a scale whereby bonus can be proportionately reduced in certain cases. Under Section 14 following days shall be deemed to be the working days of an employee and shall be counted while calculating the total working days on which he has been on work for the purpose of bonus:

- (i) Day when he has been laid off under an agreement or by a standing order under the Industrial Employment (Standing Orders) Act, 1946 or Industrial Disputes Act, 1947 or any other law.
- (ii) He has been on leave with salary or wage.
- (iii) He has been absent due to temporary disablement caused by accident arising out of and in the course of his employment and
- (iv) The employee has been on maternity leave with salary or wages during the accounting year.

According to Section 13, where an employee has not worked for all the working days in an accounting year, the minimum bonus of Rs. 100 or, as the case may be of Rs 60, if such bonus is higher than 8.33% of his salary or wage for the days he has worked in that accounting year, shall be proportionately reduced.

Question 14

Examine the powers of Government to grant exemption to an establishment from payment of bonus under the Payment of Bonus Act, 1965. (November 2000, 2004)

Answer

According to section 36 of the Payment of Bonus Act, 1965, if the appropriate Government having regard to the financial position and other relevant circumstances of any establishment or class of establishments is of the opinion that it will not be in public interest to apply all or any of the provisions of the Act, it may by notification in the official Gazette, exempt for such period as may be specified therein and subject to such conditions as it may think fit to impose, such establishment or class of establishments from all or any of the provisions of the Act. There are two stages in section 36. Viz

- (i) The Government shall consider the financial position and other relevant circumstances of an establishment or class of establishments; and
- (ii) The Government should be of the opinion that it would not be in public interest to apply all or any of the provisions of the Act.

The expression 'financial position' includes loss suffered by the establishment during the accounting year. The expression 'other relevant circumstances' will include every consideration as to whether the workmen had principally contributed to the financial loss of the company during that accounting year. If the bonus liability is negligible compared to the loss suffered, company should not be relieved of liability to pay minimum bonus. If the losses sustained by the employer is not due to any misconduct on the part of the employees, the employer is liable to pay statutory minimum bonus [J.K. Chemicals Ltd. Vs. Government of Maharashtra (1996) Bombay H.C.]

Question 15

On 1st January, 2002, Aryan Textiles Ltd. agreed with the employees for payment of an annual bonus linked with production or productivity instead of bonus based on profits subject to the limit of 30% of their salary wages during the relevant accounting year. It was also agreed by the employees that they will not claim minimum bonus stated under Section 10 of the Payment of Bonus Act, 1965. As per the agreement the employees of Aryan Textiles Ltd claimed annual bonus linked with production or productivity in the relevant accounting year. On refusal of the company the employees of the company moved to the court for relief.

Decide in reference to the provisions of the payment of Bonus Act, 1965 whether the employees will get the relief? In spite of the aforesaid agreement whether the employees are still entitled to receive minimum bonus. (November 2004)

Answer

Problem relating to bonus linked with production or productivity (Section 31A)

As per Section 31 (A) of the Payment of Bonus Act, 1965, there may be an agreement or settlement by the employees with their employer for payment of an annual bonus linked with production or productivity in lieu of bonus based on profits, as is payable under the Act. Accordingly, when such an agreement has been entered into the employees are entitled to receive bonus as per terms of the agreement/settlement, subject to the following restriction imposed by Section 31A;

- (a) any such agreement/settlement whereby the employees relinquish their right to receive minimum bonus under Section 10, shall be null and void in so far as it purports to deprive the employees of the right of receiving minimum bonus.
- (b) If the bonus payable under such agreement exceed 20% of the salary/wages earned by the employees during the relevant accounting year, such employees are not entitled to the excess over 20% of salary/wages.

In the given case Aryan Textile Ltd. agreed with the employees for payment of an annual bonus linked with production or productivity instead of based on profits subject to the limit of 30% of their salary/ wages during the relevant accounting year. According to Section 31A the maximum bonus under this provision can be given which should not exceed 20% of the salary/wages earned by the employee during the relevant accounting year. Hence, the maximum bonus may be paid upto 20% of the salary/wages. If the company agrees to pay more than 20% then it will be against the provisions of the Payment of Bonus Act, 1965.

The employees of Aryan Textiles also agreed not to claim minimum bonus stated in Section 10 of the Payment of Bonus Act, 1965 such an agreement shall be null and void as it purports to deprive the employees of their right of receiving minimum bonus. Hence, the relief may be given by the court, as regards to the payment of bonus to the employees, based on the production or productivity, if it is agreed, subject to a maximum of 20%. The employees

will also be entitled legally to claim bonus which is minimum prescribed under Section 10 of the Act, even though they have relinquished such right as per the agreement.

Question 16

Define an "Establishment in public sector". What are the circumstances when the Payment of Bonus Act, 1965 becomes applicable to such an establishment?
(May 2005)

Answer

Section 2(16) of the Payment of Bonus Act, 1965 defines 'establishment in public sector' to mean an establishment owned, controlled or managed by:

- (a) a Government company as defined in Section 617 of the Companies Act, 1956;
- (b) a Corporation in which not less than 40% of its capital is held (whether singly or taken together) by -
 - (i) the Government; or
 - (ii) the Reserve Bank of India; or
 - (iii) a Corporation owned by the Government or the Reserve Bank of India.

The provisions of the Payment of Bonus Act, 1965 do not ordinarily apply to an establishment in public sector. However, if the following two conditions are satisfied by such establishment in any accounting year, the provisions of the Act shall apply to such establishment as they apply to an establishment in the private sector:

- (i) If in any accounting year, an establishment in the public sector sells goods produced or manufactured by it or renders any services, in competition with an establishment in private sector; and
- (ii) the income from such sale or services is not less than 20% of the gross income of the establishment in public sector in that year.
(Section 20)

Question 17

Explain the rules of set on and set off of allocable surplus under the Payment of Bonus Act.
(May 2005)

Answer

Where for any accounting year, the allocable surplus exceed the amount of maximum bonus payable to the employees in the establishment under Section 11 of the Payment of Bonus Act, 1965, the excess shall, subject to the limit of 20% of the total salary or wage of the employees employed in the establishment in that accounting year, be carried forward for being set on in the succeeding accounting year and so on up to and inclusive of the 4th accounting year. This excess is to be utilized for the purpose of payment of bonus as illustrated in the 4th Schedule.

There may be a case where there is no allocable surplus or where the allocable surplus falls short of the amount of minimum bonus payable to the employee under section 10 and there is no amount or sufficient amount carried forward and set on under the aforesaid provisions which could be utilized for paying minimum bonus. In such a situation minimum amount or the deficiency as the case may be, shall be carried forward for being set off in the succeeding accounting year and so on up to and inclusive of the 4th accounting year in the manner illustrated in the 4th Schedule.

Where in any accounting year any amount has been carried forward and set on and set off under Section 15, in calculating bonus for the succeeding accounting year, the amount of set on and set off carried from the earliest accounting year shall first be taken into account. [Section 15(4)].

Question 18

Explain the meaning of "Accounting year" under the Payment of Bonus Act, 1965.

(November 2005)

Answer

Section 2(i) of the Payment of Bonus Act, 1965 defines 'accounting year'. It means,

- (i) in relation to a corporation, the year ending on the day on which the books of Accounts of the Corporation are to be closed and balanced.
- (ii) In relation to a company, this term means a period in respect of which any profit or loss account of the company laid before it in an annual general meeting is made up whether that period is a year or not.
- (iii) In any other case (a) the year commencing on the first day of April, or (b) if the accounts of an establishment maintained by the company thereof are closed and balanced on any day other than the 31st day of March then at the option of the employer, the year ending on the day on which its Accounts are so closed and balanced.

If, however, the said option is once exercised by the employer, it cannot be exercised once again, except with the permission in writing of the prescribed authority and upon such conditions as that authority may think fit. In other words, the exercise of the said option can only take place on obtaining the previous written permission of the prescribed authority, and the prescribed authority may impose such conditions as it may think fit.

Question 19

Explain the provisions of the payment of Bonus Act, 1965 relating to the following:

- (i) *Adjustment of Customary Bonus against bonus payable under the Act.*
- (ii) *What is the time limit within which payment of bonus due to an employee under the Act, be paid?*

(November 2005)

Answer

- (i) **Adjustment of customary or Interim Bonus against bonus payable under the Act (Section 17, Payment of Bonus Act, 1965):** If in any accounting year, an employer has paid any puja bonus or other customary bonus to any employee, then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year. The employee shall be entitled to receive only the balance. The employer can do the same thing even in a case where he has paid off the bonus payable under this Act to an employee before the date on which such customary bonus payable becomes payable.
- (ii) **Time limit for Payment of Bonus (Section 19):** The employer is bound to pay his employee bonus within one month from the date on which the award becomes enforceable or the settlement comes into operation, if a dispute regarding payment of bonus is pending before any authority under Section 22. In other cases, however, the payment of the bonus is to be made within a period of 8 months from closing of the accounting year. But this period of 8 months may be extended upto a maximum of 2 years by the appropriate Government or by any authority specified by the appropriate Government. This extension is to be granted on the application of the employer and only for sufficient reasons.

Question 20

Prakash Chandra is working as a salesman in a company on salary basis. The following payments were made to him by the company during the previous financial year –

- (i) overtime allowance,*
- (ii) dearness allowance*
- (iii) commission on sales*
- (iv) employer's contribution towards pension fund*
- (v) value of food.*

Examine as to which of the above payments form part of "salary" of Prakash Chandra under the provisions of the payment of Bonus Act, 1965.

(November 2005)

Answer

Computation of Salary / Wages: According to Section 2(21) of the Payment of Bonus Act, 1965 salary and wages means all remuneration other than remuneration in respect of overtime work, capable of being expressed in terms of money, which would if the terms of employment, express or implied, were fulfilled, be payable to an employee in respect of his employment, or of work done in such employment. It includes dearness allowance, i.e. all cash payment by whatever name called, paid to an employee on account of a rise in the cost of living. But the term excludes:

- (i) Any other allowance which the employee is for the time being entitled to;
- (ii) The value of any house accommodation or of supply of light, water, medical attendance or other amenities of any service or of any concessional supply of food grains or other articles;
- (iii) Any traveling concession;
- (iv) Any contribution paid or payable by the employer to any pension fund or for benefit of the employee under any law for the time being in force.
- (v) Any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex-gratia payment made to him; and
- (vi) Any commission payable to the employee.

It may be noted that where an employee is given, in lieu of the whole or part of the salary or wage payable to him, free food allowance or free food by his employer, such food allowance or the value of such food shall be deemed to form part of the salary or wage for such employee.

In view of the provisions of Section 2(21) explained above, the payment of dearness allowance and value of free food by the employer forms part of salary of Prakash Chandra while remaining three payments i.e. payment for overtime, commission on sales and employer's contribution towards pension funds does not form part of his salary

Question 21

Explain the procedure relating to computation of "working days" for the purpose of payment of bonus under the Payment of Bonus Act, 1965. Can there be a deduction in the amount of bonus on the ground that the employee has not worked for all working days in an a year?

(May 2006)

Answer

Computation of working days: Section 14 of the Payment of Bonus Act, 1956 provides for computation of number of working days for the purposes of Section 13. Section 13 in turn prescribes a scale whereby bonus can be proportionately reduced in certain cases. Under Section 14, following days shall be deemed to be the working days of an employee and shall be counted while calculating the total working days on which he has been on work for the purpose of bonus:

- (i) day when he has been laid off under an agreement or by a standing order under Industrial Employment (Standing orders) Act, 1946 or Industrial Dispute Act, 1947 or any other law,
- (ii) he has been on leave with salary or wage,
- (iii) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment and
- (iv) the employee has been on maternity leave with salary or wages during the accounting year.

As per Section 13, where an employee has not worked for all the working days in an accounting year, the minimum bonus of Rs. 100 or, as the case may be, Rs. 60, if such bonus is higher than 8.33% of his salary or wage for the days he has worked in that accounting year shall be proportionately reduced.

Both Section 13 and 14 do not cover a case where an employee was prevented from working by reason of an illegal order of termination. If an employee by himself and on his volition has not worked on all the working days in an accounting year, then the formula prescribed in Section 13 read with section 14 has to be applied. But where an employee was ready and willing to work, but for reasons beyond his control was unable to work, gets the eligibility for bonus under Section 8 of the Act, it cannot be said that section 14 is a bar for such a claim.

Question 22

Referring the provisions of the Payment of Bonus Act, 1965, state whether the following persons are entitled to bonus under the Act:

- (i) An apprentice;*
- (ii) An employee dismissed on the ground of misconduct;*
- (iii) A temporary workman;*
- (iv) A piece-rated worker.*

(November

2006)

Answer

- (i)** An Apprentice is not entitled to bonus [Wheel RIM Co. Vs. Govt. of Tamil Nadu (1971)]
- (ii)** An employee dismissed on the ground of misconduct is disqualified for any; bonus. [Pandian Roadways Corporation Ltd. Vs. Presiding Officer (1996)]
- (iii)** A temporary workman is entitled to bonus on the basis of the total number of days worked by him.
- (iv)** A piece-rated worker is entitled to bonus. [Mathurads Kani Vs. L.A. Tribunal (1958)]

Question 23

Explain the provisions of the Payment of Bonus Act, 1965 relating to 'Minimum' and 'Maximum' amount of bonus payment to an employee, for an accounting year.

(November

2006)

Answer

According to the Section 10 of the Payment of Bonus Act, 1965, subject to the other provisions of the Act, every employer shall be bound to pay to every employee in respect of every accounting year, minimum bonus which shall be 8.33% of the salary or wage earned by the employee during the accounting year or Rs. 100 whichever is higher, whether or not the employer has any allocable surplus in the accounting year.

In case of an employee who has not completed 15 years of age at the beginning of accounting year, he will be entitled to a minimum bonus which

shall be 8.33% of the salary or wage during the accounting year or Rs. 60/- whichever is higher.

Even if the employer suffers losses during the accounting year he is bound to pay minimum bonus as prescribed by Section 10 [State V. Sardar Dalip Singh Majilhia (1979)]

The maximum bonus payable to an employee in an accounting year is 20% of his salary/wages as defined under the Act.

Question 24

Examine whether the Payment of Bonus Act, 1965 be applicable to the following cases:

- (i) J, who is working in a social welfare organization.*
- (ii) D, an employee employed by an establishment engaged in an industry carried on by a department of the Central Government. (May 2007)*

Answer

- (i) As per the provisions contained in Section 32 (v) (c) of the Payment of Bonus Act, 1965, 'J' is not entitled to any bonus as the said Act is not applicable to social welfare organization.*
- (ii) Similarly the said Act is not applicable to the employees engaged by a Department of the Central Government vide Section 32 (iv).*

Question 25

During the accounting year 2005-06, XYZ Limited to which the Payment of Bonus Act, 1965 applies, suffered heavy losses. The Board of Directors of the company decided not to pay any bonus to its employees. The employees moved the Court for relief. Referring to the provisions of the Act, decide whether the employees of the company would be given any relief by the Court? (May 2007)

Answer

Yes, They will succeed. Even if the employer suffers losses during the accounting year he is bound to pay minimum bonus as prescribed by section 10 of the payment of Bonus Act, 1965. i.e. 8.33% of the basic wages (*State Vs Sardar Dalip Singh Majilhia*, 1979).

Question 26

Decide with reasons in the light of the Payment of Bonus Act, 1965 whether the following persons are entitled for bonus:

- (i) *A University teacher,*
- (ii) *An employee of the 'NABARD',*
- (iii) *A reinstated employee without wages for the period of dismissal.*
- (iv) *A retrenched employee who worked for 45 days in a year on a salary of Rs. 4,000 per month.*
- (v) *An apprentice.* (November 2007)

Answer

Every employee of an establishment covered under the Payment of Bonus Act, 1965 is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year on a salary less than Rs. 3,500 per month. [Section 2(13) and Section 8] (**Note: This amount has been revised to Rs. 10,000 now**)

In the given problem a University teacher and an employee of the NABARD are not entitled for bonus because the employees of Universities and other educational institutions and employees of the Agricultural Refinance Corporation are excluded from the operation of the Act as per Section 32 of the Payment of Bonus Act, 1965.

A reinstated employee without wages for the period of dismissal is also not entitled for bonus because only a dismissed employee reinstated with back wages is entitled to bonus. [*Gannon India Ltd. Vs. Niranjana Das* [1984] 2LLJ 223]. In this case the employee has been reinstated without wages.

A retrenched employee who worked for 45 days in a year on a salary of Rs. 4,000 per month is also not entitled for because he has worked for qualifying

days i.e. 30 days but his salary is higher than prescribed limit (Rs. 3500 per month) in the Act. **(Under the revised wage ceiling mentioned in the note above, this employee will be eligible for bonus).**

An apprentice is not entitled to bonus [*Wheel & RIM Co. vs. Government of Tamil Nadu* [1971]].

Question 27

A is an employee of a company. The amount of the bonus payable to A during the year 2006-07 is Rs. 10,000, but the company paid him Rs. 7,000 only and a sum of Rs. 3,000 was deducted from bonus against the loss suffered by the company due to misconduct of A during the same accounting year. A files a suit against the company for recovery of the deducted amount. Decide whether A would be given any relief by the court under the provisions of the Payment of Bonus Act, 1956? What will be your answer, if the losses are related to the accounting year 2005-06?

(November 2007)

Answer

As per the Payment of Bonus Act, 1965, in any accounting year, if an employee is found guilty of misconduct causing financial loss to the employer, then the employer can lawfully deduct the amount of loss from the amount of bonus payable by him to the employee in respect of that accounting year only. In this case, the employee shall get only the balance, if there be any (Section 18).

After application of the above provision it is clear that 'A' will not get any relief from the court because employer has the right to deduct the said losses from the bonus of employee.

In the second case, A will get relief from the Court because the losses are related to the accounting year 2005-06. As per the provision, the employers are entitled to deduct the losses incurred due to misconduct of the employee in the same accounting year. In this problem bonus payable year and accounting year are different.

Question 28

What are the provisions regarding set on and set off of the allocable surplus under the Payment of Bonus Act, 1965 ?
(May 2008)

Answer

Set on and set off of allocable surplus

Where for any accounting year the allocable surplus exceeds the amount of maximum bonus payable to the employees in the establishment under Section 11, then the excess shall, subject to a limit of 20% of the total salary or wage of the employees employed in the establishment in that accounting year, be carried forward for being set on in the succeeding accounting year and so on up to and inclusive of the 4th accounting year. This excess is to be utilized for the purpose of payment of bonus, in the manner illustrated in Fourth Schedule.

There may be a case where there is no allocable surplus or where the allocable surplus falls short of the amount of minimum bonus payable to the employee under Section 10 and there is no amount or sufficient amount carried forward and set on under the aforesaid provisions which could be utilized for paying minimum bonus. In such a situation minimum amount or the deficiency as the case may be, shall be carried forward for being set off in the succeeding accounting year and so on up to and inclusive of the 4th accounting year in the manner illustrated in Fourth Schedule.

Where in any accounting year any amount has been carried forward and set on or set off under this Section, then in calculating bonus for the succeeding accounting year, the amount of set on or set off carried forward from the earliest accounting year shall first be taken into account.

Question 29

X is an employee in a Company. The amount of bonus payable to him during the year 2007-08 is Rs.14,000. The company deducted a sum of Rs.4,000 against the "Puja Bonus" already paid to him during the said year and paid the remaining amount. X files a suit against the company for recovery of the deducted amount. Decide, under the Payment of Bonus Act, 1965, whether X would be given any relief by the Court?
(May 2008)

Answer

Deduction of Bonus

The problem as given in the question is based on Section 17 of the Payment of Bonus Act, 1965. As per Section 17, if in any accounting year, an employer has paid any puja bonus or other customary bonus to any employee, then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year. The employee shall be entitled to receive only the balance. The employer can do the same thing even in a case where he has paid off the bonus payable under this Act to an employee before the date on which such bonus payable becomes payable.

In the instant case X would not get any relief from the court because employer is empowered to deduct Rs.4,000/- from the total bonus (Rs.14,000) of Mr. X.

Question 30

Can the Payment of Bonus Act be made applicable to an establishment in the public sector?

(November 2008)

Answer

Applicability to an establishment in the public sector

Yes, in certain cases. According to section 20, in any accounting year if an establishment in public sector:

- (i) sells any goods produced or manufactured by it or
- (ii) renders any services in competition with an establishment in private sector, and, if the income from such sale or service or both is not less than 20% of the gross income of establishment in the public sector, then the provisions of the Bonus Act shall apply in relation to establishment in private sector [sec 20(1)]. Save as otherwise provided above, nothing in this Act shall apply to the employees employed by any establishment in the public sector [sec 20(2)].

Question 31

The management of Shakthi Mills Ltd. entered into an agreement with their employees to pay them bonus based on production in lieu of Bonus based on profits, from the accounting year 2007. The employees further agreed to forego their right to receive minimum bonus and instead accept 25% of their salary/wage as bonus based on productivity. Is such an agreement valid? Examine in the light of the provisions of the Payment of Bonus Act, 1965.

(November 2008)

Answer

Payment of bonus linked with productivity

No, such an agreement is null and void. The problem is based on Section 31A of the Payment of Bonus Act, 1965 which allows an agreement between employers and employees for payment of bonus linked with productivity. But such payment is subject to two restrictions :

- (i) That such agreement whereby the employees relinquish their right to receive minimum bonus under Sec.10, shall be null and void.
- (ii) If the bonus payable under such agreement exceeds 20% of the salary/wages earned by the employees during the relevant accounting year, such employees are not entitled to the excess over 20% of the salary/wages.

Accordingly, in the given problem, the agreement to forego the right of receiving minimum bonus is null and void. The employees shall not be entitled to receive the excess over 20% of salary/wages incase of bonus payable linked with productivity.

THE EMPLOYEES PROVIDENT FUND AND MISCELLANEOUS PROVISIONS ACT, 1952

Question 1

Who determines the money due from an employer under the Employees Provident Fund and Miscellaneous Provisions Act, 1952? State the factors considered by the authorities at the time of determining the amount. (May, 2000)

Answer

Determination of moneys due from employer (Section 7A, E.P.F. & M.P Act, 1952):

Authorities empowered to determine the amount due from an employer under the provisions of the Act and the scheme include Central P.F. Commissioner, Deputy P.F. Commissioner, Assistant P.F. Commissioner & Regional P.F. Commissioner.

The involves decisions on:

- (i) amount due as contribution
- (ii) date from which same is due
- (iii) administration charges
- (iv) amount to be transferred under Section 15 or 17 of Act.
- (v) any other charges payable by employer,

The authorities may conduct such inquiries as necessary and have powers such as are vested in Court.

Employer must be given a reasonable opportunity of representing his case.

Where any party fails to appear etc., the officer may decide on basis of evidence and documents put before him.

An *ex pane* order against employer may be set aside on application within 3 months of receiving order by him by showing sufficient cause. A fresh date shall be given for proceeding with inquiry.

As the above “proceedings are of quasi-judicial in nature and vitally affect and vitally affect the rights of parties, the principles of natural justice must be strictly followed in deciding the dispute.

Question 2

Explain the provisions of Employees' Provident Funds and Miscellaneous Provisions Act, 1952 with regard to determination of 'Escaped Amount' after an officer has passed an order concerning 'Determination of Amount' due from an Employer under the Act.

(November, 2000)

Answer

Determination of escaped amount under section 7C of the Employees Provident Funds and Miscellaneous Provisions Act, 1952: Where an order determining the amount due from an employer under Section 7A or Section 7B has been passed and if the officer who passed the order:

- (a) has reasons to believe that by reason of omission or failure on the part of the employer to make any document or report available, or to disclose, fully and truly, all material facts necessary for determining the correct amount due from the employer, any amount so due from such employer for any period has escaped his notice.
- (b) has in consequence of information in his possession, reason to believe that any amount to be determined under Section 7A or Section 7B has escaped from his determination for any period notwithstanding that there has been no omission or failure as mentioned in clause (a) on the part of the employer.

He may, within a period of five years from the date of communication of the order passed under Section 7A or Section 7B, re-open the case and pass appropriate order re-determining the amount due from the employer in accordance with provisions of this Act. However, no order re-determining the amount due from the employer shall be passed under this section unless the employer is given a reasonable opportunity of representing his case.

Question 3

Explain the salient features of Employee's Pension Scheme as provided under the Employees Provident Funds and Miscellaneous Provisions Act, 1952. (May 2001)

Answer

The Scheme called the Employees' Pension Scheme in accordance with the provisions of Section 6A of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 provides for:

- (a) superannuation pension, retiring pension or permanent total disablement pension to the employees of any establishment or class of establishments to which the Act applies; and
- (b) widow or widower's pension children pension or orphan pension payable to the beneficiaries of such employees.

The Act further provides that notwithstanding anything contained in Section 6 of the Act, there shall be established, as soon as may be after framing of the Pension Scheme, a Pension Fund into which there shall be paid, from time to time, in respect of every employees who is a member of the Pension Scheme :

- (a) such sums from the employer's contribution under "Section-6, not exceeding 8-1/3% of the basic wages dearness allowance and retaining allowance, if any, of the concerned employees, as may be specified in the Pension Scheme; such sums as are payable by the employers of exempted establishments under Sub-section (6) of Section 17.
- (b) the net assets of the Employees' Pension Fund as on the date of the establishment of the Pension Fund:
- (c) such sums as the Central Government may, after due appropriation by Parliament by law in this behalf, specify.

Further, the Pension Scheme may provide for all or any of the matters specific in Schedule III.

Question 4

Explain the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 relating to:

- (i) *Transfer of accounts of cm employee in case of his leaving the employment and faking up employment in another establishment.*
- (ii) *Liability of a transferee employer in case of transfer of establishment by an employer.*

(November, 2001)

Answer

Transfer of accounts of an employee and liability of transferee employer under employees' Provident Funds and Misc. Provisions Act, 1952:

Transfer of Accounts: (Section 17-A)

Section 17A of the Act provides for the transfer of accounts of an employee in case of his leaving the employment and taking up employment in another establishment and to deal with the case of an establishment to which the Act applies and also to which it does not apply. The option to get the amount transferred is that of the employee.

Where an employee of an establishment to which the Act applies leaves his employment and obtains re-employment in another establishment to which the Act does not apply, the amount of accumulations to the credit of such employee in the Fund or, as the case may be, in the provident fund in the establishment left by him shall be transferred to the credit of his account in the provident fund of the establishment in which he is re-employed, if the employee so desires and the rules in relation to that provident fund permit such transfer. This transfer has to be made within such time as may be specified by the Central Government in this behalf.

Conversely, when an employee of an establishment to which this Act does not apply leaves his employment and obtains re-employment in another establishment to which this Act applies, the amount of accumulations to the credit of such employee in the provident fund of the establishment left by him, if the employee so desires that the rules in relation to such provident fund permit, may be transferred to the credit of his account in the fund or as the case may be, in the provident fund of the establishment in which he is re-employed.

Liability of a transferee employer in case of transfer of establishment by the employer. (Section 17-B).

Where an employer in relation to an establishment, transfers that establishment in whole or in part by sale, gift, lease or licence or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall jointly or severally be liable to pay the contribution and other sums due from the employer under any provisions of the Act of the Scheme or the Pension Scheme, as the case may be, in respect

of the period up to the date of such transfer. It is provided that the liability of the transferee shall be limited to the value of the assets obtained by him by such transfer.

Section 17-B deals with the liability of transferor and transferee in regard to the money due under-

- (a) the Act: or
- (b) the Scheme;
- (c) Pension Scheme.

in the case of transfer of the establishment brought in by sale, gift, lease, or any other manner whatsoever, the liability of the transferor and the transferee is joint and several, but is limited with respect to the period upto the date of the transferor. Also the liability of the transferee is further limited to the assets obtained by him from the transfer of the establishment.

Question 5

State the establishments to which the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, applies. (May, 2002)

Answer

Establishments to which the Employees Provident Funds, Miscellaneous Provisions Act 1952 applies: The Employees Provident Funds and Miscellaneous Provisions Act, 1952 applies to the following establishments:

- (1) every establishment which is a factory engaged in any industry specified in Schedule I and in which 20 or more persons are employed; and .
- (2) any other establishment which employs 20 or more persons or class of such establishments which the Central Government may, by notification in the Official Gazette, specify in this behalf.

However, the Central Government may, after giving two months' notice of its intention to do so, apply the provisions of this Act to any establishment with less than 20 persons in the employment.

Notwithstanding anything stated above or in sub-section (1) of Section 16 of the Act, where it appears to the Central Provident Fund Commissioner, whether on an application made to him in this behalf or otherwise, that the employer and the majority of employees in relation to any establishment, have agreed that the provisions of this Act should be made applicable to the establishment, he may, by notification in the Official Gazette, apply the

provisions of this Act to the establishment on or from the date of such agreement or from any subsequent date specified in such agreement.

An establishment to which this Act applies must continue to be governed by this Act, *even if the number of persons employed therein at any time falls below 20.*

Question 6

Explain the provisions of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 authorising certain employers to maintain a Provident Fund Account.
(May, 2002)

Answer

Section 16-A of the Employee Provident Fund and miscellaneous Provisions Act, 1952 empowers the Central Government to authorise to certain employers to maintain a P.F. Account. This section states, the Central Government may, on an application made to it in this behalf by the employer and the majority of employees in relation to an establishment employing one hundred or more persons, authorise the employer by an order in writing, to maintain a provident fund account in relation to the establishment subject to such terms and conditions, as may be specified in the scheme.

No authorization shall, however, be made under this sub-section, if the employer of such establishment had committed any default in the payment of provident fund contribution or had committed any other offence under this Act during the three years immediately preceding the date of such authorization.

Where an establishment is authorised to maintain a provident fund account as aforesaid, the employer in relation to such establishment shall maintain such account, submit such return, deposit the contribution in such manner, provide for such facilities for inspection, pay such administrative charges, and abide by such other terms and conditions, as may be specified in the scheme.

Any authorization made under this Section may be cancelled by the Central Government by order in writing if the employer fails to comply with any of the terms and conditions of the authorization or where he commits any offence under any provisions of this Act.

Before cancellation the authorization, the Central Government shall give the employer a reasonable opportunity of being heard.

Question 7

State the kinds of establishments which are not covered under the Employee's Provident Funds and Miscellaneous Provisions Act, 1952. (Nov. 2002)

Answer

Establishments not covered under the Employee's Provident Funds and Miscellaneous Provisions Act, 1952 :

The Act is not applicable to the following establishments:

- (i) any establishment registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any state relating to co-operative societies, in any state, employing less than fifty person and working without the aid of power; or,
- (ii) any other establishment belonging to or under the control of the Central Government or a State Government and whose employees are entitled to the benefit of contributory provident fund or old age pension in accordance with any scheme or rule framed by the Central Government or the State Government governing such benefits, or
- (iii) any other establishment set up under any Central, Provincial, or State Act and whose employees are entitled to the benefits of contributory provident fund or old age pension in accordance with any scheme or rules framed under the Act governing such benefits, or
- (iv) any other establishment newly set-up, until the expiry of a period of three years from the date on which such establishment is, or has been set up.
- (v) section 16(2) lays down that if the Central Government is of the opinion that having regard to the financial position of any class of establishments or other circumstances of the case, it is necessary or expedient so to do, it may exempt that class of establishments from the operation of this Act for such period as may be specified in the notification in the official gazette. The exemption can be granted only through notification in the official gazette.

Question 8

In what way is the "Employee's Deposit-linked Insurance Scheme" regulated under the provisions of the Employee's Provident Funds and Miscellaneous Provisions Act, 1952? Explain. (Nov. 2002)

Answer

Provisions of the Employee's Provident Funds and Miscellaneous Provisions Act, 1952 relating to Employees deposit linked insurance scheme.

Section 6-C of the Act, 1952 provides that:

1. The Central Government may, by notification in the Official Gazette, frame a Scheme to be called the Employees' Deposit-linked Insurance Scheme for the purpose of providing life insurance benefits to the employees of any establishment or class of establishments to which the Act applies.
2. There shall be established, as soon as may be after the framing of the Insurance Scheme, a Deposit-linked Insurance Fund into which shall be paid by the employer from time to time in respect of every such employee in relation to whom he is the employer, such amount, not being more than one per cent of the aggregate of the basic wages, dearness allowance and retaining allowance (if any) for the time being payable in relation to such employee as the Central Government may, by notification in the Official Gazette, specify.
3. The employer shall pay into the Insurance Fund such further sums of money, not exceeding one-fourth of the contribution which he is required to make under sub-section (2), as the Central Government may, from time to time, determine to meet all the expenses in connection with administration of the Insurance Scheme other than the expenses towards the cost of any benefits provided by or under that Scheme.
4. The Insurance Fund shall vest in the Central Board and be administered by it in such manner as may be specified in the Insurance Scheme.
5. The Insurance Scheme may provide for all or any of the matters specified in Schedule IV.
6. The Insurance Scheme may provide that any of its provisions shall take effect either prospectively or retrospectively on such date as may be specified in this behalf in that Scheme.

Question 9

How is the Central Board of Trustees constituted under the provisions of the Employees Provident Fund and Miscellaneous Provisions Act, 1952? Explain its composition

(May 2003).

Answer

The Central Government may, by notification in the Official Gazette, constitute with effect from such date as may be specified therein, a Board of

Trustees for the territories to which the Employees Provident Fund and Miscellaneous Provisions Act, 1952 extends. The Central Board of Trustees consisting of the following persons as members, viz.

- (a) A Chairman and a Vice-Chairman to be appointed by the Central Government;
- (b) The Central Provident Commissioner, ex officio;
- (c) Not more than 15 persons appointed by the Central Government from amongst its officials;
- (d) Not more than 15 persons, representing Government of such State as the Central Government may specify in this behalf, appointed by the Central Government.
- (e) 10 persons representing employers of the establishments to which the Scheme applies, appointed by the Central Government after consultation with such organizations of employers as may be recognized by the Central Government in this behalf.
- (f) 10 persons representing employees in the establishments to which the Scheme applies, appointed by the Central Govt. after consultation with such organizations of employees as may be recognized by Central Government in this behalf.

Question 10

Describe the provisions relating to contribution by the employees and the employer under the Employees Provident Fund and Miscellaneous Provisions Act, 1952.
(May 2003)

Answer

According to section 6 of the EPF & MP Act, 1952, the employees' contribution to the fund shall be 10% of the basic wage, dearness allowance and retaining allowance (if any). An employee can at his will contribute beyond 10 if the scheme makes provision therefore subject to the conditions that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this Section (i.e. 10%). This rule will prevail irrespective of whether the employer employee the person directly or through contractor.

According to the first proviso to the Section 6, the Central Government may, however, raise the aforesaid percentage of contribution from 10% to 12% in respect of any establishments. It may do so after making such enquiries as it deems fit.

The following points are relevant in this regard:

- (i) Where the amount of any contribution involves a fraction of rupee, the scheme may provide for the rounding off of such fraction to the nearest rupee, half rupee or a quarter rupee.
- (ii) Dearness allowance includes cash value of any food concession allowed to the employee.
- (iii) Retaining allowance means an allowance payable for the time being to an employee of any factory or other establishment during any period in which the establishment is not working for retaining his services.

Question 11

What are the power of an "Inspector" under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952? (November 2003)

Answer

Powers of Inspector:

Under Section 13 of the Employees Provident Funds and Miscellaneous Provisions Act, 1952 the Inspector is appointed by the appropriate Government for the purpose of the Act and the Scheme. Under sub-section (2) of the said section, the Inspector has the following powers:

1. To collect information and require the employer or any contractor from whom any amount is recoverable under section 8A to furnish such information, as he may consider necessary.
2. To enter and search any establishment or any premises connected therewith.
3. To require any one found in charge of the above - mentioned establishment or premises to produce before him for examination any accounts, books, registers or other documents.
4. To examine the employer or contractor from whom any amount is recoverable.

5. To make copies of or take extract from any book, register or any other document maintained in relation to the establishment and also to seize such documents as he may consider relevant.
6. To exercise such other powers as the scheme may provide.

Question 12

An employee leaves the establishments in which he was employed and gets employment in another establishment wherein he has been employed. Explain the procedure laid down in the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 in this relation.

(November 2003)

Answer

Transfer of accumulated amount to the credit of Employees Provident Fund on change of employment: Section 17-A of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 provides for the transfer of accounts of an employee in case of his leaving the employment and taking up employment and to deal with the case of an establishment to which the Act applies and also to which it does not apply. The option to get the amount transferred is that of the employee. Where an employee of an establishment to which the Act applies leaves his employment and obtains re-employment in another establishment to which the Act does not apply, the amount of accumulations to the credit of such employees in the Fund or, as the case may be, in the provident Fund in the establishment left by him shall be transferred to the credit of his account in the provident fund of the establishment in which he is re-employed, if the employee so desires and the rules in relation to that provident fund permit such transfer. The transfer has to be made within such time as may be specified by the Central Govt. in this behalf. [Sub-Section (1)].

Conversely, when an employee of an establishment to which the Act does not apply leaves his employment and obtains re-employment in another establishment to which this Act applies, the amount of accumulations to the credit of such employee in the provident fund of the establishment left by him, if the employee so desires and the rules in relation to such provident fund permit, may be transferred to the credit of his account in the fund or as the case may be, in the provident fund of the establishment in which he is employed. [Sub-Section (2)].

Question 13

Is the amount standing to the credit of a member of the Provident Fund attachable in the execution of decree or order of the Court? Examine the law, on this point, laid down in the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. (May 2004)

Answer

Attachment of Provident Fund

According to Section 10 of E.P.F. & M.P. Act, 1952 the amount standing to the credit of any member in the fund or of any exempted employee in a provident fund shall not in any way be capable of being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member or the exempted employee, and neither the official assignee appointed under the Presidency Towns Insolvency Act nor any receiver appointed under the Provincial Insolvency Act shall be entitled to or have any claim on, any such amount.

The amounts standing to the credit of aforesaid categories of persons at the time of their death and payable to their nominees under the scheme or the rules vest in nominees, and the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or of the exempted employee and shall also not be liable to attachment under any decree or order of any court.

Question 14

Explain the concept of "Basic Wages" under the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. (May 2004)

Answer

Basic Wages under Employees Provident Fund & Miscellaneous Provisions Act, 1952

As per the provision of Section 2(b) of E.P.F. and M.P. Act, 1952 'Basic Wages' means all emoluments which are earned by an employee while on duty or on leave or on holidays with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include-

- (i) The cash value of any food concession.

- (ii) Any dearness allowance, house rent allowance, overtime allowance, bonus commission or any other similar allowance payable to the employee in respect of his employment or of work done in such employment.
- (ii) Any presents made by the employer.

Question 15

Manorama Group of Industries sold its textile unit to Giant Group of Industries. Manorama Group contributed 25% of total contribution in Pension Scheme, which was due before sale under the provisions of Employees Provident Fund and Miscellaneous Provisions Act, 1952. The transferee company (Giant Group of industries) refused to hear the remaining 75% contribution in the Pension Scheme. Decide, in the light of the Employees Provident Fund and Miscellaneous Provisions Act, 1952, who will be liable to pay for the remaining contribution in case of transfer of establishment and upto what extent?
(November 2004)

Answer

The problem as asked in the question is based on the provisions of section 17(B) of the Employees Provident Funds and Miscellaneous Provisions Act, 1952. Accordingly where an employer in relation to an establishment, transfers that establishment in whole or in part by sale, gift, lease or licence or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall be jointly or severally liable to pay the contribution and other sums due from the employer under the provisions of this Act of the scheme or pension scheme, as the case may be, in respect of the period upto the date of such transfer. It is provided that the liability of the transferee shall be limited to the value of the assets obtained by him by such transfer.

It would be thus evident from the aforesaid provisions that 17-B deals with the liability of transferor and transferee in regard to the money due under (a) the Act or (b) the scheme (c) and pension scheme. In the case of the transfer of the establishment brought in by sale, gift, lease etc. The liability of the transferor and transferee is joint and several, but it is limited to the period upto the date of transfer.

Therefore applying the above provisions in the given case the transferor Manorama Group of industries, the transferor has paid only 25% of the total

liability as contribution in pension scheme before sale of the establishment. With regards to remaining 75% liability both the transferor and transferee companies are jointly and severally liable to contribute. In case, the transferor refuses to contribute, the transferee will be liable,

The liability is limited upto the date of transfer and upto remaining amount. Further, the liability of the transferee i.e. Giant Group of Industries, is limited to the extent of assets obtained by it from the transfer of the establishment.'

Question 16

State the emoluments paid to employees, which do not come within the purview of "basic wages" under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

(May 2005)

Answer

According to Section 2(b) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 'Basic wages' means all emoluments which are earned by an employee while on duty or on leave in accordance with the terms of contract of employment which are paid or payable in cash to him but does not include:

- (i) Cash value of any food concession.
- (ii) Any dearness allowance i.e., Payments paid to an employee on account of rise in cost of living, house rent allowance, bonus, commission or over some allowance and

Any presents made by the employer.

Question 17

State the powers of the Central Government to authorize certain employers to maintain provident fund accounts under the Employees Provident Funds and Miscellaneous Provisions Act, 1952.

(May 2005)

Answer

Powers of the Central Government to authorize certain employers to maintain Provident Fund Accounts under the Employees' Provident Funds and Misc. Provisions Act, 1952 (Section 16A):

Under Section 16A of the Employees Provident Fund and Miscellaneous Provisions Act, 1952, the Central Government may, on an application made to it in this behalf by the employer and majority of employees in relation to an establishment employing 100 or more persons, authorize the employer, by an order in writing, to maintain a provident fund account in relation to the establishment subject to such terms and conditions as may be specified in the scheme.

The Central Government shall, however, not make such authorization if the employer of such establishment had committed any default in the payment of provident fund contribution or had committed any other offence under the Act during the three years immediately preceding the date of such authorization.

When an establishment is authorized to maintain a provident fund account, the employer in relation to such establishment shall maintain such account, submit such return, deposit the contribution in such manner, provide for such facilities for inspection, pay such administrative charges and abide by such other terms and conditions, as may be specified in the scheme.

Any authorization so made by the Central Government may be cancelled by an order in writing if the employer fails to comply with any of the terms and conditions of the authorization or where he commits an offence under any of the provisions of the Act. Before canceling the authorization, the Central Government shall give the employer a reasonable opportunity of being heard.

Question 18

State the establishments to which the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, applies.

(November 2005)

Answer

Establishments under the EPF & MP Act, 1952: According to Section 13(1) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 applies to the following establishments:

- (a) every establishment which is a factory engaged in any industry specified in schedule 1 and in which 20 or more persons are employed; and
- (b) any other establishment which employs 20 or more persons or class of such establishments which the Central Government may, by notification in Official Gazette specify in the behalf.

However, the Central Government may, after giving not less than 2 months notice of its intention to do so, apply the provisions of this Act to any establishment with less than 20 persons in the employment.

Further, notwithstanding anything mentioned above or in sub-section (1) of Section 16, where it appears to the Central Provident Fund Commissioner, whether on an application made to him in this behalf or otherwise, that the employer and the majority of employees in relation to any establishment, have agreed that the provisions of this Act should be made applicable to the establishment, he may, by notification in the official, Gazette, apply the provision of this Act to the establishment on and from the date of such agreement or from any subsequent date specified in such agreement.

An establishment to which this Act applies must continue to be governed by this Act, even if the number of persons employed therein falls at any time below 20.

Question 19

Explain the manner in which the "Executive Committee" under the provisions of the employees' Provident Fund and Miscellaneous Provisions Act, 1952 is constituted. State its composition.

(November 2005)

Answer

Executive Committee under EPF & MP Act, 1952 – (Section 5A): The Central Government may, by notification in the official Gazette, constitute, with effect

from such date as may be specified therein, on Executive Committee to assist the Central Board in the performance of its functions.

The Executive Committee shall consist of the following persons as members, namely:

- (a) A chairman appointed by the Central Government from amongst the members of the Central Board;
- (b) Two persons appointed by the Central Government from amongst the persons referred to in clause (b) of sub-section (1) of Section 5A.
- (c) Three persons appointed by the Central Government from amongst the persons referred to in clause (c) of sub-section (1) of Section 5A.
- (d) Three persons representing the employers elected by the Central Board from amongst the persons referred to in clause (d) of sub-section (i) of Section 5A.
- (e) Three persons representing the employees elected by the Central Board from amongst the persons referred to in clause (e) of sub-section (i) of Section 5A.
- (f) The Central Provident Fund Commissioner, ex-officio.

The terms and conditions subject to which a member of the Central Board may be appointed or elected to the Executive Committee and the time, place and procedure of the meetings of the Executive Committee shall be such as may be provided for in the scheme.

Question 20

Explain the Law relating to extent of contribution by an employee to his Provident Fund under the Employees Provident Fund and Miscellaneous Provisions Act, 1952. Can the employee increase the amount of contribution?

(May 2006)

Answer

Contribution to Provident Fund: Section 6 of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 states that the employee contribution to the fund shall be 10% of the basic wage, dearness allowance and retaining allowance (if any). An employee can at his will contribute beyond 10% if the scheme makes provision therefore subject to the conditions that the employer shall not be under an obligation to pay any contribution over and above his contribution

payable under this Section. This rule will prevail irrespective whether the employer employs the person directly or through contractor.

According to the first proviso to the said section the Central government may, however, raise the aforesaid percentage of contribution from 10% to 12% in respect of any establishments. It may do so after making such enquiries as it deems fit. According to the second proviso if the amount of any contribution involves fraction of a rupee, the scheme may provide for rounding off such fraction to the nearest rupee, half of a rupee or a quarter of rupee.

It may be noted that the dearness allowance mentioned above shall be deemed to include also the cash value of any food concession, allowed to the employees; also that "retaining allowance" means an allowance payable for the time being to an employee of any factory or other establishment during any period in which the, establishment is not working for retaining his service.

Question 21

*Explain the salient features of the "Employees Pension Scheme" as provided under the Employees Provident Fund and Miscellaneous Provisions Act, 1952.
(May 2006)*

Answer

Employees' Pension Scheme: The scheme called the Employees' Pension Scheme in accordance with the provisions of Section 6A of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 provides for:

- (a) Superannuation pension, retiring pension or permanent total disablement pension to the employees of any establishment or class of establishments to which the Act applies; and
- (b) Widow or widower's pension, children pension or orphan pension payable to the beneficiaries of such employees.

The Act further provides that notwithstanding anything contained in Section 6 of the Act, there shall be established, as soon as may be after framing of the Pension Scheme, a Pension Fund into which there shall be paid, from time to time, in respect of every employee who is a member of the pension scheme:

- (a) Such sums from the employers' contribution under Section 6 not exceeding $8\frac{1}{3}\%$ of the basic wages, dearness allowance and retaining

allowance, if any, of the concerned employees, as may be specified in the pension scheme;

- (b) Such sums as are payable by the employers of exempted establishments under sub-section (6) of Section 17.
- (c) The net assets of the Employees' Family Pension Fund as on the date of the establishment of the Pension Fund;
- (d) Such sums as the Central Government may, after due appropriation by Parliament by law in this behalf, specify.

Further, the pension scheme may provide for all or any of the matters specified in Schedule III.

Question 22

Explain the provisions of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 relating to the liability of an employer in case of transfer of the establishment to another person.

(November 2006)

Answer

According to Section 17B of the Employee's Provident Fund and Miscellaneous Provisions Act 1952, where an employer in relation to an establishment, transfer that establishment in whole or in part by sale, gift, lease or licence or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall jointly or severally be liable to pay the contribution and other sum due from the employer under any provision of this Act of the Scheme or the pension scheme, as the case may be, in respect of the period up to the date of such transfer. The liabilities of the transferee shall be limited to the value of the assets obtained by him by such transfer. The liability of transferor and transferee in relating to all the money due under the Act or the Scheme or pension scheme in case of the transfer of the establishment.

Question 23

Explain the provisions of the Employees Provident fund and Miscellaneous Provisions Act, 1952 relating to the following and state:

- (i) *Whether the balance to the credit of Provident Fund Account of an employee is attachable by the decree of a Court ?*

- (ii) *Whether the payment of contribution to provident fund of an employee, to be made by his employer, who has become insolvent, a preferential payment* (November 2006)

Answer

- (i) According to Section 10 of Employee's Provident Fund and Miscellaneous Provisions Act 1952, the amount standing to the credit of any member in the fund or credit of any exempted employee in provident fund shall not in any way capable or, being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member on the exempted employee.

The amount standing to the credit of the aforesaid categories of persons at the time of their death and payable to their nominees under the scheme or the rules vests in nominees. And the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or the exempted employee and shall also not be liable to attachment under any decree or order of any court.

- (ii) According to Section 11 of the Employee's Provident Fund and Miscellaneous Provisions Act 1952, if the employer is adjudged as insolvent or if the employer is a company and an order winding thereof has been made, the amount due from the employer whether in respect of the employee's contribution or employer's contribution must be included among the debts which are to be paid in priority to all other debts in the distribution of the property of the insolvent or the assets of the company. In other words, this payment will be a preferential payment provided the liability thereof has accrued before this order of adjudication or winding up is made.

Question 24

While an employee may increase his contribution to Provident Fund, is an employer also liable to proportionately increase his contribution to the above under the Employees Provident Funds and Miscellaneous Provisions Act, 1952 ? Explain. (May 2007)

Answer

Section 6 of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 provides that an employee can at his will contribute beyond 10% if the scheme makes provision therefor subject to the condition that the employer

shall not be under an obligation to pay any contribution over and above his contribution payable under this section.

Question 25

Explain the meaning of the term 'Basic Wages' under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. (May 2007)

Answer

"Basic wages" means all emoluments which are earned by an employee while on duty or on leave or on holidays with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include:

- (i) the cash value of any food concessions;
- (ii) any dearness allowance (that is to say all cash payment, by whatever name called, paid to an employee on account of rise in the cost of living), house rent allowance, overtime allowance, bonus, commission or pay and other similar allowance payable to the employee in respect of his employment or of work done in such employment; or
- (iii) any presents made by the employer. (Section 2(b), EPF & MP Act, 1952.

Question 26

Is the payment of provident fund contribution a preferential payment in case of the employer being insolvent under the Employees Provident Funds and Miscellaneous Provisions Act, 1952? (November 2007)

Answer

Section 11 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 provides that if the employer is adjudged an insolvent or if the employer is a company and an order for winding up thereof has been made, the amount due from the employer whether in respect of the employee's contribution or the employer's contribution must be included among the debts which are to be paid in priority to all other debts under Section 49 of the Presidency -Towns Insolvency Act, Section 61 of the Provincial Insolvency Act, Section 530 of the Companies Act, 1956, in the distribution of the property of the insolvent or the assets of the company. In other words, this payment will be preferential payment provided the liability therefor has accrued before this order of adjudication or winding up is made.

Question 27

Explain the salient features of the 'Employee's Deposits Linked Insurance Scheme' as provided under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952.

(November 2007)

Answer

The Central Government under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 framed the Employees' Deposit-linked Insurance Scheme, 1976. The Insurance Scheme came into force on the 1st day of August, 1976.

Soon after the framing of the above scheme, there was established a Deposit-linked Insurance Fund (called Insurance Fund). The employer shall pay into the fund from time to time in respect of his employees an amount not exceeding 1 % of the aggregate of the basic wages, dearness allowance and retaining allowance (if any) as the Centre Government may, by notification in the Official Gazette, specify. He shall also pay into the fund such further sum of money not exceeding 1/4th of the contribution which he is required to make as the Central Government may, from time to time determine. This payment is required to be made to meet all the expenses in connection with the administration of the Employees' Deposit-linked Insurance Scheme other than the expenses towards the cost of any benefit provided by or under that scheme [Section 6C (4) (a)].

The Insurance Fund shall vest in the Central Board and be administered by it in such manner as may be specified in the Insurance Scheme [Section 6C (5)]. The Insurance Scheme may provide for all or any of the matters specified in Schedule IV [Section 6C (7)].

The Insurance Scheme may provide that any of its provisions and amendment shall take effect either prospectively or retrospectively on such date as may be specified in this behalf in that Scheme [(Section 6C and 7)].

The Provident Fund claims complete in all respects submitted along with the requisite documents shall be settled and the benefit amount paid to the beneficiaries within 30 days from the date of its receipt by the Commissioner. If there is any deficiency in the claim, the same shall be recorded in writing and communicated to the applicant within 30 days from the date of receipt of such application. In case the Commissioner fails without sufficient cause to settle a claim complete in all respects within 30 days, the Commissioner shall be liable for the delay beyond the said period and penal interest at the rate of

12% per annum may be charged on the benefit amount and the same may be deducted from the salary of the commissioner.

Question 28

Explain the provisions of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 regarding the following:

- (i) rate of interest on amount due from the employer under the Act.*
- (ii) maximum limit of interest rate*
- (iii) the period for which the employer is liable to pay the said interest. (May 2008)*

Answer

Rate, limit and period of payment of interest

As per Section 7Q of the Employees Provident Fund and Miscellaneous Provisions Act, 1952

- (i) the employer shall be liable to pay simple interest at the rate of 12 per cent per annum or at such higher rate as may be specified in the Scheme on any amount due from him under this Act.
- (ii) although limit of interest rate is not given in the Act, but it is clearly given the higher rate of interest specified in the Scheme cannot exceed the lending rate of interest of any scheduled bank.
- (iii) the period for which the employer is liable to pay the interest is from the date which the amount has become so due till the date of its actual payment.

Question 29

Vimal is an employee in a Company. The following payments were made to him during the previous year:

- (i) Piece rate wages*
- (ii) Productivity bonus*
- (iii) Additional dearness allowance*
- (iv) Value of Puja gift.*

Examine as to which of the above payments form part of "Basic Wage" of Vimal under the Employees Provident Fund and Miscellaneous Provisions Act, 1952. (May 2008)

Answer

Basic Wages

As per Section 2 of the Employees Provident Fund and Miscellaneous Provision Act, 1952, the “Basic Wages” means all emoluments which are earned by an employee while on duty or on leave or on holidays with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include:

- (i) the cash value of any food concessions;
- (ii) any dearness allowance (that is to say all cash payments, by whatever name called, paid to an employee on account of rise in the cost of living), house rent allowance, overtime allowance, bonus, commission or pay and other similar allowance payable to the employee in respect of his employment or of work done in such employment; or
- (iii) any presents made by the employer.

Applying the above provisions of the Act to the given problem, the Basic wages of X will include only piece rate wages but it excludes the Productivity bonus, additional dearness allowance and value of puja gift.

Question 30

What kind of entities fall within the purview of the Employees’ Provident Fund and Miscellaneous Provision Act ,1952 ? (November 2008)

Answer

Entities within the purview of the Act

The Act applies to the following entities subject to the exceptions contained in Sec.16:

- (a) Every establishment which is a factory engaged in any industry specified in schedule I and in which twenty or more persons are employed and
- (b) Any other establishment which employs twenty or more persons or class of such establishments which the central government may by notification in Official Gazette specify in this behalf.

Question 31

Who is to constitute the Central Board of Trustees? How many persons shall be there in the Central Board? Answer the questions with reference to the Employees Provident Fund and Miscellaneous Provisions Act, 1952. (November 2008)

Answer

Constitution of the Central Board of Trustees

According to Section 5A the Central Government may constitute a Board of Trustees, i.e. the Central Board. It consists of the following persons, as members, namely:

- (a) A chairman and a vice – chairman to be appointed by the Central Government;
- (aa) The Central Provident Fund Commissioner, ex–officio;
- (b) Not more than fifteen persons appointed by the Central Government from amongst its Officials:
- (c) Not more than fifteen persons, representing Governments of such State as the Central Government may specify
- (d) Ten persons representing employers of the establishments to which the scheme applies, appointed by the Central Government after consultation with such organizations of employers as may be recognized by the Central Government in this behalf; and
- (e) Ten persons representing employees in the establishment to which the scheme applies, appointed by the Central Government after consultation with such organizations of employees as may be recognized by the Central Government in this behalf.

THE COOPERATIVE SOCIETIES ACT, 1912 INCLUDING THE MULTI-STATE COOPERATIVE SOCIETIES ACT, 2002

Question 1

Under what circumstances shall a Member of a Society Registered under the Cooperative Societies Act, 1912 cease to be the member of such a society? Explain. (November 2000)

Answer

Cessation of Membership in a Co-operative Society under the Cooperative Societies Act, 1912: Rule 19 of the Act provides that a person shall cease to be a member on the ground of:

1. his resignation.
2. transfer of his share.
3. his death.
4. his removal.
5. his expulsion, and
6. his incurring any of the disqualifications specified in the Act.

A person once admitted to the membership of a society can not be removed by the general body or the Managing Committee. (*Postal Cooperative House Construction Ltd. v. Registrar*).

Question 2

Explain the provisions of Cooperative Societies Act 1912 with regards to inquiry by the Registrar into the affairs of a society and inspection of books of an indebted society.

(November, 2001)

Answer

**Inspection by the Registrar under Cooperative Societies Act, 1912:
Enquiry by the Registrar (Section 35)**

The Registrar may on his own motion, and shall on the request of the collector, or on the application of a majority of the Committee, or of not less than 1/3rd of the members, hold an inquiry or direct some person authorized by him by order in writing in this behalf to hold an inquiry into the constitution, working and financial condition of a registered society. All the officers (and members) of the society are bound to furnish such information as may be demanded of them by the Registrar or by the person authorized by the Registrar.

Inspection of books of indebted society: (Section 36) The Registrar shall, on the application of a creditor of a registered society, inspect or direct some person authorized by him by order in writing in this behalf to inspect the books of the society, provided that:

- (i) The applicant satisfies the Registrar that the debt, and sum then due, and that he has demanded payment thereof but has not received satisfaction within a reasonable time.
- (ii) The applicant deposits with the Registrar such sum as security for the costs of the proposed inspection, as the Registrar may require.

Question 3

Explain the amendment of the bye-laws of a registered society under the Co-operative Societies Act, 1912. (May, 2002)

Answer

Amendment of the bye-law: The provisions relating to the amendment of the bye laws of the registered society are contained in Section 11 of the Co-operative Societies Act, 1912. The registered society is empowered to amend its bye laws provided the amendment is not - contrary to (i) this Act, or (ii) the Rules 'of the Society and (iii) amendment has been registered with the Registrar under the Act.

Amendment made by a registered society is not valid until the same has been registered for which purpose a copy of the amendment is to be forwarded to the Registrar who may register the amendments if he is satisfied that the amendment of the bye laws is not contrary to this Act or to the rules.

When the Registrar registers an amendment of the bye laws of a registered society, he shall issue to the society a copy of the amendment certified by him, which shall be conclusive evidence that the same is duly registered. The validity of the bye laws cannot be questioned on the ground of irregularities when an amendment of the bye laws is within the powers of the society but had been irregularly done and the Registrar registered the amendment and issued the certificate.

Question 4

State and explain the circumstances under which the Registrar of Co-operative Societies may cancel the registration of a co-operative society under the provisions of the Co-operative Societies Act, 1912. (May, 2002)

Answer

Cancellation of registration of a society by the Registrar of Co-operative Societies:-

Under the following circumstances, Registrar of Co-operative Societies is empowered to cancel the registration of the society. These circumstances are;

- (i) After an inquiry which the registrar held under section 35 of the Co-operative Societies Act, 1912, into the constitution, working and financial condition of a registered society, or after an inspection of the books of the society made under section 36, or after an application made by three-fourths of the members of a society, he is of the opinion that the society ought to be dissolved. The cancellation takes effect after the expiry of two months from the date of the order of cancellation, if no appeal is preferred against the order of cancellation. The appeal can be preferred by any member of the society within the prescribed period (2 months), if, however, an appeal is presented within that period, the cancellation takes effect only when it is confirmed by the appellate, authority i.e. the State Government (Section 39).
- (ii) Where it is a condition of the registration of the society that it should consist of at least ten members, and it is proved to the satisfaction of the Registrar that the number of the members has been reduced to less than ten. In this case, the cancellation takes effect from the date of the order. (Section 40 and 41 of Co-operative Societies Act, 1912).

Question 5

State the conditions which are essential for the registration of 'Multi-State Cooperative Society under the Multi-State Cooperative Societies Act, 1984. (Nov. 2002)*

Answer

Conditions for the registration of Multi-state co-operative societies:

A Multi-state Co-operative society may be registered under the Multi State Co-operative Societies Act, 1984* subject to the following conditions :

1. its main objectives should be to serve the interest of members in more than one State.

* As amended by the Multi State Co-operative Societies Act, 2002

2. the objectives should be to promote the economic and social betterment of its members through mutual aid and in accordance with the co-operative principles which are stated in the First Schedule of the Act.
3. it facilitates the other Multi-state co-operative societies or other co-operative societies, or both.
4. the application for registration must fulfil the conditions as per the provisions of the Act and Rules framed.
5. there is no other Multi-state co-operative society with the identical objects and the same area of operation.
6. the proposed bye-laws of the society are not contrary to the provisions of the Act and the Rules.
7. the proposed bye-laws of the Society do not conflict with the co-operative principles as specified in the First Schedule of the Act.
8. the proposed Society should have reasonable prospects being a viable unit.

Question 6

State the ways in which a society may invest its own funds under the Cooperative Societies Act, 1912. Whether such funds may be divided among the members of the Society?

(Nov. 2002)

Answer

Investment of funds by a society :

According to Section 32, a registered society under the Co-operative Societies Act, 1912 may invest or deposit its funds :

- (i) in the Government Savings Bank; or
- (ii) in any of the securities specified in Section 20 of the Indian Trusts Act, 1882; or
- (iii) in the shares or on the security of any other registered society; or
- (iv) with any bank or person carrying on the business of banking approved for this purpose by the Registrar; or
- (v) in any other mode permitted by the rules.

Whether funds or profits may be divided to the members of the society (Section 33)

According to Section 33 of the Act, 1912 generally, no part of the funds of a registered society shall be divided by way of bonus or dividend or otherwise among its members. However, where the liquidity is limited, at least one forth of the net profits in any year must be carried to a reserve fund, and payments from the remainder of such profits and from any divisible profits of past years may be made among the members to such extent and under such conditions as may be prescribed by the rules or bye-laws. In the case of societies with unlimited liquidity, no distribution of profits shall be made, without the permission of the State Government.

Question 7

Explain the manner in which 'Net Profits' of a Multi-State Cooperative Society can be appropriated. Examine also the validity of the following acts of the society during a particular year:

- (i) The society declares dividend 11% on its paid-up Share Capital.*
- (ii) The society decides to donate a sum of Rs.10 lakhs out of its 'Net profits'. (Nov. 2002)*

Answer

The net profits of a Multi State Cooperative Society are to be appropriated in the following manner:

1. at least 25% of the net profits should be transferred to the Reserve Fund.
2. 1% of the net profits (Rule 4 of the rules of operation) should be credited to the National Co-operative Union of India Ltd. as contribution to the education fund maintained by the Union.
3. for constitution of or contribution to special funds as may be specified in the bye-laws.
4. not more than 5% of net profits for giving donations or charities for charitable purposes as defined in Section 2 of Charitable Endowments Act, 1990.
5. for payment of ex-gratia amount to employees to the extent and in the manner specified in the bye-laws.

6. for payment of dividends.

Such societies are prohibited for using its funds for any political purposes. [Section 61 (3)]. Further in terms of the provisions of Section 61 the society is subject to the following restrictions with regard to disposal of Net Profit:

1. no dividend shall be declared or paid except from out of the Net Profits and shall not exceed 12% per annum on the paid up share capital.
2. no dividend shall be declared or paid while a claim due from a Multi State Cooperative Society to a depositor or lender remains unsatisfied.
3. no donation made by the Multi State Cooperative Society out of the net profits of any year exceed Rs. 5 lakhs.

Thus applying the above provision in the given cases the answers to the questions asked are as under:

- (i) Declaration of dividend @ 11% on the paid share capital of the society is quite valid as it does not exceed 12%.
- (ii) The decision to donate Rs. 10 lakhs out of the society's Net Profits is not valid since the limit is Rs. 5 lakhs in a year:-

Question 8

A Co-operative Society with unlimited liability wants to expel its member, who prejudices the society by his misconduct. For this purpose, the society wants to amend its bye-laws. State the grounds which should be included in the bye-laws of the society so as to expel such member from the membership of the society.

(Nov. 2002)

Answer

Expulsion of a member of a society:

A member who degenerates in conduct or character and thereby prejudices the society may be expelled from the society subject to the provisions in the bye-laws of the society for this purpose. The bye-laws of the society should contain such provisions and thereupon he may be expelled if :

- (i) he fails to fulfil his obligations in the matter of dues (the number of months arrears being specified).
- (ii) he becomes a member of another similar society and refuses to withdraw and thereby it may be possible that he may pass on such information to a rival society of which he is a member.
- (iii) he is to be proceeded against for debts;
- (iv) he becomes insolvent.
- (v) he engages in such activities as might be contrary to the principles of the society;
- (vi) he becomes insane;
- (vii) he is convicted by a criminal court, especially of bribery, forgery, theft or fraud; and
- (viii) he has committed an act which is considered dishonourable by a managing committee.

If a member of a society with unlimited liquidity joins another society and so pledges his liquidity twice over he should be expelled.

Question 9

A Multi-State Cooperative Society is desirous of amending its bye-laws. Advise the society as to what procedure is required to be followed for the said purpose under the Multi-State Cooperative Societies Act, 2002 ? (May 2003)

Answer

Amendment of Bye-Laws by a Multi-State Co-operative Society:

A Multi-State Cooperative Society desirous of amending its bye-laws has to take the following steps in accordance with the provisions of section 11 of the Multi-State Co-operative Societies Act, 2002:

1. Pass a resolution at the meeting of the Executive Committee, finalize the draft amendments to be made in the bye laws and also for issuing a notice of the proposed amendment to the members in according with the bye-laws.
2. Issue 15 clear days' notice to the members of the Society for a proposed annual or special meeting to consider the proposed amendment of bye-laws.
3. Pass the resolution for amendment of the bye-laws by 2/3rd majority of the members present and voting at the general meeting;
4. Make an application to the Central Registrar for registration of the amendment within 60 days from the date of the general meeting at which amendment was passed. Such an application should be accompanied with the following documents:
 - (i) Copy of resolution.
 - (ii) Statement containing the particulars of the date of the general meeting, the number of days notice given to convene the general meeting, total number of members of the society on the date of meeting, number of members forming the quorum, number of members present at the meeting, number of members exercising the right of voting, and number of members voted in favour of the amendment.
 - (iii) Copy of the existing bye-laws with amendment proposed to be made together with reasons justifying such amendment.
 - (iv) Four copies of the text of bye laws as they will stand after the amendment signed by the officers duly authorized by the general body.
 - (v) Copy of the notice given to members for convening the general meeting and proposal to amended the bye laws.
 - (vi) Certificate signed by the presiding authority of the general meeting stating that the resolution was passed by the 2/3rd majority and that valid 15 clear days' notice was given for convening the meeting to consider the amendment.
 - (vii) Any other particular which may be required by the Central Registrar for this purpose.

On satisfying himself, the Central Registrar will register the amendment and issue a certified copy of the amended bye-laws.

Question 10

What are the conditions of registration of a society under the provisions of the Co-operative Societies Act, 1912 ?
(May 2003)

Answer

Registration of A Society

According to Section 6 of the Co-operative Societies Act, 1912, the conditions for registration of a society under the Act, are as follows:

1. A society, other than a society of which a member is a registered society, shall not be registered under this Act if it does not consist of at least 10 persons above the age of 18 years and, where the object of the society is the creation of funds to be lent to its members, unless such persons:
 - (i) reside in the same town or village or in the same group of villages; or
 - (ii) save where the Registrar otherwise directs, are members of the same tribe, class, caste or occupation.
2. The word 'limited' shall be the last word in the name of every society with limited liability registered under this Act.

It should, however, be noted that if the society fails to retain 10 members such a failure may lead to the cancellation of its registration (Section 40). But the breach of the conditions referred to in (1) and (2) above does not lead to cancellation unless the bye-laws so provide for.

Question 11

State the law relating to appointment and powers of the Central Registrar under the Multi-State Co-operative Societies Act, 2002 .
(May 2003)

Answer

The Central Government is empowered to appoint a person as the Central Registrar of Co-operative Societies and also it can appoint such persons to help the Central Registrar in discharging duties and exercising his powers. There shall be only one person appointed as Central Registrar, however, other persons appointed by the Government to assist Central Registrar may

be designated as Deputy/Assistant, Additional or Joint Central Registrars (Section 4, the Multi-State Co-operative Societies Act, 2002).

Powers of Central Registrar

The Central Registrar may register the Multi-State Co-operative Societies Act, 2002 with regard to (i) Registration (ii) Control (iii) Supervision (iv) Audit (v) Inspection (vi) Inquiry and (vii) Winding up of a Multi-State Co-operative Society. Some of the important powers are given below:

- (1) The Central Registrar can exercise certain powers under the Multi-State Co-operative Society and its bye-laws if he is satisfied with regard to matters specified in section 7 and issue a certificate of Registration under Section 8.
- (2) He may register the proposal for amendment of Bye-laws, if he is satisfied with regard to matters specified in section 11.
- (3) He may register amalgamation or transfer of assets and liabilities or division of Multi-state Co-operative Society under Section 17.
- (4) He can make a requisition for a special general meeting of a Multi-State Co-operative Society. If the Chief Executive of the Society fails to convene the meeting, he can proceed to call the meeting himself (Section 40).
- (5) If at an annual general meeting no auditor is appointed or re-appointed, the Central Registrar may appoint a person to fill the vacancy (Section 70).
- (6) Section 78 empowers the Central Registrar to make an enquiry by himself or direct some persons authorised by him by order in writing into the constitution, working and financial condition of a Multi-State Co-operative Society.
- (7) Multi-State Co-operative Societies may be inspected either by himself or by some person authorised by him (Section 79).

Question 12

Sohan is a member of a co-operative society registered with the unlimited liability under the Cooperative Societies Act, 1912. Holding shares of the society for ten months, Sohan transfers his shares to Mohan. Decide whether transfer of shares in favour of Mohan is valid?

(May 2003)

Answer

Transfer of Share of a Member In a Co-operative Society

According to Section 14(2) of the Co-operative Societies Act, 1912, in case of a society registered with unlimited liability, a member cannot transfer any share held by him or his interest in the capital of the society or any part thereof unless:

- (i) he has held such shares or interest for not less than one year; and
- (ii) the transfer or charge is to the society or to a member of the society.

A member can transfer his shares only when both the conditions are fulfilled.

Hence, the transfer of shares by Sohan is not valid since he had held these shares only for 10 months.

Question 13

State the purpose for which Net Profits of a Multi-State Co-operative Society may be utilised under the provisions of the Multi - State Co-operative Societies Act, 1984.*

(November 2003)

Answer

Net profits of a Multi State Cooperative Society can be utilized under the Multi State Cooperative Societies Act, 1984 (Now Act of 2002):

Section 63 of the Multi State Co-operative Societies Act, 2002 (earlier Act of 1984) deal with the purposes for which net profits of a multi-state cooperative society can be utilized;

1. Transfer at least 25% of the net profits to the Reserve Fund.
2. Credit 1% of the net profits to the National Cooperative Union of India Ltd., New Delhi as contribution to education fund maintained by the Union.
3. Transfer an amount not less than 10% to a reserve fund for meeting unforeseen losses.

After transferring the fund to the “above purposes, the balance of the net profits may be utilized for all or any of the following purposes viz.

* Now. Act of 2002

- (i) payment of dividend to the members on their paid-up share capital at a rate not exceeding the prescribed limit.
- (ii) constitution of, or contribution to, such special funds including education funds, as may be specified in the bye laws.
- (iii) purpose connected with the development of cooperative movement or charitable purpose as defined in Section 2 of the Charitable Endowments Act, 1890;
- (iv) payment of ex-gratia amount to the employees of the multi-state co-operative society to the extent and in the manner specified in the bye laws.

Question 14

Explain the provisions regarding regulation of contribution made by the societies registered under the Co-operative Societies Act, 1912. (November 2003)

Answer

Contributions made by the societies for charitable purposes: Section 34 of the Cooperative Societies Act, 1912 permits a registered society to contribute to a charitable purpose subject to certain conditions and limitations which are as follows:

1. One-fourth of the net profits in any year shall be carried to a reserve fund, as contemplated by first proviso to section 33.
2. Thereafter, out of the remaining profits, the aforesaid registered society may contribute an amount not exceeding 10% to any charitable purpose, as defined in the Charitable Endowments Act.
3. Such a contribution can be made only with the sanction of the Registrar.

Question 15

Describe the procedure of registration of a Multi-State Cooperative Society laid down in the Multi State Co-operative Societies Act, 1984. Which are the documents required to be filed at the time of registration of such a society? (November 2003)*

Answer

* Now. Act of 2002

Procedure for registration of a Multi State Cooperative Society and the documents to be filed;

1. An application for the registration of a society shall be made to the Central Registrar in prescribed form with requisite particulars.
2. The application shall be signed by members of the Society, in case of which all members are:
 - (a) Individuals - at least 50 persons from each of the state concerned.
 - (b) Cooperative societies - duly authorized representatives of at least 5 such societies registered with different states.
 - (c) Multi-State Cooperative Society and other Co-operative Societies - duly authorized representatives of each of such societies, subject to condition of at least two of co-operative societies registered not in the same state.
 - (d) Cooperative; Societies or Multi-State Co-operative Societies and Individuals by at least:
 - (i) 50 persons being individuals from each of the two states or more and
 - (ii) One cooperative society from two states or more, or one multi-state cooperative society.
3. Application shall be accompanied by 4 copies of the proposed bye-laws of the multi-state cooperative society and the persons by whom or on whose behalf such application is made shall furnish such information in regard to the society as the Central Registrar may require.

After receiving the application duly accompanied with documents, the Central Registrar may register the multi-state cooperative society and its bye-laws if he is satisfied that the application complies with the provisions of the Act and the Rules;

basis criterion that its objects are to serve the interests of members in more than one State, bye-laws provide for social and economic betterment of its members through self-help and mutual aid in accordance with the cooperative principles, and the proposed bye-laws are not contrary to the provisions of the Act and the Rules. The Central Registrar shall then issue a Certificate of Registration under his signature and bearing his official seal containing the registration number and the date of registration of the society.

Question 16

Mohan, a member of a cooperative society, registered with unlimited liability, desires to withdraw from the membership of the society. Advise in the light of provisions of the Cooperative Societies Act, 1912, whether Mohan can do so. What will be the consequences of such withdrawal from the society? (November 2003)

Answer

The right of withdrawal from the membership of a society by a member is in conformity with the principles of cooperation. In the case of a society with unlimited liability, a member thereof should be able to withdraw before any liability is incurred. He is only liable for the debts that exist at the time he ceases to be a member (Section 23, Cooperative Societies Act, 1912).

Where the member ceases to reside within the area of the society [Section 6(1) (a)], both the member and the society may insist on withdrawal. The share value is paid to the member, but he has no claim on the reserve or other assets and may be made to pay off his share of any deficit. His legal claim in share capital lapses in 2 years. If the society is dissolved within 6 months of the withdrawal, the withdrawal is null and void.

Question 17

Is the power to cancel registration of a society available to the Registrar under the provisions of the Cooperative Societies Act, 1912? If yes, explain the circumstances where under the said power can be exercised by the Registrar. (May 2004)

Answer

Cancellation of Registration of Society

The Registrar may cancel the registration of a society in the following circumstances:

- (i) If the registrar, after an enquiry has been held by him under Section 35 of the Cooperative Societies Act, 1912, into the Constitution, working and financial condition of a registered society, or after an inspection of the books of a society has been made under Section 36 or on receipt of an application made by $\frac{3}{4}$ of the members of a society, is of opinion that the society ought to be dissolved [Section 39(1)].
- (ii) Where it is a condition of the registration of a society that it should consist of at least ten members and the number of the members has been reduced to less than ten [Section 40].

Question 18

Can a cooperative society be converted into a Multi-State Cooperative Society? If yes, state the procedure of the said conversion under the provisions of the Multi-State Cooperative Societies Act, 2002. (May 2004)

Answer

Conversion of Society

According to the Section 22 of the Multi-State Co-operative Societies Act, 2002 the procedure for conversion of a co-operative society into Multi-State Co-operative Society is as follows:

- (i) Amending its bye-laws to extend its jurisdiction.
- (ii) Registration of amended bye-laws with the Central Registrar [in accordance with the procedure laid down in Section 11(4)].
- (iii) If the Central Registrar has satisfied himself that such amendment fulfils the requirements of the members being from more than one state and is in accordance with the provisions contained in Sections 11(4), he may

register the amendment within a period of 6 months from the date of receipt of amended bye-laws by him.

- (iv) A Co-operative Society shall be deemed to have been converted into a Multi-state Co-operative Society only from the date of registration of amendment of bye-laws [Section 22(5)].
- (v) The Central Registrar shall thereafter forward a copy of registered amendment together with a certificate signed by him and such certificate shall be conclusive evidence that the amendment has been registered.
- (vi) If the Registrar refuses to register the amendment of bye-laws, it shall be communicated within seven days from the date of refusal.

Question 19

Describe the privileges available to a Multi-State Cooperative Society under the Multi-State Cooperative Societies Act, 2002. (May 2004)

Answer

Privileges of Multi-State Co-operative Society under the Multi-State Co-operative Societies Act, 2002

- (i) The Society shall have the charge and it may be set off in respect of share or contribution or interest in the capital and on deposit of members (Section 55).
- (ii) The share or contribution or interest of a member or past or deceased member in the capital of a society shall not be liable to attachment (Section 56).
- (iii) Register of members would be the evidence of proof (Section 57).
- (iv) Admissibility of copy of entry as evidence (Section 58).
- (v) Exemption from compulsory registration of instruments (Section 59).
- (vi) Deduction from salary to meet Multi-State Co-operative Societies claim in certain cases (Section 60).
- (vii) Government aid to Multi-State Co-operative Societies (Section 61).

Question 20

Discuss the restrictions on the powers of a society registered under the Cooperative Societies Act, 1912 to make loans and to contribute to charitable purposes (May 2004)

Answer

Restrictions on the powers of a registered society under Co-operative Societies Act, 1912 [Section 29]

The following are the restrictions on the right of a society to lend money:

- (i) It cannot make a loan to any person other than a member. However, a registered society may make loans to another registered society after taking the general or special sanction of the Registrar.
- (ii) A society with unlimited liability cannot lend money on the security of movable property, except with the sanction of the Registrar.
- (iii) The State Government may, by general or special order, prohibit or restrict the lending of money on mortgage of immovable property by any registered society or class of registered societies.

Contribution to Charitable purpose (section 34)

The registered society is permitted to contribute to a charitable purpose subject to the following restrictions:

- (i) One-fourth of the net profits in any year shall have been carried to a reserve fund.
- (ii) Out of the remaining net profits a society may contribute an amount not exceeding 10% to any charitable purpose.
- (iii) Such contribution can be made only with the sanction of the Registrar.

Question 21

State the restrictions imposed on a registered society under the Cooperative Societies Act, 1912 regarding investment or deposit of its surplus funds. (November 2004)

Answer

Section 32 of the Co-operative Societies Act, 1912 provides restrictions on investment of funds by a co-operative society. Accordingly the co-operative society may invest or deposit its funds;

- (i) in the Government Savings Bank or
- (ii) in any of the securities specified in section 20 of the Indian Trust Act, 1882 or

- (iii) in the shares or on the security of any other registered society, or
- (iv) with any bank or person carrying on the business of banking approved for the purpose by the Registrar, or
- (v) in any other mode permitted by the rules.

Question 22

State the provisions of law relating to functions of a Federal Cooperative Society under the Multi-state Cooperative Societies Act, 2002. (November 2004))

Answer

Functions of a Federal Co-operative Society

Under Section 24 of the Multi-State Co-operative Societies Act, 2002, a federal co-operative society registered with the aim of self-help and mutual aid is authorised to do the following functions -

- (a) ensure compliance of the co-operative principles;
- (b) make mode bye-laws and policies for consideration of its member co-operative;
- (c) provide specialised training, education and data-base information;
- (d) undertake research, evaluation and assist in preparation of prospective development plans for its member co-operative;
- (e) promote harmonious relations amongst member co-operative;
- (f) help member co-operative to settle disputes among themselves;
- (g) undertake business services on behalf of its member co-operative, if specifically required by or under the resolution of the general body or the ward, or bye-laws of a member co-operative;
- (h) provide management development services to a member co-operative;
- (i) evolve code of conduct for observance by a member co-operative;
- (j) evolve viability norms for a member co-operative;
- (k) provide legal aid and advice to a member co-operative;
- (l) assist member co-operative in organizing self-help.
- (m) develop market information system, logo brand promotion, quality control and technology up gradation.

Question 23

M/s Supreme Society Ltd., a Multi-state Cooperative Society, is contemplating to transfer some of its assets and liabilities to another Multi-state Cooperative Society. Advise the management of the society about the steps to be taken in this regard.
(November 2004)

Answer

Transfer of Assets & Liabilities - Steps to be taken

1. M/s Supreme Society Ltd can transfer its assets and liabilities in whole or in part to any other Multi-State Co-operative Society by passing a resolution by a majority of not less than two-thirds of the members present and voting at a general meeting of the society held for this purpose. The resolution should contain the particulars of the assets and liabilities to be transferred.
2. After passing the resolution, M/s Supreme Society Ltd should give notice thereof in writing to all the members and creditors giving them an option of withdrawing their shares, deposits or loans as the case may be. This option has to be exercised within a period of one month of the date of service of the notice and if any member or creditor who does not exercise his option within one month, shall be deemed to have assented to the proposal contained in the resolution. The resolution passed by the society shall not take effect until the assent thereto of all the members and creditors has been obtained.
3. The society should make arrangements for meeting in full or otherwise satisfy all claims of the members and creditors who exercise the option to exist from the society.
4. On receipt of necessary documents relating to the resolution passed by the society, the Central Registrar on being satisfied that the resolution has become effective will issue an order under Section 21 of the Multi-state Co-operative Societies Act, 2002. This will be a sufficient conveyance to vest the assets and liabilities in the transferee society without any further assurance.

Question 24

A group of people having common interest wish to form and registered a society under the Cooperative Societies Act, 1912. Describe briefly

- (i) *the eligibility conditions to be fulfilled by the group for registration, and*

- (ii) *the power of Registrar to decide the eligibility conditions. .*
(November 2004)

Answer

The eligibility conditions to be fulfilled by the group for registration of a society under the Co-operative Societies Act, 1912 are as follows;

- (a) A society other than a society of which a member is a registered society, shall not be registered under the Act if it does not consist of at least 10 persons above the age of 18 years and where the object of the society is the creation of funds to be lent to its members, unless such person;
 - (i) reside in the same town or village or in the same group of villages;
or
 - (ii) save where the Registrar otherwise directs, are members of the same tribe, class, caste or occupation.
- (b) The word “Limited” shall be the last word in the name of every society with limited liability registered under this Act.

If the society fails to retain 10 members, such a failure may lead to the cancellation of its registration.

Powers of Registrar

Under Section 7 of the Act, the Registrar has the final power to decide:

- (a) Whether a person is an agriculturist or a non-agriculturist.
- (b) Whether any person is resident in a town or a village or group of villages.
- (c) Whether two or more villages will be deemed to have formed a group; or
- (d) Whether any person belongs to any tribe, class, caste or occupation.

Question 25

State the provisions relating to the conduct of audit applicable to a society registered under the Cooperative Societies Act, 1912?
(May 2005)

Answer

According to Section 17 of the Co-operative Societies Act, 1912, it is obligatory for the Registrar to audit or cause to be audited by some persons authorized by him by a general or special order in writing the accounts of every registered society at least once in every year. The audit as

contemplated by the said section includes an examination of over-due debts, if any, and a valuation of the assets and liabilities of the society. Audit also means such an examination of the books, accounts and vouchers of a business as shall enable the auditor to satisfy himself whether or not the balance sheet is properly drawn up so as to exhibit a true and correct view of the state of affairs of the business according to the best of his information and the explanations given to him. The Registrar or any person authorized by a general or special order in writing in this behalf by the Registrar will have access to all the books, accounts, papers and securities of a society. Every officer of the society should furnish such information in regard to the transactions and working of the society as the person making such inspection may require.

Question 26

*State the restrictions on borrowings on a multi-state cooperative society under the Multi-state Cooperative Societies Act.
(May 2005)*

Answer

Restriction on borrowing:

- (a) A Multi-state Co-operative Society under the Multi-State Co-operative Societies Act, 2002 may receive deposits, raise loans and receive grants from external sources to such extent as may be specified in the bye-laws. This is however, subject to the condition that the total amount of deposits and loans received during any financial year shall not exceed 10 times of the sum of subscribed share capital and accumulative reserves. While calculating the total sum subscribed capital and accumulated reserves, the accumulated losses shall be deducted.
- (b) A multi-state Co-operative Society may accept funds or borrow funds for the fulfillment of its objects on such terms and conditions as are mutually contracted upon
- (c) A multi-state Co-operative Society may issue non-convertible debentures or other instruments subject to the provisions of any laws in force to raise resources for the fulfillment of its objects to the extent of 25% of its paid up share capital.

- (d) However, transactions of such a society with any non-member shall be subject to prohibitions and restrictions as may be specified in bye-laws of the society. (Section 68)

Question 27

PQR Cooperative Society Ltd., a Multi-state Cooperative Society desires to change its bye-laws in respect of the following matters:

- (i) To increase the number of members of the board from existing 18 to 24.*
- (ii) To increase the tenure of the directors from the present limit of 4 years to 6 years.*
- (iii) To reduce the frequency of the board meetings from existing figure of 6 to 4 meetings in a year.*

After completion of the required formalities, the society has made an application to the central registrar for registration of the amendments.

Examine the powers of the registrar to register the amendments in the light of the provisions of the Multi-state Cooperative Societies Act.

(May 2005)

Answer

According to Section 10 of the Multi-State Co-operative Societies Act, 2002 every society can make its own bye-laws which are consistent with the provisions of the Act and not contrary to the provisions of the Act. Accordingly,

- (i) The increase in the number of members of the board from the existing strength of 18 to 24 is not permissible because the maximum limit prescribed under the Act is 21.
- (ii) The tenure of the directors from the present limit of 4 to 6 years is not permissible because there is a ceiling of 5 years tenure for the directors and other office bearers including the chairperson of the society.
- (iii) There are no restriction on the frequency of the board meetings yet the society can reduce the board meetings from 6 to 4.

Thus, the Central Registrar will not approve in the bye-laws in respect of (i) and (ii) items referred to above. Where the Central Registrar registers the amendment, he shall forward a copy of the registered amendments together

with a certificate, within a period of one month from the date of registration thereof which shall be conclusive evidence of such amendment(s).

Question 28

Explain the conditions of registration of a society under the Cooperative Societies Act, 1912.

(November 2005)

Answer

Conditions of Registration of Society (Section 6): The conditions for registration of a society under Section 6 of the Cooperative Society Act, 1912 are as follows:

- (1) A society, other than a society of which a member is a registered society, shall not be registered under this Act if it does not consist of at least ten persons above the age of eighteen years and, where the object of the society is the creation of funds to be lent to its members, unless such persons:
 - (a) reside in the same town or village or in the same group of villages; or
 - (b) save where the Registrar otherwise directs, are members of the same tribe, class, caste or occupation.
- (2) The word “limited” shall be the last word in the name of every society with limited liability registered under this Act.

If the society fails to retain 10 members, such a failure may lead to the cancellation of its registration (Section 40). But the breach of the conditions referred to in (i) and (ii) above does not lead to cancellation unless the byelaws so provide for.

Question 29

What are the disqualifications for member of a multi-state cooperative society under the Multi-state Cooperative Societies Act, 2002?
(November 2005)

Answer

Disqualifications for member of a Multi-State Co-operative Society: Under Section 29 of the Multi-State Co-operative Societies Act, 1984 as amended by the Amendment Act, 2002, a person shall not be eligible for being a member of a Multi-State Co-operative Society if: -

- (1) his business is in conflict or competitive with the business of such Multi-state Co-operative Society; or
- (2) he used for two consecutive years the services below the minimum level specified in the bye-laws; or
- (3) he has not attended three consecutive general meetings of the Multi-State Co-operative Society and the members in the general meeting have not condoned such absence.
- (4) he has made any default in payment of any amount to be paid to the Multi-State Co-operative Society under the byelaws of such society.

Question 30

*Discuss the provisions relating to disposal of net profits of a society registered under the Multi-state Cooperative Societies Act, 2002
(November 2005)*

Answer

Disposal of Net Profits (Section 63): Section 63 of the Multi-State Co-operative Societies Act, 2002 provides that out of net profits, a Multi-State Co-operative Society.

- (a) transfer at least 25% of the net profits to the Reserve Fund.
- (b) one percent of the Net Profits should be credited to the National Co-operative Union of India Limited, New Delhi as contribution to the Education Fund maintained by the union;
- (c) transfer on amount not less than 10% to a reserve fund for meeting unforeseen losses.

After transferring the fund to above purposes, the balance of the net profits may be utilized for all or any of the following purposes, namely: -

- a) payment of dividend to the members on their paid-up share capital at a rate not exceeding the prescribed limit;
- (b) constitution of, or contribution to, such special funds including education funds, as may be specified in the bye-laws;
- (c) purposes connected which the development of Co-operative Movement of charitable purpose as defined in Section 2 of the Charitable Endowments Act, 1890;

- (d) payment of ex-gratia amount to employees of the Multi-State Co-operative Society to the extent and in the manner specified in the byelaws.

Question 31

State the grounds on the basis of which a member of a Society registered under the cooperative Societies Act, 1912 can be expelled?
(May 2006)

Answer

Expulsion of a member: Section 43(2)(ii) of the Co-operative Societies Act, 1912 provides the grounds of expulsion of a member. As per provisions of the Act a member may be expelled if:

- (i) he fails to fulfill his obligations in the matter of dues (the number of months' arrears being specified);
- (ii) he becomes a member of another similar society and refuses to withdraw (because each member has the right to inspect the books of the society and may pass information to a rival society of which he is a member);
- (iii) he is to be proceeded against for debts;
- (iv) he becomes insolvent;
- (v) he engages in such activities as might be contrary to the principle of the society;
- (vi) he becomes insane;
- (vii) he is convicted by Criminal Court, especially of bribery, forgery, theft or fraud; and
- (viii) he has committed an act which is considered dishonourable by the Managing Committee.

If a member of society with unlimited liability joins another society and so pledges his liability twice over, he should be expelled.

Question 32

What qualifications and disqualifications have been laid down for appointment of a person on the post of auditor of a Multi-State Cooperative Society under the Multi-State Cooperative Societies Act, 2002?
(May 2006)

Answer

Qualification and disqualifications of auditors: As per section 72 of the Multi State Co-operative Society Act, 2002 the qualification and disqualifications of an auditor are as under:

Qualification: A person shall not be qualified for appointment as an auditor of a Multi State Co-operative Society unless he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.

Disqualifications: None of the following persons shall be qualified for appointment as an auditor of a Multi-State Co-operative society:

- (a) A body corporate
- (b) An officer or employee of the multi state co-operative society.
- (c) A person who is a member, or who is in the employment of an officer or employee, of the Multi-State Co-operative Society.
- (d) A person who is indebted to Multi-State Co-operative Society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the Multi-State Co-operative Society for an amount exceeding one thousand rupees.

A person shall also not be qualified for appointment as an auditor of a Multi-State Co-operative Society if he is, by virtue of sub-section (2), disqualified for appointment as an auditor of any other body corporate or Multi-State Co-operative Society or Co-operative Society.

If an auditor becomes subject, after his appointment, to any of the disqualification specified above, he shall be deemed to have vacated his office as such.

Question 33

A society; registered under the Multi-state Cooperative Societies Act, 2002 intends to issue non-convertible debentures to the general public. Referring to the provisions of the Multi-state Cooperative Societies Act, 2002 state whether a society registered under the Act is empowered to do so.

(November 2006)

Answer

According to the Section 67 of the Multi-State Co-operative Societies Act, 2002, a Multi State Co-operative Society may be issue non-convertible debentures to the extent of 25% or its paid up share capital for the fulfillment of its objects on such terms and conditions as are mutually contracted upon. However, the total amount of deposits and loans received during any financial year shall not exceed ten times or the sum of subscribed share capital and accumulated reserves.

Question 34

Explain the powers of the Board of Directors of a multi-state Cooperative Society, as conferred upon the Board under Multi-state Cooperative Societies Act, 2002. (November 2006)

Answer

According to Section 49(2) of the Multi-State Co-operative Societies Act, 2002, the Board of Directors may exercise the following powers:

- (i) to admit member;
- (ii) to interpret the organizational objectives and set up specific goals to be achieved towards these objectives;
- (iii) to make periodic appraisal of operations;
- (iv) to appoint and remove a Chief Executive and such other employees of the society as are not required to be appointed by the Chief Executive;
- (v) to make provisions for regulating the appointment of employees of the Multi-State Co-operative Society and the scales of pay, allowances and other conditions of service of, including disciplinary action against, such employees;
- (vi) to place the annual report, annual financial statements, annual plan and budget for the approval of the general body;
- (vii) to consider audit and compliance report and place the same before the general body;
- (viii) to acquire or dispose of immovable property;
- (ix) to review membership in other co-operatives;
- (x) to approve annual and supplementary budget;
- (xi) to raise funds;

- (xii) to sanction loans to the members; and
- (xiii) to take such other measures or to do such other acts as may be prescribed or required under this Act or the by-laws or as may be delegated by the general body.

Question 35

In what ways does the Cooperative Societies Act, 1912 restricts the powers of a society registered under the Act, to make loans to its members and to borrow money the reform? can such borrowings be made by a Society from non-members also ? Explain. (November 2006)

Answer

According to Section 29 of the Co-operative Societies Act, 1912, a registered society can make loan only to members, and with the general or special sanction of the Registrar, to another registered society.

A society with unlimited liability is prohibited from lending money on the security of movable property without the sanction of the Registrar. Lending of money on mortgage of immovable property by any registered society may be prohibited or restricted by the State Government.

According to Section 30 of the Act, savings of members must be accepted in preference to deposits from non-members, the section provides that deposits and loans from non-members shall be received only to such extent and under such conditions as may be prescribed by the rules or by-laws.

Question 36

State the circumstances under which the Registrar of Societies may cancel the registration of a society registered under the Cooperative Societies Act, 1912. What is the effect of such cancellation ? Explain. (May 2007)

Answer

The Registrar may cancel the registration of a society under the Co-operative Societies Act, 1912 in the following circumstances:

- (i) If the Registrar, after an inquiry has been held by him under Section 35 of the Act, into the constitution, working and financial condition of a registered society, or after a inspection of the books of a society, or after

inspection of the books of a society has been made under Section 36, or on receipt of an application made by three-fourths of the members of the members of a society, is of opinion that the society ought to be dissolved. The cancellation take effect after the expiry of two months from the date of the order of cancellation, if no appeal is preferred against the order by any member within that period. If, however, an appeal is presented within that period, the cancellation takes effect only when it is confirmed by the appellate authority i.e., the State Government (Section 39)

- (ii) Where it is a condition of the registration of a society that it should consist of at least ten members, and it is proved to the satisfaction of the Registrar that the number of members has been reduced to less than ten. In this case, the cancellation takes effect from the date of the order (Section 40 and 41).

The effect of such cancellation is that the society ceases to exist as a corporate body from the date the cancellation takes effect (Section 41) and the Registrar may appoint a competent person to be liquidator of the society (Section 42).

Question 37

*Explain the provisions of the Multi-State Cooperative Societies Act, 2002 relating to the appointment and removal of auditors of a society registered under the Act.
(May 2007)*

Answer

Provision relating to appointment and removal of auditors: (Section 71, Multi-State Co-operative Societies Act, 2002)

- (1) A special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed.
- (2) On receipt of notice of such a resolution, the multi-state co-operative society shall forthwith send a copy thereof to the retiring auditor.
- (3) Where such notice is given and the retiring auditor makes representations in writing to the society (not exceeding a reasonable length) and requests their notification to members, the society shall, (unless the representation are received by it too late):
 - (a) state the fact of the representations having been made, in any notice of the resolution given to members, and

- (b) send a copy of the representation to every member of the multi-state co-operative society to whom notice of the meeting is sent.
- (4) If a copy of the representation is not sent to the members because they were received too late or because of the society's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.

Question 38

State the grounds on which a member of a society registered under the Multi-State Cooperative Societies Act, 2002 may be expelled from the membership of the Society.

(May 2007)

Answer

The bye-laws of a co-operative society registered under the Multi State Co-operative Society Act, 2002 may provide that a member may be expelled if:

1. he fails to fulfil his obligations in the matter of dues (the number of months' arrears being specified).
2. he becomes a member of another similar society and refuses to withdraw (because according to the policy of publicity, each member has the right to inspect the books of the society and may pass information to a rival society of which he is a member).
3. he is to be proceeded against for debts.
4. he becomes insolvent.
5. he engages in such activities as might be contrary to the principles of the society.
6. he becomes insane.
7. he is convicted by a criminal court, especially of bribery, forgery, theft or fraud; and
8. he has committed an act, which is considered dishonourable by the Managing Committee.

Further, if a member of a society with unlimited liability joins another society and so pledges his liability twice over, he should be expelled.

Question 39

Decide, under the Cooperative Societies Act, 1912, whether a society can transfer the share or interest of a member on his death. If yes, to what extent? Whether the estate of a deceased member can be appropriated to pay-off the debts of the society?
(November 2007)

Answer

As per the Cooperative Societies Act, 1912, the share or interest of a member may transfer to the nominee or heir or legal representative on his death. Section 22 states that all transfer and payments made by a registered society to the nominee or heir or legal representative of the deceased member in respect of such member's share or interest or dues in accordance with the rules or bye-laws made in this behalf shall be valid and effectual against any demand made upon the society by any other person.

In case of a society with unlimited liability, such nominee, heir or legal representative, as the case may be, may require payment by the society of the values of the share or interest of the deceased member and in the case of a limited liability society the share or interest of such member can only be transferred to the nominee, heir or legal representative if he is qualified for membership, or on his application within one month of the death of the member to any person specified in the application- who is so qualified (Proviso to Section 22).

A past member remains liable for the debts of the society for two years from the date of his ceasing to be a member, and the estate of a deceased member for one year from the time of his death (Sections 23 and 24)

Question 40

Who appoints the liquidator for winding up of a Multi-state Cooperative Society? Referring to the provisions of the Multi-state Cooperative Societies Act, 2002, point out any six powers of the liquidator.
(November 2007)

Answer

The Central Registrar may appoint a liquidator for the purpose of winding up of a Multi-State Co-Operative Society and may fix his remunerations. As per Section 90 of this Act, 2002, the powers of liquidator are as follows:

The liquidator shall have the power to realize the assets by sale or otherwise to clear the claims of Multi-State Co-operative society. He shall also have power, subject to the control of the Central Registrar:

- (i) to institute and defend suits and other legal proceedings on behalf of the society by the name of his office;
- (ii) to determine from time to time the contribution (including debts due and costs of liquidation) to be made or remaining to be made by the members, or past members or by the estates of nominees, heirs or legal representatives of deceased members or by any officer or former 'Officers, to the assets of the Society;
- (iii) to investigate all claims against the Society and subject to the provisions of the Act, to decide questions of priority arising between claimants;
- (iv) to pay claims against the society, including interest upto the date of winding up according to their respective priorities, if any, in full or ratably, as the assets of the society may permit, the surplus, if any, remaining after payment of the claims being applied in payment of interest from the date of such order of winding up at a rate fixed by him but not exceeding the contract rate in any case;
- (v) to determine by what persons and in what proportions the costs of liquidation are to be borne;
- (vi) to determine whether any person is a member, past members or nominee of a deceased member;
- (vii) to give such directions in regard to the collection and distribution of the assets of the society as may appear to him to be necessary for winding up the affairs of the society,
- (viii) to carry on the business of the society so far as may be necessary for winding up the affairs of that society; .
- (ix) to make any compromise or arrangement with any person between whom and the society there exists any dispute and to refer any such dispute for decision;
- (x) after consulting the members of the Society to dispose of the surplus, if any, remaining after paying the claims against the society, in such manner as may be prescribed;
- (xi) to compromise all calls or liabilities to calls and debts and liabilities capable of resulting in debts, and all claims, present or future, certain or contingent, subsisting or alleged to be subsisting between the society and a contributory or other debtor or person apprehending liability to the

Multi-State Co-operative Society and all questions in any way relating to or affecting the assets or the winding up of the society on such terms as may be agreed and take any security for the discharge of any such call, liability, debts or claim and give a complete discharge in respect thereof.

After the winding up proceedings are complete, the liquidator is to make a report to the Central Registrar and deposit the records of the society in such place as the Central Registrar may direct [Section 90 (3)].

Question 41

An existing Multi-state Cooperative Society desires to change its registered office from Mumbai to Bhopal. Advice as to what steps are required to be taken for the said change under the Multi-state Cooperative Societies Act, 2002? (November 2007)

Answer

Every change in principal place of business (i.e. registered office) of multi-state cooperative society shall be made by an amendment of its bye-laws after following the procedure laid down in Section 11 of the Multi-State Cooperative Societies Act, 2002.

- (1) No amendment of any bye-law of a Multi-State Cooperative Society shall be valid, unless such amendment has been registered under this Act.
- (2) The amendment to the bye-laws of a Multi-State Cooperative Society shall be made by a resolution passed by a two-thirds majority of the members present and voting at general meeting of the society.
- (3) The resolution, as aforesaid, shall not be valid unless fifteen clear days' notice of the proposed amendment has been given to the members.
- (4) In every case in which a multi-state cooperative society proposes to amend its bye-laws, an application to register such amendments shall be made to the Central Registrar together with:
 - (a) a copy of the resolution referred to in sub-section (2)
 - (b) a statement containing the required particulars.

Question 42

State the privileges of a Cooperative Society registered under the Cooperative Society Act, 1912 relating to the exemption from Income-tax, Stamp duty and Registration fee. (May 2008)

Answer

Privileges of society under the Co-operative Societies Act, 1912

Section 28 of the Co-operative Societies Act, 1912 provides a registered society, an exemption from payment of income tax, Stamp duty and registration fees as follows:

- (i) The Central Government may, by notification in the Official Gazette, remit the income tax payable in respect of the profits of any registered society or class of registered society, or of the dividends or other payments received by the members of the society on account of profits [Sub-Section (1)].
- (ii) The Government, by way of notification in the Official Gazette, may, in the case of registered society, remit
 - (a) the stamp duty with instruments executed by or on behalf of a registered society or by an officer or member and relation to the business of such society, are chargeable and
 - (b) any fees payable under the law of registration [Sub-Section (2)]

In sub-section (2), 'Government' means Central Government in relation to stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts and in relation to any stamp duty falling within Entry 96 in List I in the Seventh Schedule to the Constitution. Same as aforesaid, 'Government' means the State Government.

Question 43

State the eligibility and disqualification of the members of a Multi-State Cooperative Society under the provisions of the Multi-State Cooperative Society Act, 1984 (as amended by the Act of 2002).

(May 2008)

Answer

Eligibility and Disqualification of Members (Multi-State Cooperative Society)

Persons eligible to become members of Multi-State Cooperative Society (Section 25 Multi-State Cooperative Societies Act, 1984 (as amended by Act of 2002))

- (a) an individual competent to contract under section 11 of the Indian Contract Act;
- (b) any Multi-State Co-operative Society; or any Co-operative Society,
- (c) the Central government

- (d) a State Government
- (e) the National Co-operative Development Corporation established under the National Co-operative Development Corporation Act, 1962
- (f) any other corporation owned or controlled by Government
- (g) any Government company as defined in Section 617 of the Companies Act, 1956;
- (h) such class or classes of persons or association of persons as may be permitted by the Central Registrar having regard to the nature and activities of Multi-State Co-operative Society.

However, no individual person shall be eligible for admission as a member of a national Co-operative Society or a Federal Co-operative (Section 25(2)).

Disqualification for member of a Multi-State Cooperative Society (Section 29)

- (1) his business is in conflict or competitive with the business of such Multi-State cooperative society; or
- (2) he used for two consecutive years the services below the minimum level specified in the bye laws; or
- (3) he has not attended three consecutive general meetings of the Multi-State Cooperative Society and such absence has not been condoned by the members in the general meeting; or
- (4) he has made any default in payment of any amount to be paid to the Multi-State Co-operative Society under the bye-laws of such society.

Question 44

State the ways in which a Society, registered under the Cooperative Societies Act, 1912 may invest its own funds. Whether the amount of such fund can be given to the members of the Society by way of profit?
(May 2008)

Answer

Investment of funds (Cooperative Societies Act, 1912)

A registered society may invest or deposit its funds –

- (i) in the Government savings bank; or
- (ii) in any of the securities specified in Section 20 of the Indian Trusts Act, 1882; or
- (iii) in the shares or on the security of any other registered society; or

(iv) with any bank or person carrying on the business of banking, approved for this purpose by the Registrar; or

(v) in any other mode permitted by the rules. (Section 32)

Fund not to be divided by way of profit (Section 33): Generally, no part of the funds of a registered society shall be divided by way of bonus or dividend or otherwise among its members. However, where the liability is limited, at least one-fourth of the net profits in any year must be carried to a reserve fund and payments from the remainder of such profits and from any divisible profits of past years may be found among the members to such extent and under such conditions as may be prescribed by the rules or by-laws. In the case of societies with unlimited liability, no distribution of profits shall be made without the permission of the State Government.

Question 45

What is the mode of disposal of Net profits by a Multi-state Co-operative society?

(November 2008)

Answer

Disposal of net profits (THE MULTI-STATE CO-OPERATIVE SOCIETIES ACT, 2002)

Section 63 of the Act provides that out of net profits, a Multi-state Co-operative society must -

- (i) transfer at least 25% of the net profits to the Reserve fund
- (ii) credit 1% of the net profits to the National Co – operative Union of India Ltd., New Delhi as contribution to the education fund maintained by the union
- (iii) transfer an amount not less than 10% to a reserve fund for meeting unforeseen losses.

After transferring the fund to the above purposes, the balance of the net profits may be utilized for all or any of the following purposes namely;

- (i) payment of dividend to the members on their paid-up share capital at a rate not exceeding the prescribed limit.
- (ii) constitution of, or contribution to such special funds including

education fund as may be specified in the bye-laws.

- (iii) purpose connected with the development of Co-operative movement or charitable purpose as defined in the Charitable Endowments Act, 1890.
- (iv) payment of ex-gratia amount to employees of the Multi-state Co-operative society to the extent and in the manner specified in the bye-laws.

Question 46

Are there any restrictions on the powers of a society registered under the Multi-State Cooperative Societies Act, 2002, to make loans and to borrow ? (November 2008)

Answer

Restrictions on loans and borrowings (THE MULTI-STATE CO-OPERATIVE SOCIETIES ACT, 2002)

According to Section 66, a Multi-State Co-operative Society, other than a Co-operative bank shall not make a loan to a member on the security of his share or on the security of a non-member. However, it can make a loan to the depositor on the security of his deposit.

As per Section 67, a Multi-State Co-operative Society may-

- (i) receive deposits, raise loans and receive grants from external sources to such extent and under such conditions as may be specified in the bye-laws.
- (ii) issue non-convertible debentures to the extent of 25% of its paid-up share capital for the fulfillment of its objects on such terms and conditions as are mutually contracted upon.

But the total amount of deposits and loans received during any financial year shall not exceed ten times of the sum of subscribed share capital and accumulated reserves.

Question 47

State the privileges of a society registered under the Co – operative Societies Act, 1912

(November 2008)

Answer

Privileges of a registered society (THE CO-OPERATIVE SOCIETIES ACT, 1912)

The privileges of a registered society are covered under the sections 18 to 28 of the Co-operative Societies Act. The main privilege of a registered society is that on registration, such a society becomes a body corporate by the name under which it is registered, having a perpetual succession and a common seal with a right to hold property, to enter into contracts, to institute and defend suits and other legal proceedings and to do all things necessary for the purposes of its constitution (section 18).

Other privileges which a registered society enjoys are:

- (a) Subject to any prior claim of the Government in respect of land revenue, it is entitled in priority to other creditors to enforce any outstanding demand in respect of certain dues from a member or past member. (section 19).
- (b) In respect of any debt due from a member or past member it will have a charge upon the share or interest in the capital, and on deposits of, or other sums payable to, a member or past member, and it may set off any sums payable to a member or past member in or towards payment of any such debt (section 20).
- (c) The share or interest of a member in the capital of a registered society is not liable to attachment (section 21); nor is it claimable by the Official Assignee or a Receiver under the insolvency laws (section 21).
- (d) All transfers and payments made by a registered society to the nominee or heir or legal representative of the deceased member in respect of such member's share or interest or dues in accordance with the rules or bye-laws made in this behalf shall be valid and effectual against any demand made upon the society by any other person (section 22).
- (e) A past member remains liable for the debts of the society for two years from date of his ceasing to be a member, and the estate of a deceased member for one year from the time of his death (section 23 & 24).
- (f) Any register or list of members or shares kept by the registered society shall be evidence of the date at which the name of any person was entered, and the date at which such person ceased to be a member (section 25).
- (g) A certified copy of any entry in a book of registered society shall be received as evidence in any suit or legal proceedings of the existence of such entry (section 26).

- (h) The provisions of section 17(1), (b) & (c) of the Indian Registration Act, 1908 do not apply in relation to shares and debentures of a registered society (section 27).
- (i) A registered society may be exempted by the Government from payment of income tax, stamp duty and registration fee (section 28).

THE COMPANIES ACT, 1956*

Question 1

A public company proposes to purchase its own shares. State the source of funds that can be utilised by the company for purchasing its own shares and the requirements to be complied with by the company under the Companies Act before and after the shares are so purchased.

(May 2000, Nov. 2004)

Answer

Sources of funds for buy-back of shares: A company can purchase its own shares or other specified securities. The purchase should be out of:

- (i) its free reserves; or
- (ii) the securities premium account; or
- (iii) the proceeds of any shares or other specified securities.

However, buy-back of any kind of shares or other specified securities cannot be made out of the proceeds an earlier issue of the same kind of shares or same kind of other specified securities [Section 77A(l)].

'Specified securities' includes employees' stock option or other securities as may be notified by the Central Government from time to time. [Explanation (a) under Section 77A],

Requirements to be complied with before buy-back: The company shall not purchase its own shares or other specified securities unless:

- (a) the buy-back is authorised by its articles;
- (b) a special resolution (also Declaration of Solvency to be filed with ROC & SEBI in case shares are listed on any recognised stock exchange), authorising the buy-back is passed in general meeting of the company;

* Updated as per the Companies (Second Amendment) Act, 2002.

- (c) the buy-back is or less than 25% of the total paid-up capital and free reserves of the company;

Provided that the buy-back of equity shares in any financial year shall not exceed 25% of its total paid up equity capital in that financial year.

- (d) the ratio of the debt owed by the company is not more than twice the capital and free reserves after such buy-back;

Provided that the Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies. The expression 'debt' includes all amounts of unsecured and secured debts,

The expression "free reserves" shall have the same meaning assigned to it in Clause (b), Explanation to Section 372A, which means those reserves which, as per latest audited balance-sheet of the company are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.

- (e) all the shares or other specified securities for buy-back are fully paid-up;
- (f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by SEBI in this behalf;
- (g) the buy-back in respect of shares or other specified securities other than those specified in Clause (f) is in accordance with guidelines as may be prescribed. [Sections 77A(2) and 77A(6)].

The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating;

- (a) a full and complete disclosure of all material facts;
- (b) the necessity for the buy-back;
- (c) the class of security intended to be purchased under the buy-back;
- (d) the amount to be involved under the buy-back; and
- (e) the time limit for completion of buy-back. [Section 77A(3)].

Requirements to be complied with after buy-back: These are dealt with in Sections 77A and 77AA of the Companies Act, 1956 [as amended by the Companies (Amendment) Act, 1999] and narrated below:

- (1) The securities bought back should be extinguished and physically destroyed within 7 days after completion of buy-back [Section 77A(7)].
- (2) After completion of buy-back, a company cannot issue same kind of shares or security (which was bought back) for a period of 24 months. Allotment of rights issue renounced by members is also not permissible in this period. However, following are permitted:
 - (i) issue of security of a different class that is other than one which was bought back,
 - (ii) bonus issue,
 - (iii) subsisting obligations such as conversion of warrants,
 - (iv) stock option to employees
 - (v) sweat equity
 - (vi) conversion of preference shares or debentures into equity shares [Section 77A(8)].
- (3) The company should maintain a register showing securities bought back and consideration paid for the buy-back, date of cancellation of securities, date of extinguishment and physical destruction of securities other prescribed particulars [Section 77A(9)].
- (4) After completion of buy-back, a return has to be filed with the Registrar of Companies and Securities and Exchange Board of India if the company is listed within 30 days giving details as prescribed [Section 77A(10)].
- (5) If the buy-back is from free reserves, a sum equal to the nominal value of shares purchased will be transferred to capital redemption reserve account. Details of such transfer will be disclosed in the balance sheet of the company (Section 77A).

Question 2

How far can a minor become a member of a company under the Companies Act, 1956?

(May, 2000)

Answer

The Company Law Board has laid down in *Nandita Jain v. Bennet Coleman & Co. Ltd.* that a minor can become a member provided four conditions are fulfilled:

- (a) Company must be a Co. Ltd. by shares.
- (b) Shares are fully paid up.
- (c) Application for transfer is made on behalf of minor by lawful guardian.
- (d) The transfer is manifestly for the benefit of the minor.

This was also confirmed in *S.L. Bagree v. Britannia Industries*.

In also *Diwan Singh v. Minerva Films Ltd.* [(3958) 28 Comp. Cases 191 (Punj.), (1959) 29 Comp. Cases 263 (Punj.)], the Punjab High Court held that there is no legal bar to minor becoming a member of a company by acquiring shares (by way of transfer) provided the shares are fully paid and no further obligation or liability is attached to them.

Minor can become member by transfer or transmission, but a company may not allow a minor to be a member by allotment.

Question 3

Explain the meaning and significance of the 'Pari Passu' clause in a debenture. State the particulars to be filed with the Registrar of Companies in case of such debentures secured by a charge on certain assets of the company. (May, 2000)

Answer

'Pari Passu': Pari passu clause in a debenture means that all the debentures of the series are to be paid rateably, if, therefore, security is insufficient to satisfy the whole debts secured by the series of debentures, the amounts of debentures will abate proportionately. If the clause is not made a use of then the debentures rank in accordance with the date of issue, and if they are all issued on the *same* date they will be payable according to their numerical order. A company, however, cannot issue a new series of debentures so as to rank '*puri passu*' with prior series unless the power to do so is expressly reserved and contained in the debenture deed of the previous series.

Registration: In the event of the '*puri passu*' clause being included in the debentures secured by a charge, it is enough if the following particulars are filed with the Registrar of Companies within 30 days after the execution of the deed containing the charges or where there is no deed after the, execution of debentures of the series:

- (i) the total amount secured by the whole series;
- (ii) the dates of the resolutions authorising the issue of the series;

- (iii) the date of deed, if any, by which security is created;
- (iv) a general description of the property charged; and
- (v) the name of the trustees for debenture holders, if any, together with the deed containing the charge or a certified copy of the deed or, if there is no deed, one of the debentures of the series (Section 128).

Where more than one issue is made of debentures in the series, particulars of the date and the amount of each issue must be filed with the Registrar. But an omission to do so will not affect the validity of the debentures issued.

Question 4

'A company is a person separate from its members Explain. Examine the circumstances under which the Courts may disregard the Company's Corporate Personality. (November, 2000)

Answer

COMPANY IS A PERSON SEPARATE FROM ITS MEMBERS: A company in the eyes of law is regarded as an entity separate from its members, it has an independent corporate existence. Any of its members can enter into contracts with the company in the same manner as any other individual can and he cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The company's money and property belong to the company, and not to the shareholders, (*Salomon v. Salomon & Co. Ltd.*).

Further, from the juristic point of view, a company is a legal person distinct from its members (*Salomon v. Salomon & Co.*). It has its own corporate personality. This principle may be referred to as '*the veil of incorporation*'. The Courts in general consider themselves bound by this principle. The effect of this principle is that there is a Fictional veil between the company and its members. That is, the company has a corporate personality which is distinct from its members.

The human ingenuity, however, started using this veil of corporate personality blatantly as a cloak for fraud or improper conduct. Thus, it became necessary for the Courts to break through or lift the corporate veil or crack the shell of corporate personality or disregard the corporate personality of the company. Thus while by fiction of law a corporation is a distinct entity, yet, in reality it is an association of persons who are in fact the beneficial owners of all the corporate property (*Gallagher v. Germania Brewing Co.*).

The circumstances or the cases in which the Courts have disregarded the corporate personality of the company are:

1. Protection of revenue: The Courts may ignore the corporate entity of a company where it is used for tax evasion. (*Juggilal v. Commissioner of Income-tax*).
2. Prevention of fraud or improper conduct: The legal personality of a company may also be disregarded in the interest of Justice where the machinery of incorporation has been used for some fraudulent purpose like defrauding creditors or defeating or circumventing law. Thus where a company was incorporated as a device to conceal the identity of the perpetrator of the fraud, the Court disregarded the corporate personality. (*Jones v. Lipman*).
3. Determination of character of a company whether it is enemy: A company may assume an enemy character when persons in de facto control of its affairs are residents in an enemy country. In such a case, the court may examine the character of persons in real control of the company and declare the company to be an enemy company. (*Daimler Co. Ltd. V. Continental Tyre & Rubber Co. Ltd.*).
4. Where the company is a sham: The Courts also lift the veil or disregard the corporate personality of a company where a company is a mere cloak or sham [hoax]. (*Gilford Motor Co. Ltd. V. Horne*).
5. Company avoiding legal obligations: Where the use of an incorporated company is being made to avoid legal obligations, the Court may disregard the legal personality of the company and proceed on the assumption as if no company existed.
6. Company acting as agent or trustee of the shareholders: Where the Company is acting as agent for its shareholders, the shareholders will be liable for the acts of the company. (*F.G. Films Ltd. In re.*).
7. Avoidance of welfare legislation: Where the Courts find that there is avoidance of welfare legislation, it will be free to lift the corporate veil. [*Workmen of Associated Rubber Industry Ltd. V. Associated Rubber Industry Ltd.*].
8. Protecting Public Policy: The Courts invariably lift the corporate veil or disregard the corporate personality of a company to protect the public policy and prevent transactions contrary to public policy, (*Connors v. Connors Ltd.*).

Question 5

Define a Private Company. Explain the procedure for conversion of a Public Company into a Private Company.
(November 2000)

Answer

Definition of a Private Company: According to Section 3(1) (iii) of the Companies Act, 1956 a 'private company' means a company which has a minimum paid-up capital of one lakh rupees or such higher paid-up capital as may be prescribed and by its articles:

- (a) restricts the right to transfer its shares if any.
- (b) limits the number of its members to 50 not including its employee members (present or past) [Joint holders of shares are treated as a single member].
- (c) prohibits any invitation to the public to subscribe for any shares, or debentures of the company.
- (d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relations.

Procedure for conversion of a Public Company into a Private Company: A private limited company, if it desires to convert itself into a public company will have to follow the under-mentioned procedure:

- (1) It should take the necessary decision in its board meeting and fix up the; time, place and agenda for convening a general meeting to alter the articles of association and consequently the name by a special resolution as well as to alter by special resolution the "object clause" of the memorandum subject to the confirmation of the Company Law Board (Now Central Government) under Section 17 and by ordinary resolution the share capital clause under Section 94 if the alteration of share capital is involved in the process.
- (2) The company has to see that any change in the articles confirms to the provisions of the Companies Act [Section 31(1)]; also to see that such change does not increase the liability of any member who had become the member before the alteration.

- (3) It must issue notices for the general meeting in order to pass there at the special resolutions together with the explanatory statements for the alteration of the articles and the memorandum.
- (4) It will have to convene the general meeting in order to pass there at the special resolution (i) for the purpose of the alteration of the memorandum and article of association; and (ii) also for the purpose of deleting those articles which are required to be included in the articles of a private company only [Section 3(i)(iii)]. Such other articles which do not apply to a public company should be deleted and those which apply should be inserted. Consequent upon the above changes, it will have to delete the word "private" from its name [Section 21].
- (5) It shall file either the prospectus in the Form prescribed under Schedule II or the statement in lieu of prospectus in the form prescribed under Schedule IV within 30 days of the passing of the resolution mentioned in (4) above in the manner stated in Section 44.

The-aforesaid prospectus or the statement in lieu of the prospectus must be in conformity with Parts I and II of Schedule IV respectively.

- (6) In the matter of the prospectus or the statement in lieu of the prospectus the company has to adopt abundant caution against any untrue statement being included therein, because inclusion of untrue statement will attract penalty by virtue of Section 44(4). It may be noted that a statement included in a prospectus or statement in lieu of prospectus shall be deemed to be untrue if it is misleading in the form and context in which it is included. Likewise, where the omission from prospectus or a statement in lieu of prospectus of any matter is calculated to mislead, it shall be deemed, in respect of such omission, to be a prospectus or a statement in lieu of prospectus in which an untrue statement is included.
- (7) It shall file with the concerned stock exchange 6 copies of such amendments on both articles and memorandum, one of which must be a certified copy.
- (8) It shall file with the Registrar the said special resolution together with the explanatory statement within 30 days of their passing [Section 192].
- (9) It must take some of the steps regarding further issue of capital under Section 81 which are not in common with the steps discussed in relating to further issue of shares.

(10) The company has to apply to the Registrar for the issue of a fresh certificate of incorporation for the changed name, namely, the existing name with the word "private" deleted. On issue of such certificate shall be name of the converted company be final and complete [Section 23].

Question 6

What do you understand by the term 'Charge'? State the list of charges which are required to be filed for Registration with the Registrar of Companies. (November 2000)

Answer

The word "Charge" has not been adequately defined in the Companies Act, 1956. Section 124 of the Companies Act, 1956 provides that the expression "charge" shall include a mortgage. The meaning of the term, is not clearly explained here too. However, it can be understood that where in a transaction for value, both parties evidence the intention that -property existing or future shall be made available as security for the payment of a debt and that the creditor/mortgage shall have a present right to have it made available, there is a charge.

The conditions of borrowing as they normally do, confer charge on the company's assets (movables as well as immovables). It is thus important to those who are dealing with the company to know how much of its assets are subjected to charges which encumber company's property(ies) without actually delivering possession thereof to be filed and registered on the file of the company at the office of the registry i.e. the Registrar of the Companies concerned.

List of charges to be registered:

1. a charge to secure any issue of debentures.
2. a charge on an uncalled share capital of the company.
3. a charge on an immovable property, wherever situated or any interest therein.
4. a charge on book-debts of the company.
5. a charge, not being a pledge on any movable property of the company.
6. a charge on calls made but not paid.
7. a charge on goodwill on a patent or a copyright.

8. a floating charge on the undertaking or any property of the company including stock-in-trade.
9. A charge on a share or every share in ship.

Question 7

When can a Public Company offer the new shares (further issue of shares) to persons other than the existing shareholders of the Company? Can these shares be offered to the Preference Shareholders? (November, 2000)

Answer

Issue of Further Shares: Section 81 of the Companies Act, 1956 provides that if, at any time after the expiry of 2 years from the formation of the company or after the expiry of one year from the first allotment of shares, whichever is earlier, it is proposed to increase the subscribed capital by allotment of further shares, it should be offered to the existing equity shareholders of the company in proportion to the capital paid up on those shares.

The new shares of a company may-be offered to outsiders or any persons (including the equity shareholders) if-

- (a) a special resolution to that effect is passed by the company.
- (b) an ordinary resolution is passed and the approval of the Central Government is obtained. The Central Government will accord its approval if it is satisfied that the proposal is most beneficial to the company.
- (c) if any shareholder to whom the shares are offered declines to accept the shares. In such a case the Board of Directors may dispose of the shares in such a manner as they think most beneficial to the company.
- (d) if the new shares are issued within 2 years from the formation of the company or 1 year of the allotment made for the first time.

Preference Shareholders - whether (Further Issue of Capital) be offered to:

From the wordings of Section 81, it is quite clear that these shares can be issued only to equity shareholders, unless procedure as stated above has been adopted for issue of these shares to outsiders, etc. Therefore, in general these shares can not be offered to preference Shareholders.

Question 8

Explain the circumstances in which a company can alter its 'Objects' as slated in the Memorandum of Association. What procedure shall such a company follow to give effect to the alteration ? (May, 2001)

Answer

Under the provisions of Section 17 of the Companies Act, 1956 a company may alter its objects by passing special resolution in the following circumstances :

1. when the company wants to carry in business more economically or more efficiently.
2. when the company wants attain its main purpose by new or improved means.
3. when the company wants enlarge or change the local area of its operations.
4. when the company wants to carry on some business, which may conveniently or advantageously be combined with the objects specified in the Memorandum.
5. when the company wants to restrict or abandon any of the objects specified in the memorandum.
6. when the company wants to sell or dispose of the whole or any part of the undertaking.
7. when the company wants to amalgamate with any other company or body of person.

Procedure :

1. Special Resolution to be passed at a general meeting to alter the objects of the company.
2. Copy of special resolution to be filed with the Register of Companies within one month from the date of the resolution with a printed copy of the Memorandum as altered.
3. Certification of registration: The Registrar shall register the special resolution and certify the registration under his hand within one month from the date of the filing of the special resolution. Such certificate shall be conclusive evidence that all the requirements with respect to alteration have been complied with and memorandum so altered shall be the memorandum of the company.

If the documents required to be filed with the Registrar under Section 18 are not filed within the prescribed time, the alteration shall at the expiry of such period, become void and inoperative. (Section 19)

Question 9

With reference to the provisions of the Companies Act, 1956 explain the circumstances under which a subsidiary company can become a member of its holding company- Examine the position of the following with regard to membership in a company :

- (i) An Insolvent*
- (ii) Partnership Firm.*
(May 2001)

Answer

In accordance with the provisions of Section 42 of the Companies Act, 1956, a subsidiary company cannot become a member in its holding company and any allotment or transfer of ' shares in a company to its subsidiary is void. The section however does not apply where:

- (a) the subsidiary company is a legal representative of a deceased member of the holding company, or
- (b) the subsidiary company is a trustee and the holding company or a subsidiary thereof is not beneficially interested under the trust, or
- (c) allotment or transfer of shares is by way of security for the purpose of a transaction entered into by the holding company in the ordinary course of business which includes the lending of money.

Position of the following with regard to membership in a company:

1. Partnership Firm: A partnership may firm hold shares in a company in the individual names of partners as joint shareholders. As an un incorporated association, a firm is not a person and as such it cannot be entered as a member in the register of members. (Ganesh Das Ram Gopal v. R.G. Cotton Mills Ltd.) Section 25 of the Companies Act however, permits a firm to be a member of a company licensed under Section 25.
2. An Insolvent: An insolvent may be a member of a company. So long as his name appears in the register of members, he is a member and is entitled to vote even though his shares vest in the Official Assignee or Receiver. (Morgan v. Gray)

Question 10

Explain the following with reference to transfer of shares in a company registered under the Companies Act 1956:

- (i) *Blank Transfers*
- (ii) *Forged Transfers.*
(May 2001)

Answer

- (i) **Blank Transfers** : A blank transfer is an instrument of transfer signed by the transferor in which the name of the transferee and the date of the transfer are not filled. The ownership of the shares in a company is generally transferred from one person to another by the execution of a document by the seller and the buyer. This document is variously described as a "transfer instrument" or "transfer deed" or simply "transfer". But in a blank transfer, the seller fills in his name and signs it. Neither the buyers' name nor his signature and the date of sale is filled in the transfer. This practice enables the buyer to -sell it again and the subsequent buyer also can sell these shares again by the same transfer deed. This process can be used for a number of times. For such ultimate transfer and registration the first seller will be treated as the transferor.
- (ii) **Forged Transfers:** A Forged transfer is a nullity. It does not give the transferee concerned any title to the shares. If the company acts on a forged transfer and removes the name of the real owner from the Register of Members, then it is bound to restore the name of the real owner on the register as the holder of the shares and to pay him dividends which he ought to have received.

A buyer of shares on the basis of forged transfer does not get any title to the shares, since forgery is nullity. However, the company shall be liable to compensate the purchaser in so far as the company had issued a certificate to transfer and was therefore estopped from denying the liability accruing from its own acts.

Question 11

In what way does the Companies Act, 1956 regulate and restrict the/allowing in respect of a company going/or public issue of shares :

- (i) *Minimum Subscription: and*

(ii) *Application Money payable on shares being issued ? Explain.*
(May 2001)

Answer

Companies Act, 1956 by virtue of provisions as contained in Section 69 (1) and Section 69 (3) to (6) regulate and restrict the minimum subscription and the application money payable on shares being issued by a company going for public issue of shares. These sections provide asunder:

Minimum subscription [Section 69 (1)]

No Allotment shall be made of any share capital of a company offered to the public for subscription; unless; -

- (a) the amount stated in the prospectus as the minimum amount has been Subscribed, provided that such amount shall not be less than 5% of the nominal amount of the shares being issued; and
- (b) the sum payable on application for such amount has been paid to and received by the company-

If the application are not received by the company for such quantum of shares for making the minium subscription, within 120 days after the issue of prospectus, all money received from the applicants for share shall be repaid without interest. If any such money is not repaid within 130 days after the issue of prospectus, moneys will be repaid with interest at the rate of 6% from the expiry of 130 days.

Application money:

Section 69 (3) provides that the amount payable on application on each share shall not be less than 5% of the nominal amount of the share. All moneys received from application for shares shall be deposited and kept deposited in a Schedule Bank:

- (a) until the certificate to commence business is obtained under Section 149, or
- (b) where such certificate has already been obtained, until the entire amount payable on application for shares in respect of the minimum subscription has been received by the company, and where such amount has not been received by the company within the time on the expiry of which the moneys received from the applicant for shares are required to be repaid without interest under Sub-section (5), all moneys received

from applications for shares shall be returned in accordance-with the provisions of that sub-section, as stated above.

Question 12

ABC Limited realised on 2nd May, 2001 that particulars of charge created on 12th March, 2001 in favour of a Bank were not filed with the Register of Companies for Registration, What procedure should the Company follow to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created on 12th February, 2001 instead of 12th March, 2001? Explain with reference to the relevant provisions of the Companies Act, 1956. (May 2001)

Answer

Registration of charge : The prescribed particulars of the charge together with the instrument, if any by which the charge is created or evidenced, or a copy thereof shall be filed with the Registrar within 30 days after the date of the creation of charge. [Section 125 (1)]. In this case particulars of charge have not been filed within the prescribed period of 30 days.

However, the Registrar is empowered under proviso to section 125 (1) to extend the period of 30 days by another 30 days on payment of such additional fee not exceeding 10 times the amount of fee specified on Schedule X as the Registrar may determine. Taking advantage of this provision, ABC Ltd., should immediately file the particulars of charge with the Registrar and satisfy the Registrar that it had sufficient cause, for not filing the particulars of charge within 30 days of creation of charge.

If the charge was created on 12th Feb., 2001, then the company has to apply to the Company Law Board (Now tribunal) under Section 341 and seek extension of time for filing the particulars for registration. The company must satisfy the Company Law Board (Now tribunal) (a) that the omission was accidental or due to inadvertence or due to some other sufficient cause or was not of the nature to prejudice the position of creditors or shareholders of the company, or that it is just and equitable to grant relief on the other grounds. On such satisfaction, the Company Law Board (Now tribunal) may extend the term for the registration of charge or; such terms and conditions as it may think expedient. Once the time is extended and it is made out that the particulars have been filed within the extended time, the registrar is bound to register the charge.

Question 13

Explain clearly the meaning of the term 'Underwriting' and 'Underwriting' Commission'. In what way, does the Companies Act, 1956 regulate payment of such Commission ? Explain.

(May 2001)

Answer

'Underwriting' is a contract entered into between the company and certain parties (called underwriters) before the shares or debentures are offered to the public for subscription. The contract is that in case the whole or an agreed portion of the shares or debentures are not applied for, then the underwriters will themselves apply for subscribed shares or debentures; alternatively, they will procure persons to apply for them. The company is least concerned with how the underwriters procure the purchasers. Thus, the underwriters expose themselves to a great risk in 'placing' the shares before the public. And in return for this exposure to the risk the underwriters get commission. The commission is payable on the amount of shares underwritten. It will be payable even if the underwriters are not ultimately called upon to take up any shares.

Conditions to be satisfied:

Payment of underwriting commission is regulated by the provisions of Companies Act, 1956 stating certain conditions as contained in Section 76. The conditions to be fulfilled are :

- (i) the payment of commission should be authorised by the articles.
- (ii) the names and addresses of the underwriters and the number of shares or debentures underwritten by each of them should be disclosed in the prospectus.
- (iii) the amount of commission should not exceed, in the case of shares, 5% of the price at which the shares have been issued or the amount or rate authorised by the articles whichever is less, and in the case of debentures it should not exceed 2-1/2 %.
- (iv) the rate should be disclosed in the prospectus, or in the statement in lieu of prospectus (or in a statement in prescribed form signed in the like manner as the statement in the lieu of prospectus) and should be filed with the Registrar along with a copy of the underwriting contract before the payment of the commission.

- (v) the number of shares or debentures which persons have agreed to subscribe absolutely or conditionally for commission, should be disclosed in the manner aforesaid.
- (vi) a copy of the contract for the payment of the commission should be delivered to the Registrar along with the prospectus or the statement in lieu of prospectus for registration.

Section 76 (4A) clarifies that commission to the underwriters is payable only in respect of those shares or debentures which are offered to the public for subscription. However where, (i) a person, who for a commission has subscribed (or agreed to subscribe) for shares or debentures of a company and before the issue of the prospectus (or statement in lieu of prospectus) for such shares or debentures, some other person (or persons) has subscribed for any or all of them, and (ii) such a fact together with the aggregate amount of commission payable to the underwriter is disclosed in such prospectus (or statement in lieu of prospectus), then the company may pay commission to the underwriter in the respect of his subscription irrespective of the fact that the shares or debentures have already been subscribed.

Question 14

Explain clearly the doctrine of 'Indoor Management' as applicable in cases of companies registered under the Companies Act, 1956. Explain the circumstances in which an outsider dealing with the company cannot claim any relief on the ground of 'Indoor Management'

(November 2001)

Answer

Doctrine of indoor Management & Exceptions:

One limitation to the doctrine of constructive notice of the memorandum and articles of a company is the doctrine of indoor management. According to the doctrine of indoor management, the outsider, dealing with the company are entitled to assume that as far as the internal proceedings of the company are concerned, everything has been regularly done. They are bound to read the registered documents and to see that the proposed dealing is not inconsistent therewith, but they are not bound to do more, they need not inquire into the regularity of the internal proceedings as required by the

memorandum and Articles. This limitation of the doctrine of constructive notice is known as the 'Doctrine of Indoor Management', popularly known as rule in *Rovul British Bank v. Turquand*. Thus the doctrine of indoor management aims to protect outsiders against the company.

Exceptions:

In the following circumstances an outsider dealing with the company cannot claim any relief on the ground of 'indoor Management'

1. *Knowledge of irregularity*: Where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management: he cannot claim the benefit under the rule of indoor management. (*T.R. PRATT (Bombay) Ltd. v. E.D. Sassoon & Co. Ltd.*).
2. *Negligence*: Where a person dealing with a company could discover the irregularity if he had made proper inquiries, he cannot claim the benefit of the rule of indoor management. The protection of the rule is also not available where the circumstances surrounding the contract- are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry (*Anand Bihari Lal v. Dinshaw & Co.*) Also the case of *Underwood v. Bank of Liverpool*.
3. *Act void ab initio and forgery*: Where the acts done in the name of a company are void ab initio, the doctrine of indoor management does not apply. The doctrine applies only to irregularities that otherwise might affect a genuine transaction. It does not apply to a forgery. A Company can never be held liable for forgeries committed by its officers. (*Ruben v. Great Fingall Consolidated Co.*).
4. *Acts outside the scope of apparent authority* : If an officer of a company enters into a contract with a third party and if the act of the officer is beyond the scope of his authority, the company is not bound. (*Kreditbank Cassel v. Schenkers Ltd.*).
5. A person having no knowledge of Articles cannot seek protection under Indoor Management.

Question 15

State the remedies available against a company to a subscriber for allotment of shares on the faith of a misleading prospectus. What conditions must be satisfied by such a subscriber before opting for the remedies? (November 2001)

Answer

A person who has been induced to subscribe for shares/debentures on the faith of misleading prospectus has the following remedies against the company. If there is a misstatement of a material information in a prospectus, and if it has induced any shareholder to purchase shares, he can:

1. rescind the contract, and
2. claim damages from the company whether the statement is fraudulent or an innocent one. .

RESCISION OF THE CONTRACT

Any person who takes shares on the faith of statements of fact contained in a prospectus, can apply to the Court for the rescission of the contract if those statements are false or fraudulent or if some material information has been withheld. He must, however, apply for the rescission within a reasonable time and before the company goes into liquidation. But he will have to surrender to the company the shares allotted to him, His name is then removed from the register of members and he gets back the money paid by him to the company along with interest. The contract can be rescinded if the following conditions are satisfied:

1. the statement must be a material misrepresentation of facts.
2. the statement must have induced the shareholder to take the shares,
3. the statement must be untrue.
4. the deceived shareholder is an allottee and he must have relied on the statement in the prospectus.
5. the omission of material fact must be misleading before rescission is granted.
6. the proceedings for rescission must be started as soon as the allottee comes to know of a misleading statement in the prospectus on the faith of which he had subscribed for shares and before the company goes into liquidation.

Rescission is available only if the aggrieved shareholder:

- (a) acts within reasonable time;
- (b) before the company goes into liquidation;
- (c) has not done any act indicating the upholding of the contract to take shares like:
 - (1) having attended a meeting of the company or

(2) accepted dividends declared by the company.

DAMAGES:

Any person induced by a fraudulent statement in a prospectus to take shares is entitled to sue the company for damages. He must prove the same matters in claiming damages for deceit as in claiming rescission of the contract. He cannot both retain the shares and get damages against the company. He must show that he has repudiated the shares and has not acted as a shareholder after discovering the fraud or misrepresentation.

Question 16

XYZ Co. Ltd. was in the process of incorporation. Promoters of the company signed an agreement for the purchase of certain furniture for the company and payment was to be made to the suppliers of furniture by the company after incorporation. The company was incorporated and the furniture was used by it. Shortly after incorporation, the company went into liquidation and the debt could not be paid by the company for the purchase of above furniture. As a result suppliers sued the promoters of the company for the recovery of money.

Examine whether promoters can be held liable for payment under the following situations:

- (i) When the company has already adopted the contract after incorporation?’*
- (ii) When the company makes a fresh contract with the suppliers in terms of preincorporation contract?*
(November 2001)

Answer

The promoters remain personally liable on a contract made on behalf of a company which is not yet in existence. Such a contract is deemed to have been entered into personally by the promoters and they are liable to pay damages for failure to perform the promises made in the company's name (*Scot v. Lord Ebury*), even though the contract expressly provided that only the company shall be answerable for performance.

In *Kelner v. Baxter* also it was held that the persons signing the contracts viz. Promoters were personally liable for the contract.

Further, a company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purported to have been made on its behalf before it came into existence as ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contracts for a principal who is in existence and who is competent to contract at the time of contract by the agent.

The company can, if it desires, enter into a new contract, after its incorporation with the other party. The contract may be on the same basis and terms as given in the pre-incorporation contract made by the promoters. The adoption of the pre-incorporation contract by the company will not create a contract between the company and the other parties even though the option of the contract is made as one of the objects of the company in its Memorandum of Association. It is, therefore, safer for the promoters acting on behalf of the company about to be formed to provide in the contract that: (a) if the company makes a fresh contract in terms of the pre-incorporation contract, the liability of the promoters shall come to an end; and (b) if the company does not make a fresh contract within a limited time, either of the parties may rescind the contract.

Thus applying the above principles, the answers to the questions as asked in the paper can be answered as under:

- (i) the promoters in the first case will be liable to the suppliers of furniture. There was no fresh contract entered into with the suppliers by the company. Therefore, promoters continue to be held liable in this case for the reasons given above.
- (ii) in the second case obviously the liability of promoters comes to an end provided the fresh contract was entered into on the same terms as that of pre-incorporation contract.

Question 17

M Company Limited issued 2,00,000 equity shares of Rs 10 each. You are allotted 100 shares. Explain any ten rights you have as a member of the company.
(November, 2001)

Answer

Rights of the member in a company:

A member of a company has the following rights against the company:

1. Right to have the certificate of shares held or the certificate of stock issued to him within the prescribed time.
2. Right to have his name borne on the register of members.
3. Right to transfer shares subject to any restrictions imposed by the articles of the company.
4. Right to attend meeting of shareholders, received proper notice and to vote at the meetings.
5. Right to associate in the declaration of dividends and to apply to the Court for an injunction restraining the directors from paying dividends on an ultra virus declaration or out of capital.
6. Right to inspect the registers, indexes, returns and copies of a certificates etc. kept by the company and to obtain extracts or copy thereof.
7. Right to obtain copies of Memorandum and Articles on request and on payment of the prescribed fees.
8. Right to have the first option in case of issue of new shares or a further issue of shares (i.e. right to pre-emption) by the company.
9. Right to receive a copy of the Statutory Report.
10. Right to apply to the court to have any variation or abrogation to his rights set aside by the Court.
11. Right to have notice of any resolution requiring special notice.
12. Right to obtain on request minutes of proceedings at general meeting.
13. Right to remove directors by joining with others.
14. Right to obtain a copy of the profit and loss account and the balance sheet with the auditor's report.
15. Right to apply for the appointment of one or more competent inspectors by the Government to investigate into the affairs of the company as well as for reporting thereon.
16. Right to participate in the appointment of an auditor at the AGM.
17. Right to inspect the auditor's report-at the AGM of the company.
18. Right to receive a share in the capital of the company and in the surplus assets, if any, on the company's liquidation.
19. Right to participate in passing of the special resolution what the company may be wound up by the court or voluntarily.

20. Right to participate in the appointment and in fixation of remuneration of one or more liquidators in the case of a Member's voluntary Winding-up and to fill any vacancy in the office of a liquidators so appointed by him.

Question 18

Can a Public Limited Company reduce its Share Capital? If so, when and how? Also state the procedure it has to follow for doing so. (November, 2001)

Answer

Reduction of Share Capital:

A company is allowed to reduce its share capital subject to special safeguards.

Section 100 of the Companies Act, 1956. provides that a company, limited by shares or guarantee and having share capital, if so authorised by the articles, may by special resolution and the confirmation of the Court, reduce its share capital in any way and in particular by.

- (a) extinguishing or reducing the liability of members in respect of the capital not paid up;
- (b) writing off or cancellation any paid-up capital which is in excess of the needs of the company,
- (c) paying off any paid-up share capital which is in excess of the needs of the company.

Reduction in (b) and (c) may be made either in addition or without extinguishing or reducing the liability of the member for uncalled capital.

Reduction of share capital may in reality take three forms, viz..

- 1. Reducing the value of shares in order to absorb the accumulated losses suffered by the company without any payment to the shareholders.
- 2. Extinction of liability of capital not paid; and
- 3. Paying off any paid up share capital,

The interest of creditors is involved only in the cases stated in 2 and 3.

Procedure to be adopted

- 1. A special resolution is to be passed under Section 100.
- 2. An application is to be made under Section 101 to the Court for an order confirming the reduction.

3. After the petition for Court's confirmation is filed, the Court must settle the list of creditors who are entitled to object such as creditors having a debt or a claim admissible on a winding up.
4. The Court must ascertain the names of those creditors and the nature and amount of their debts or claims.
5. The Court may publish notices fixing a day or days within which the creditors not entered on the list are to claim to be so entered or are to be excluded from the right of objecting to the reduction.
6. The Court has power to dispense with the consent of the dissenting creditor, on the company securing the paying of the debt or claim by appropriating the full amount of the amount fixed by the Court.

However, the Court has discretionary power having regard to any special circumstances of the case to direct that the provisions of Section 101(2) shall not apply as regards any classes of creditors. The special circumstances should be convincing to the Court.

After being satisfied the Court may make an order confirming the reduction on such terms and conditions as it thinks fit. The company then has to put the words "and reduced" to the name of the company.

Question 19

What conditions as required under the Companies Act, 1956 must be satisfied by a company for the forfeiture of shares of a member, who has defaulted the payment of calls? What are the consequences of such forfeiture?(November, 2001)

Answer

FORFEITURE OF SHARES AND THE CONSEQUENCES

CONDITIONS TO BE SATISFIED FOR FORFEITURE:

1. In accordance with the Articles: Forfeiture-must be authorized by the Articles of the company and must be for the benefit of the company.
2. Notice prior to forfeiture: Before shares can be forfeited, the company must serve a notice on the defaulting shareholder requiring payment of unpaid call together with any interest which may have accrued. (Article 29:Table A).
3. Give not less than 14 days time from the date of service of notice for the payment of the amount due;

4. State that in the event of non-payment of the amount due within the period mentioned in the notice, the shares in respect of which the call was made will be liable to be forfeited, (article 30. Table A). The notice of forfeiture must also specify the exact amount due from the shareholder. If the notice is defective in any respect, the forfeiture will be invalid.
5. Resolution of the Board: If a defaulting shareholder does not pay the amount within the specified time as required by the notice, the directors must pass a resolution forfeiting the shares. (Article 31). If this resolution is not passed, the forfeiture is invalid. If, however, the notice threatening the forfeiture incorporates the resolution of forfeiture as well, e.g., when it states that in the event of default the shares shall be deemed to have been forfeited, no further resolution is necessary.
6. Good faith: The power to forfeit shares must be exercised by the directors in good faith and for the benefit of the company.

EFFECT OF FORFEITURE:

1. Cessation of membership: A person whose shares have been forfeited ceases to be a member in respect of the shares so forfeited. He, however, remains liable to pay to the company all moneys which, at the date of forfeiture were payable by him to the company in respect of the shares.
2. Cessation of liability: The liability of the person whose shares have been forfeited ceases if and when the company receives payment in full of all such money in respect of the shares,
3. If a company is wound up more than 1 year after the forfeiture, The member whose shares have been forfeited cannot be held liable as a contributory.
4. Forfeited shares become the property of the company and may be reissued or otherwise disposed of on such terms and in such manner as the Board thinks fit. The purchaser would be liable to pay all the calls due on the shares including the call for which shares were forfeited. But where the articles provide that a shareholder whose shares have been forfeited is to remain liable for the call occasioning the forfeiture, the purchaser is liable only for the difference between the amount of the call and the sum realized on reissue, should this be less than the call.

Question 20

What is a Debenture Certificate? When and within what time it should be issued? Is there any penalty for the delay or default in the issue of such certificate?
(November, 2001)

Answer

Meaning of Debenture Certificate:

Debenture Certificate is an acknowledgement by a company that the certificate holder is a creditor of the company to the extent of the number of debentures multiplied by the face value of each debenture. Thus, if the certificate states 100 debentures of Rs. 100/- each, then the person having the certificate is entitled to get Rs.10,000/- from the company at the time of the redemption of such debentures by the company.

Thus this certificate entitled the holder to get repayment of principal sum at the appointed date and the payment of interest at a fixed rate. This certificate is issued by the company to the Debenture Holders of the company. The debentures are issued under the common seal of the company.

Debenture certificate is to be issued within three months of the allotment of debentures or debenture stock and within two months after the application for registration of the transfer of any such debentures or debenture stock, deliver the certificates of all debentures and debenture stock allotted or transferred in accordance with the procedure laid down in Section 53 of the Companies Act, 1956.

The C.L.B. (Now Central Government) is empowered to extend the period within which the debenture certificate may be delivered to a further period not exceeding nine months, if it is satisfied that it is not possible for the company to deliver the certificates within the said period,

Penalty: Where the default is made in the delivery of debenture certificate within the specified time, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and the company and every officer of the company who is in default shall be punishable with the fine which may extend to Rs.5000 per day of default.

If a company on which a notice has been served requiring it to make good the default fails to do so within 10 days of the service of the notice, the CLB (Central Government) may on an application made by the aggrieved person, make an order directing the company and any officer of the company to deliver the securities within the period mentioned in the order. The order

may provide that all costs incidental to the application shall be borne by the company or by the officer of the company responsible for the default.

Question 21

Explain fully the doctrine of Ultra Vires and state its implications. (November, 2001)

Answer

The objects or the acts which a Company is empowered to do are specified in the Memorandum of Association of the company and the company cannot cross the boundary drawn by the Memorandum of Association. The company is empowered to do only such acts which are:

- (a) within the framework of the Memorandum *i.e.* stated in clear terms in the Memorandum of Association of the company, or
- (b) which are reasonably and fairly incidental to the attainment of its objects, or
- (c) which are otherwise authorised by the Companies Act. If the company does any acts which are not covered under the three categories, such acts shall be beyond the power of the company and shall be declared *ultra vires* the Memorandum of the Company.

The term *ultra virus* means *beyond powers*. A company binds itself to work within the frame work of those objects as stated in its Memorandum of Association and if it does any act beyond the scope of its objects clause, then act or acts is declared as *ultra virus*. These ultra vires acts may be categorized under the following three heads:

- (a) Acts *ultra virus* the directors, *i.e.* acts beyond the powers of the Directors of the company. Such are not altogether void and inoperative. They can be ratified by the shareholders in a general meeting.
- (b) Acts *ultra vires* the Articles of Association of the company, *i.e.* the acts which are beyond the powers of the company given to it by its Articles of Association. These acts are also not altogether void and inoperative. They can also be ratified by the company, by altering the articles through a special Resolution.
- (c) Acts *ultra vires* the Memorandum of Association of the company, *i.e.* acts which are beyond the powers of the company given to it by its Memorandum of Association. As a matter of fact such acts are beyond the legal powers of the company and therefore, known as "*ultra vires the company*". These Acts are wholly void and inoperative; they cannot be

ratified since they are beyond the legal powers, of the company. The company, therefore, is not bound by such acts at all. Most important thing is, that such acts cannot be ratified even by the whole body of the shareholders of the company.

The decisions given in the following leading cases, have proved the point in question, that *ultra vires* acts of the company are void and inoperative wholly. The cases are:

- (1) Ashbury Railway Carriage and Iron Co. Ltd. V. Riche (1875)
- (2) Re German Date Coffee Co. (1882)
- (3) Egyptian Salt Co. v. Port said Salt Association (1931)

Implications of *ultra vires* Acts:

Their implications can be stated asunder:

- (1) *Infliction against the Company*: Any member of the company can obtain injunction from the court i.e. an order from the court to restrain the company from proceeding with the *ultra vires* acts-
- (2) *Personal liability of the Directors*: The directors of the company are personally liable to the company for the *ultra vires* acts. It is the duty of the directors to see that the company's capital is used for the legitimate objects of the company and not otherwise. However, if the person receiving the money knows that he is receiving payment for an *ultra vires* act, then he is bound to return the money back to the director.
- (3) *Personal liability of the directors to third parties*: Directors action is treated to be an action of an agent who acts beyond his authority and, therefore, the directors for *ultra vires* act(s) shall be held personally liable towards the third party for any loss suffered by such third parties.
- (4) *Ultra vires contracts are void*: This is because of the fact, that the Company is not empowered to enter into such contracts, as well such contracts cannot become inter vires by subsequent ratification even by the shareholders of the company.

A contract of a company which is *ultra vires* the company is void ab initio and of no legal effect. Neither the company nor other contracting party can enforce the *ultra vires* contract. The company may, however, after the objects clause for the future, but such alteration will not validate the past *ultra vires* acts done.

Question 22

A company refuses to register transfer of shares made by X to Y. The company does not even send a notice of refusal to X or Y within the prescribed period. Has the aggrieved party any right(s) against the company for such a refusal? Advise. (May, 2002)

Answer

The problem as asked in the question is based upon Section 111 of the Companies Act dealing with the refusal to register transfer and appeal against refusal.

On refusal to register a transfer or transmission by operation of law, of the right to any shares in, or debentures thereof, the company has to send notice of refusal giving reasons to the transferee or the transferor or to the person giving intimation of such transmission, or on delivery of transfer deed to the company, as the case may be within a period of 2 months from the date of the intimation or delivery of the transfer deed to the company. In the given case the company has failed to give such notice of refusal to the aggrieved parties within the stipulated time of 2 months. Failure to give notice of refusal gives a right/remedies to the aggrieved parties.

Rights/remedies to aggrieved parties:

The aggrieved parties may apply to the Company Law Board (Tribunal) under sub-section (2) or (4) of Section 111 against refusal or for rectification of the register of members, if his name is entered in the register without sufficient cause, or for omission of his name from the register or default in making an entry of his name in the register. The time of filing such appeal is 4 months from the date of lodgement of transfer application. There is no limitation period provided for making an application for rectification of register of members, under subsection (4). The company is also punishable under subsection (12) with a fine upto Rs.500 per day.

Question 23

When is an Allotment of Shares treated as an irregular allotment? State the effects of an irregular allotment. (May, 2002)

Answer

Irregular allotment:

Allotment of shares is irregular when it has been made by a company in violation of Section 69 or 70. Thus:

1. where the company has issued a prospectus, the allotment is irregular if it; (i) has not been able to raise the amount of minimum subscription, (ii) has not collected application money (which shall not be less than 5% of the nominal amount of the shares); and (iii) has not kept the money so received in a Scheduled Bank.
2. where the company has not issued a prospectus, the allotment is irregular if it does not file with the Registrar for registration, a statement in lieu of prospectus at least 3 days before 'the first allotment of shares.

In spite of these stringent provisions, sometimes an allotment is made by the directors in utter disregard of the provisions, such an allotment is treated by the Act not as void ab initio but as irregular.

Effects of irregular allotment:

Allotment is voidable at the option of the allottee: The option must be exercised by the allottee: (a) within 2 months after holding of the statutory meeting of the company, or (b) where the company is not required to hold a statutory meeting, or where the allotment is made after the holding of statutory meeting, within 2 months after the date of allotment.

Notice of avoidance given within this time will be sufficient, though actual legal proceedings if necessary, may be commenced thereafter. Such an allotment is avoidable even if the company is in the course of winding up (*Re National-Motor Mail Coach Co. Ltd. 1908 Ch. 228*).

It is not necessary that the allottee should commence actual legal proceedings within 2 months. It is enough for him to give a notice to the company of his intention to revoke the allotment.

Compensation: Any director, who has knowledge of the fact of the irregular allotment of shares, shall be liable to compensate the company and the shareholder respectively for any loss, damages or costs which the company or the allottee may have sustained or incurred there by. Proceedings to recover any such loss, damages or costs can be only be commenced within 2 years from the date of the allotment.

Question 24

Can a non-profit organization be registered as a company under the Companies Act? If so, what procedure does it have to adopt? (May, 2002)

Answer

Procedure/or Registration of a non-profit organisation as a company: An association of persons set up for promoting commerce, arts, science, religion, charity or any other useful , object and intends to apply its profits or other income in promotion of its objects can be registered as a Company under the Companies Act. However, it has to prohibit payment of any dividend to its members.

Procedure: The association has to apply to the Central Government for issuing a licence. Through this licence the Central Government shall direct the Registrar to register the association as a company with limited liability without the addition of words 'limited' or 'private limited' to its name. Therefore, the association may be registered accordingly.

The association has to fulfill the conditions needed for registration as a company, i.e. it must have its name, its Memorandum of Association, its Articles of Association or Rules/Bye-laws and signatures of its founder members with two witnesses. On registration (subject to the provisos of Section 25) it will have the same privileges and obligations as a limited company has. This licence is revocable by the Central Government, and on revocation the Registrar shall put the words 'Limited' or 'Private Limited' against the company's name in the Register. But 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.

Question 25

Explain the meaning of 'Sweat Equity Shares' and state the conditions a company has to fulfil for issuing such shares. (May, 2000,2002 & Nov. 2003)

Answer

Mewing of Sweat Equity Shares: Sweat equity shares mean equity shares issued by thy company to employees or directors at a discount or for consideration oilier than cash for providing know-how or making available right in the nature of intellectual properly rights or value additions, by whatever name called. [Explanation II to Section 79A, Companies (Amendment) Act, 2000].

Conditions to be fulfilled before issue of Sweat Equity Shares:

Notwithstanding anything contained in Section 79 (Providing for issue of shares at a discount), a company may issue sweat equity shares if the following conditions are fulfilled:

1. Shares of a class which have already been issued only can be issued as 'sweat equity shares'.
2. Issue of 'sweat equity-shares' should be authorised by a special resolution passed by the company in general meeting.
3. The resolution should specify number of shares, current market price, consideration, if any and class or classes of directors or employees to whom the 'sweat equity shares' may be issued.
4. The 'sweat equity shares' may be issued only one year after the company was entitled to commence business.
5. If the company is listed on stock exchange 'sweat equity shares' can be issued as per regulations made by SEBI. If the company is not listed on the stock exchange 'sweat equity shares' will be issued in accordance with guidelines of Central Government. (Section 79A(1)).
6. The 'sweat equity shares' have same limitations restrictions and rights as are applicable to other equity shares. [Section 79A(2)].

Question 26

Explain the term 'Share Warrant'. How does it differ from 'Share Certificate'? (May, 2002, 2003)

Answer

Meaning of Share Warrant: Share warrant is a document which a public company issues in conformity with statutory requirements, under the common seal of the company and states that the holder of the warrant is entitled to certain number of shares specified therein. Share warrant is a bearer document and the title to the shares specified therein can be transferred by mere delivery of the share warrant. To that extent, it is a negotiable instrument.

Under Section 114 of the Companies Act, 1956 the issue of such shares warrant can be made only if the company is so authorised by its articles and permission of the Central Government has been obtained. (Table A contains regulations permitting issue of shares warrants). Further, share warrants to bearer can be issued only in respect of fully paid shares. Dividend coupons are attached to the share warrants providing for the payment of future dividends on the shares specified in the warrants.

Distinction between a share warrant and a share certificate:

- (i) All companies, whether public or private are required to issue share certificates. Share warrant can be issued only by public companies.
- (ii) A share warrant can be issued by a public company if it is empowered to do so by its Articles of Association and has obtained prior approval of the Central Government. There is statutory obligation on every company issuing shares to issue a share certificate. No such power need be taken in the articles of Association, nor is the approval of the Central Government required.
- (iii) A share warrant can be issued only with respect of fully paid up shares, A share certificate is to be issued even where the shares are partly paid-up.
- (iv) The holder of a share certificate is a member of the company but the holder of a share warrant is not a member unless the Articles otherwise provide.
- (v) A share warrant is by mercantile usage a negotiable instrument. A share certificate is not.
- (vi) A share warrant can be transferred by mere delivery and no registration of transfer with the company is required. The shares can be transferred by execution of a transfer deed and its delivery along with the share certificate. The transfer is complete when it is registered by the company,
- (vii) No stamp duty is payable on transfer of a share warrant whereas stamps duly is payable on transfer of shares specified in a share certificate.
- (viii) Where a director is required to hold some qualification shares, a share warrant docs not constitute such a qualification whereas a share certificate does.
- (ix) A share certificate is a document showing prima facie title to the shares represented thereby. A share warrant is the share security itself, transformed for the purpose of negotiation into a different character.
- (x) The holder of a share certificate can present a petition for winding up of the company. The holder of a share warrant cannot do so.
- (xi) Dividend is paid to the holder of a share certificate by the issue of a dividend warrant in his favour. Dividend due on a share warrant is advertised in newspapers and is payable to the holder of the dividend warrant on presentation of the relevant coupon attached to the share warrant.

Question 27

Name any five charges which are required to be registered under the Companies Act, 1956. What is the effect of non-registration of a charge under Companies Act, 1956?
(May, 2002)

Answer

In accordance with the provisions of the Companies Act 1956, as contained in Section 125, the following are the charges required to be registered with the Registrar of companies within 30 days after the date of its creation:

- (i) a charge for the purpose of recurring any issue of debentures;
- (ii) a charge on uncalled share capital of the company;
- (iii) a charge on any immovable property, wherever situate, or any interest therein;
- (iv) a charge on any book debt of the company.
- (v) a charge, not being a pledge, on any movable property of the company;
- (vi) a floating charge on the undertaking or any property of the company including stock-in-trade;
- (vii) a charge on calls made but not paid;
- (viii) a charge on a ship or any share in ship;
- (ix) a charge on goodwill, on a patent or licence under a patent, on a trademark or on a copyright or a licence under a copyright.

Effect of non-registration:

If any of the charges is not registered; it shall be void against the liquidators and any creditor of the company. [Section 125(1)].

- (i) When the charge becomes void, the money secured thereby shall immediately become payable. (Section 125(3)).
- (ii) The company and every officer of the company may be subjected to a penalty upto Rs. 5,000/- for every day during which the default continues.

In the event of the charge being void for non-registration no right of lien can be claimed on the documents of title, as they are only ancillary to the charge and were delivered pursuant to the charge. Though the charge becomes void for non-registration, but the debt is good as a simple debt.

Question 28

Describe the ways to become a member of a company.

A company issued 20 partly paid equity shares and registered them in the name of the minor describing him as minor. The father of the minor signed the application on the minor's behalf. After some time company went into liquidation. The company filed a suit against father of the minor to recover the remaining amount on the shares. Whether the company will succeed? Advise. (Nov. 2002)

Answer

The membership of a company may be acquired in the following ways :

1. *By subscribing to memorandum (Section 41):* This section provides that the subscribers of the memorandum of association shall be deemed to have agreed to become the members of the company and on its registration shall be entered as members in the register of members.
2. *By allotment:* A person may become a shareholder by agreeing to take shares in the company by allotment.
3. *By transfer:* Section 41 says that every subscribers to the memorandum of a company and every other person who agrees in writing to become a member of the company and whose name is entered in its register of members. Thus it requires two thing a) an agreement in writing to become a member and b) an entry in the register.
4. *By transmission:* Here a person may become a shareholder by transmission of shares through death, lunacy or insolvency.
5. *By estoppel:* This arises when a person holds himself out as a member or knowingly allows his name to remain on the register when he has actually parted with his shares. In the event of winding up he will be liable like other genuine members as a contributory (*Hansraj A. Ashtana*). However, he may escape liability by applying for removal of his name under Section 155.

Answer to the problem :

Every person who is competent to contract may become a member. A minor and a person of unsound mind, being incompetent to contract, cannot be members of the company. It has been held in *Mohri Bihi vs. Dharmadas Ghose (1930)* that since a minor has no contractual capacity, the agreement with the minor is void ab initio.

The Companies Act, 1956 prescribes no qualification for membership. Therefore, in India, the minor may be allotted shares. His name may remain on a company's register of members, but during minority he incurs no liability. In the given problem the company issued 20 partly paid shares and registered it in the minor's name. The transaction was void and the father who signed the application on the minor's behalf could not be treated as having contracted for the shares; as such he could not be placed on the list of contributors when the company goes in liquidation. The facts of this problem are related to *Palaniappa B. Official Liquidator AIR 1942 Mad. 470*.

Question 29

Whether a company can issue shares at premium?

State the purposes for which the Share Premium account can be used under the provisions of the Companies Act, 1956. (Nov. 2002)

Answer

Issue of shares at premium (Section 78)

If the market exists, a company may issue its shares at premium i.e. the price higher than their nominal value. There is no restriction contained in the Companies Act, 1956 on the sale of shares at a premium. But SEBI guidelines have to be observed as they indicate when an issue has to be at par and when premium is chargeable. Premium may be received in cash or kind. Where the value of assets received by a company as a consideration for allotment is greater than the nominal value of shares, it is in essence an allotment at a premium. An amount equal to extra value of the assets would have to be carried to the securities premium account. The amount to the credit of share premium account has to be maintained with the same sanctity as share capital and can be reduced only in the manner of share capital. The act does regulate the disbursement of the amount collected as premium. Such account can be used in the following ways by the company.

- (a) it may be applied to issue to the members as fully paid by way of bonus the unissued shares of the company.
- (b) it may be used to write off preliminary expenses.
- (c) it may be used to write off commission or discount account.
- (d) it may be spent in providing for the premium payable on the redemption of preference shares or debentures of the company.

Question 30

In what way does the Companies Act, 1956 regulate the holding of an Annual General Meeting by a public limited company? Explain. (Nov. 2002)

Answer

Provision relating to – regulation of AGM under the Companies Act, 1956

Section 166 of the Companies Act, 1956 regulate the holding of an Annual General Meeting by a public limited company. Accordingly, section provided that:

1. Every company shall in each year hold in addition to any other meeting a general as its annual general meeting and shall specify the meeting as such in the notices calling it; and not more than 15 months shall elapse between the date of one annual AGM of a company and that of the next. A company may hold its first AGM within a period of not more than 18 months from the date of its incorporation; and if such general meeting is held within that period, it shall not be necessary for the company to hold any AGM in the year of its incorporation or in the following year. However, the Registrar may, for any special reason, extend the time within which any AGM (not being the first AGM) shall be held, by a period not exceeding 3 months.
2. Every AGM shall be called for a time during business, on a day that is not a public holiday, and shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate.

The Central Government may exempt any class of companies from the provisions of this sub-section subject to such conditions as it may impose. Further, a public company or a private company which is a subsidiary of a public company, may by its articles fix the time for its AGM and may also by a resolution passed in one AGM fix the time for its subsequent AGMs

Section 167 provides that:

- (1) If default is made in holding an AGM in accordance with Section 166, the CLB may, notwithstanding anything in the Act or in the articles of the company, on the application of any member of the company, call, or direct the calling of, a general meeting of the company and give such ancillary or consequential directions as the CLB thinks expedient in relation to the calling, holding and conducting of the meeting.

- (2) A general meeting held in pursuance of sub-section (1) shall, subject to any directions of the CLB, be deemed to be an AGM of the company.

Further Section 168 provides that if default is made in holding a meeting of the company in accordance with Section 166, or in complying with any directions of the Central Govt. under sub-section (1) of Section 167, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 50,000 and in the case of a continuing default, with a further fine which may extend to Rs. 2,500 for every day after the first during which such default continues.

Question 31

Explain the limitations relating to alternation of Articles of Association of a company.

(Nov. 2002)

Answer

Limits on the Alteration of Articles:

Every company has a right to alter its articles. A company cannot divest itself of these powers. Matters as to which the memorandum is silent can be dealt with by the alteration of articles. Such alteration is effective by passing a special resolution. The right to alter the article is subject to the following limitations:

- (i) The alteration must not exceed the powers given by memorandum or conflict with the provisions thereof.
- (ii) It must not be inconsistent with any provisions of the Companies Act or any other statute.
- (iii) It must not be illegal.
- (iv) It shall not be in fraud on minority or inflict a hardship on minority shareholders, without any corresponding benefits to the company as a whole.
- (v) It must not be inconsistent with any order of the court, under section 404 any subsequent alteration thereof which is inconsistent with such an order can be made by the company only with the leave of the court.
- (vi) It may have retrospective effect so long as it does not affect the things already done by the company (*Allen B. Gold Reef of West Africa [1909] SC 732*)

- (vii) If a public company is converted into a private company, then the approval of Central Government is necessary (Section 31(1)) In this regard an injunction cannot be granted to prevent the adoption of new article which constituted a breach of contract. But if the company acts on them it may be liable to damages [*Shirlaw Vs Southern Foundaries Ltd. 1940 AC 701 (760)*].
- (viii) An alteration should not increase the liability of a member unless he has agreed thereto in writing (Section 38)
- (ix) A reserve capital once created cannot be unreserved but may be cancelled on a reduction of capital (*Midland Railway Carriage Wagon Co. 1907*) Section 99.
- (x) Any irregular alteration which have been acted on for many years are binding.

Question 32

Explain clearly the meaning of Lifting the Corporate Veil, as applicable in case of companies incorporated under the Companies Act, 1956. Under what circumstances the veil of a company can be lifted by the court? (Nov. 2002)

Answer

Lifting of the corporate veil and the cases in which veil of a company can be lifted:

A company in the eyes of law is regarded as an entity separate from its members. It has an independent corporate existence. Any of its members can enter into contracts with the company in the same manner as any other individual can and he cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The company's money and property belong to the company, and not to the shareholders. (*Salomon v. Saloman & Co. Ltd.*)

Further, from the juristic point of view, a company is a legal person distinct from its members (*Salomon v. Salomon & Co.*). It has its own corporate personality. This principle may be referred to as 'the veil of incorporation'. The Courts in general consider themselves bound by this principle. The effect of this principle is that there is a fictional veil between the company and its members. That is, the company has a corporate personality which is distinct from its members.

The human ingenuity, however, started using this veil of corporate personality blatantly as a cloak for fraud or improper conduct. Thus it became necessary for the Courts to break through or lift the corporate veil or crack the shell of corporate personality or disregard the corporate personality of the company. Thus while by fiction of law a corporation is a distinct entity, yet, in reality it is an association of persons who are in fact the beneficial owners of all the corporate property (*Callaghar v. Gernania Brewing Co.*)

The circumstances or the cases in which the Courts have disregarded the corporate personality of the company are:

2. Protection of revenue: The Courts may ignore the corporate entity of a company where it is used for tax evasion. (*Juggilal v. Commissioner of Income tax*).
3. Prevention of fraud or improper conduct: The legal personality of a company may also be disregarded in the interest of justice where the machinery of incorporation has been used for some fraudulent purpose like defrauding creditors or defeating or circumventing law. Professor Cower has rightly observed in this regard that the veil of a corporate body will be lifted where the 'corporate personality is being blatantly used as a cloak for fraud or improper conduct'. Thus where a company was incorporated as a device to conceal the identity of the perpetrator of the fraud, the Court disregarded the corporate personality. (*Jones v. Lipman*).
4. Determination of character of a company whether it is enemy: A company may assume an enemy character when persons in de facto control of its affairs are residents in an enemy country. In such a case, the Court may examine the character of persons in real control of the company and declare the company to be an enemy company. (*Daimler Co. Ltd. V. Continental Tyre & Rubber Co. Ltd.*)
5. Where the company is a sham: The Courts also lift the veil or disregard the corporate personality of a company where a company is a mere cloak or sham (hoax). (*Cilford Motor Co. Ltd. V. Horne*).
6. Company avoiding legal obligations: Where the use of an incorporated company is being made to avoid legal obligations, the Court may disregard the legal personality of the company and proceed on the assumption as if no company existed.

7. Company acting as agent or trustee of the shareholders: Where a company is acting as agent for its shareholders, the shareholders will be liable for the acts of the company. (F.C. Films Ltd., In re.)
8. Avoidance of welfare legislation: Where the Courts find that there is avoidance of welfare legislation, it will be free to lift the corporate veil. (Workmen of Associated Rubber Industry Ltd. V. Associated Rubber Industry Ltd.).
9. Protecting public policy: The Courts invariably lift the corporate veil or disregard the corporate personality of a company to protect the public policy and prevent transactions contrary to public policy. (Connors v. Connors Ltd.).

Question 33

Who is an 'Expert'? When an expert is not liable for the mis-statement in the prospectus of a public company? (Nov. 2002)

Answer

The Experts consent to the issue of Prospectus :

A prospectus may contain a statement purporting to be made by an expert. The term expert includes an engineer, a valuer, an accountant, and any other person whose profession gives authority to a statement made by him [section 59 (2) of Companies Act, 1956].

When an expert is not liable ?

An expert who would be liable by reason of having given his consent under section 58 to the issue of the prospectus containing a statement made by him would not be liable if he can prove.

- (i) that having given his consent to the issue of prospectus, he withdrew it in writing before the delivery of a copy of the prospectus for registration, or.
- (ii) that after the delivery of a copy of the prospectus for registration but before allotment, he on becoming aware of the untrue statement withdrew his consent in writing and gave reasonable public notice thereof and the reason therefore, or.
- (iii) that he was competent to make the statement and he had reasonable ground to believe and did up to the time of allotment of the shares or debentures believe, that the statement was true. (Section 62 (3)).

Question 34

ABC Company Limited at a general meeting of members of the company pass an ordinary resolution to buy-back 30% of its Equity Share Capital. The articles of the Company empower the company for buy-back of shares. The company further decide that the payment for buy-back be made out of the proceed of the company's' earlier issue of equity shares. Explaining the provisions of the Companies Act, 1956, and stating the sources through which the buy-back of companies own shares be executed. Examine.

- (i) *Whether company's proposal is in order?*
- (ii) *Would your answer be still the same in case the company instead of 30% decide to buy-back only 20% of its Equity Share Capital? (Nov. 2002)*

Answer

Buy Back of own Shares : Sources of Funds etc.

A company can purchase its own shares or other specified securities. The Purchase should be *out of*:

- (i) its free reserves; or
- (ii) the securities premium account,. or
- (iii) the proceeds of any shares or other specified securities.

However, buy back of any kind of other specified securities cannot be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities [Section 77A(i)].

'Specified securities' includes employees' stock option or other securities as may be notified by the Central Government from time to time (Explanation (a) section 77A).

In accordance with the provisions of the Companies Act, 1956, as contained in section 77A, the company deciding for buy back of shares must pass a special resolution in a general meeting of its members authorizing the company for the buy back. Secondly, the buy back is or less *than* 25% of the total paid-up *capital and* free reserves of the company.

Taking into account these two provisions (conditions) itself, the questions as asked in the problem can be answered as under:

1. The company's proposal for buy-back is not in order as it has passed only an ordinary resolution and the percentage of 30% buy-back is in violation of the provisions

2. The answer to the second question shall also be the same since there also the resolution passed by the company is an ordinary resolution and not special resolution, though the percentage of buy-back, i.e. 20% is not violative.

Question 35

State the types of debentures which may be issued by a public company. (Nov. 2002)

Answer

Types of debentures:

Different types of debentures may be enumerated as follows :

- (i) *Naked or unsecured debentures* : Such debentures do not carry any charge on the assets of the company. The holders of these debentures do not have any security as to repayment of principal or interest thereon.
- (ii) *Secured debentures* : Such debentures are secured by a mortgage of the whole or part of the assets of the company and known as mortgaged or secured debentures.
- (iii) *Redeemable debentures*: Debentures that are redeemable at the expiry of a certain period are known as redeemable debentures. Such redeemable debentures may be reissued again under section 121 of the Companies Act, 1956.
- (iv) *Perpetual debentures*: Where the debentures are redeemed on the happening of specified events which may not happen for an indefinite period e.g. winding up, they are known as perpetual debentures.
- (v) *Bearer Debentures* : These Debentures are payable to a bearer and are transferred by delivery and no stamp duty is payable on transfer. The Debenture holder is not registered in the stock of the company but is entitled to claim interest and repayment of principle. A bonafide transferee for value is not affected by the defect in the title of the transfer.
- (vi) *Registered Debentures* : The debentures are payable to registered holder. A registered holder is one whose name appears on the debenture certificate/ letter of allotment and is registered on the company's register of debenture holders maintained under section 152 of the Companies Act, 1956.

Company may also issue convertible debentures which may be classified as :

- (a) Fully Convertible Debentures
- (b) Non Convertible Debentures
- (c) Partly Convertible Debentures

Convertible debentures may be converted into equity share capital .

Question 36

Define the term 'Small Depositors'. State the legal provisions relating to acceptance, repayment and further deposits of such small depositors under the Companies Amendment Act, 2000. (Nov. 2002)

Answer

Definition of 'Small Depositors':

According to Section 58A of the Companies (Amendment) Act, 2000 a 'small depositor' means a depositor who has deposited in a financial year a sum not exceeding twenty thousand rupees in a company and includes the successors, nominees and legal representatives. It does not include those depositors who renew their deposits and those depositors whose repayment is not made due to death or has been stayed by a competent court.

Acceptance, repayment and further deposits :

1. Every company accepting deposit from the small depositor shall intimate to the Company Law Board (now Tribunal) within fifty days, the name and address of each small depositor to whom it had defaulted in repayment of deposit or interest thereon. Thereafter the intimation shall be given on a monthly basis.
2. On receipt of the intimation, it shall direct the company to repay the deposit and for this purpose an appropriate order is to be passed within thirty days if it is delayed an opportunity to the small depositor must be given of being heard, for this purpose presence of the small depositor is not essential.
3. Restriction on the company:
 - (a) Unless the company repays all matured deposits along with interest due thereon, it shall not accept further deposits from small depositors.
 - (b) If on any occasion, if company makes default in repayment of small deposits, it shall state in all its future advertisement and application

inviting deposits the details regarding total number of small depositors and the amount due thereon.

- (c) Where the interest accrued on small deposits has been waived, such fact must be mentioned in every future advertisement and application for inviting deposits.
- (d) The application form inviting deposits must contain a statement that the applicant had been appraised of every past default, waiver of interest, etc.
- (e) If the company subsequent to acceptance of small deposits avails any working capital from any bank, it shall first be utilized for repaying the principal and interest due to small depositors before applying the funds for any other purpose.
- (f) The penalty for failure to comply with the provisions of section 58AA or order of Company Law Board (now, Tribunal) is subject to a fine of Rs. 500 per day and imprisonment upto three years. The directors are also liable to be proceeded against. Such offence shall be cognizable offence under the Criminal Procedure Code. No court shall take cognizance of any offence under this provision except on a complaint made by the Central Government or any officer authorized by it in this behalf.

Question 37

'A' commits forgery and thereby obtains a certificate of transfer of shares from a company and transfers the shares to 'B' for value acting in good faith. Company refuses to transfer the shares to 'B'. Whether the company can refuse? Decide the liability of 'A' and of the company towards 'B' (Nov. 2002)

Answer

Problem relating to forged transfer:

A forged transfer is a nullity. It does not give the transferee concerned any title to the shares. Since the forgery is an illegality therefore it cannot be a source of a valid transfer of a title. Although the innocent purchaser acting in good faith could validly and reasonably assume that the person named in the certificate as the owner of the shares was really the owner of the shares represented by the certificate. Even then the illegality cannot be converted into legality. Therefore, in this case company is right to refuse to do the transfer of the shares in the name of the transferee B.

Here, as regards to the liability of A against 'B', A does not stand directly responsible according to provisions of company law as he has already committed forgery which is illegal but A is liable to compensate the company as he has lodged the forged transfer and the company has suffered the loss.

As regards to the liability of the company towards B, the company shall be liable to compensate to B in so far as the company had issued a certificate to transfer and was, therefore, stopped from denying the liability accruing from its own act. Further, as the company has refused to register him as a shareholder, company has to compensate B. However, in this case the interest of the original shareholder will be protected.

Question 38

Briefly explain the doctrine of "Constructive Notice" under the Companies Act, 1956. Are there any exceptions to the said doctrine? (May 2003)

Answer

Doctrine of Constructive Notice Etc.,

In consequences of the registration of the memorandum and articles of association of the company with the Registrar of Companies, a person dealing with the company is deemed to have constructive notice of their contents (*T.R. Pratt (Bombay) Ltd. v. E.D. Sassoon & Co. Ltd.*). This is because these documents are construed as 'public documents' under Section 610 of the Companies Act, 1956. Accordingly if a person deals with a company in a manner incompatible with the provisions of the aforesaid documents or enters into transaction which is ultra vires these documents, he must do so at his peril.

The doctrine of constructive notice is not a positive one but a negative one like that of estoppel of which it forms parts. It operates only against the person who has been dealing with the company but not against the company itself; consequently he is prevented from alleging that he did not know that the constitution of the company rendered a particular act or a particular delegation of authority ultra vires.

There is one limitation to the doctrine of constructive notice of the Memorandum and the Articles of a company. The outsiders dealing with the company are entitled to assume that as far as the internal proceedings of the company are concerned, everything has been regularly done. They are bound to read the registered documents and to see that the proposed dealing is not

inconsistent therewith, but they are not bound to do more; they need not inquire into the regularity of the internal proceedings as required by the Memorandum and the Articles. This limitation of the doctrine of constructive notice is known as the 'doctrine of indoor management' or the rule in *Royal British Bank v. Turquand*. Thus whereas the doctrine of constructive notice protects the company against outsiders, the doctrine of indoor management seeks to protect outsiders against the company.

Question 39

Explain the concept of "Shelf Prospectus" in the light of Companies (Amendment) Act, 2000. What is the law relating to issuing and filing of such prospectus? (May 2002, 2003)

Answer

Shelf Prospectus

According to Section 60-A as inserted by the Companies (Amendment) Act, 2000 'Shelf Prospectus' means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

Any public financial institution, a public sector bank or scheduled bank whose main object is financing, shall file a shelf prospectus. 'Financing means making loans to or subscribing in the capital of, a private industrial enterprise engaged in infrastructural financing, or such, other company as the Central Government may notify in this behalf.

A company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus. It shall be required to file an information memorandum. On all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and the succeeding offer of securities within the time prescribed by the Central Govt., prior to making of a second or subsequent offer of securities under the shelf prospectus.

An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue securities under that prospectus.

Where an update of information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

Question 40

Explain clearly the concept of “Perpetual Succession” and “Common Seal” in relation to a company incorporated under the Companies Act, 1956. (May 2003)

Answer

Perpetual Succession and Common Seal

A company is a juristic person with a perpetual succession. It never dies, nor does its life depend upon the life of its members. It is not in any manner affected by insolvency, mental disorder or retirement of any of its members. It is created by a process of law and can be put to an end only by the process of law. Members may come and go but the company can go on forever (until dissolved). It continues to exist even if all its human members are dead. Even during the war all the members of a private company, while in general meeting, were killed by a bomb, the company survived, not even a hydrogen bomb could have destroyed it [*K/9 Meat Supplies (Guildford Ltd, Re 0966)* 3 All E.R. 320].

Perpetual succession, therefore means that a company's existence persists irrespective of the change in the composition of its membership. Thus its continued existence is not affected by a constant change in its membership.

Common Seal:

Since a company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal acts as the official signature of the company.

Question 41

What are the conditions and procedure whereunder shares may be forfeited under the Companies Act, 1956? (May 2003)

Answer

Procedure and Conditions for Effecting Forfeiture:

Shares can be forfeited if the following conditions are fulfilled:-

- (1) Shares can be forfeited only if authorised by Articles of Association of the Company. Ordinarily forfeiture of shares can take place only for the non-payment of calls due to company and in such cases, calls must have been validly made. But articles may provide other grounds for forfeiture. (*Naresh Chandra Sanyal V. Calcutta Stock Exchange Association Ltd.*)
- (2) Forfeiture is in the nature of penal proceedings. It is valid if only if the provisions of the Articles are strictly complied with.
- (3) The power of forfeiture must be exercised bonafide, in the interests of the company.

Procedure

The procedure to be followed is laid down in Table A of Schedule I to the Companies Act. Articles of a company, usually, contain similar provisions. The procedure to be followed is narrated below.

- (1) The company must serve a notice on the defaulting shareholder requiring payment of the unpaid call together with any interest which may have accrued (Articles 29 of Table A).
- (2) The notice must -
 - (a) give not less than 14 days time from the date of service of notice for the payment of the amount due.
 - (b) state that in the event of non-payment of the amount due within the period mentioned in the notice, the shares in respect of which the call was made will be liable to be forfeited (Article 30 of Table A).

The notice of forfeiture must also specify the exact amount due from the shareholder. If the notice is defective in any respect e.g. where it does not specify the amount claimed by the company, or where it claims a wrong amount, the forfeiture will be invalid.

- (3) If the defaulting share holder does not payment the amount within the specified time as required by the notice, the directors must pass a resolution forfeiting the shares (Article 31 of Table A).

Question 42

After receiving 80% of the minimum subscription as stated in the prospectus, a company allotted 100 equity shares in favour of 'X'. The company deposited the said amount in the bank but withdrew 50% of the amount, before finalisation of the allotment, for the purchase of certain assets. X refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act, 1956. Comment. (May 2003)

Answer

Allotment of Shares

The company has received 80% of the minimum subscription as stated in the prospectus. Hence the allotment is in contravention of section 69(1) of the Companies Act and the allotment is irregular attracting the provisions of Section 71 of the Companies Act 1956.

The consequences of such irregular allotment are as follows:

The allotment is rendered voidable at the option of the applicant. The option must however be exercised -

- (i) Within 2 months after the holding of the statutory meeting of the Company; or
- (ii) Where the Company is not required to hold a statutory meeting or where the allotment is made after the holding of the statutory meeting, within 2 months after the date of allotment [Section 71(1)].

The irregular allotment is voidable even if the company goes into liquidation on the meantime [section 71(2)].

In view of the above, refusal by 'X' to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act is valid provided he has exercised his option to avoid the allotment within the period mentioned in Section 71(1) of the Companies Act.

The Company has also violated the provisions of Section 69(4) of the Companies Act in withdrawing 50% of the amount deposited with the bank before receiving the entire amount payable on application for shares in respect of the minimum subscription.

Question 43

The Directors of a company registered and incorporated in the name "Mars Textile India Ltd." desire to change the name of the company entitled

“National Textiles and Industries Ltd.” Advise as to what procedure is required to be followed under the Companies Act, 1956? (May 2003)

Answer

Change In the Name of Company:

In the first instance, Mars Textile India Ltd., should ascertain from the Registrar of Companies whether the proposed name viz. National Textiles and Industries Ltd. is available or not. For this purpose, the company should file the prescribed Form No.1A with the Registrar along with the necessary fees. The Registrar after examination will inform whether the new name is available or not for registration.

In case the name is available, the company has to pass a special resolution approving the change of name to National Textiles and Industries Ltd.

Thereafter the approval of the Central Government should be obtained as provided in Section 21 of the Companies Act, 1956. The power of Central Government in this regard has been delegated to the Registrar of companies. Thus, the company has to file an application along with the prescribed filing fee for change of name. The change of name shall be complete and effective only on the issue of a fresh certificate of incorporation by the Registrar. The Registrar shall enter the new name in the Register in place of the former name. The change of name shall not affect any rights or obligations of the company and it shall not render defective any legal proceedings by or against it.

Question 44

The Board of Directors of a company decide to pay 5% of issue price as underwriting commission to the underwriters. On the other hand the Articles of Association of the company permit only 3% commission. The Board of Directors further decide to pay the commission out of the proceeds of the share capital. Are the decisions taken by the Board of Directors valid under the Companies Act, 1956? (May 2003)

Answer

Underwriting Commission

Considering the provisions of Section 76 of the Companies Act, 1956:

- (i) The payment of commission should be authorised by the articles.

- (ii) The amount of commission should not exceed, in the case of shares, 5% of the price at which the shares have been issued or the amount or rate authorised by the articles whichever is less, and in the case of debentures, it should not exceed 2-1/2%.

Answer to problem:

Thus taking into account the above provisions it is concluded that the Board of Director's decision to pay 5% is not valid, since the payment cannot exceed 3% as provided in the Articles of the company. Secondly, decision of the Board to pay the commission out of capital is valid since underwriting commission can be paid both out of capital as well as out of profits (*Madan Lal Fakir Chand v. Shree Changdeo Sugar Mills Ltd. MR (1962) s.c. 1543*).

Question 45

Explain the provisions of the Companies Act, 1956 relating to establishment of an "Investors Education and Protection Fund." (May 2003)

Answer

Investor Education & Protection Fund:

A Fund called Investor Education and Protection Fund is established by Central Government under section 205C of the Companies Act 1956. The fund will be utilised for promotion of investor awareness and protection of investors [Section 205C(3)].

The fund will get amounts from the following sources [Section 205C(2)].

1. Amount of unpaid dividends.
2. Application moneys received by company for allotment of any securities and due for refund.
3. Matured but unpaid deposits with companies.
4. Matured but unpaid debentures with companies.
5. Interest accrued but unpaid on aforesaid amounts.
6. Grants and donations from Central Government, State Government, Companies or any other Institutions.
7. Interest or other income received out of the investments from the fund.

The amounts due for payment by company on account of dividend/refund of application money/debentures repayment/deposits repayment will be kept

by company for seven years. If these are not claimed by investor/share holder within seven years, these will be paid by company to the prescribed authority of the fund. Once the funds are transferred, the liability of company ceases. The investor/shareholder is not entitled to get any amount after it is transferred by company to the Fund.

A committee appointed by the Central Government will administer the investor fund and spend moneys out of the fund for carrying out objects for which the fund has been established. [Section 205C(3) and (4)].

Question 46

Advise the Board of Directors of a public limited company in relation to following matters, under the provisions of the Companies Act, 1956:

Answer

Sources of Dividend Declaration and Transfer of Profits:-

The dividend can be declared or paid by a company for any financial year only;-

- (i) out of profits of the company for that year arrived at after providing for depreciation in the manner laid down in the Act; or
- (ii) out of profits of the company for any previous financial year or years arrived at after providing for depreciation, and remaining undistributed, or
- (iii) out of both, or
- (iv) out of moneys provided by Central Government or a State Government for the payment of dividend in pursuance of a guarantee given by that Government

The Central Government may, if it thinks necessary so to do in the public interest, allow any company to declare or pay dividend for any financial year out of the profits of the company for that year or any previous financial year or years without providing for depreciation. [Section 205(1)].

Transfer to Reserves Upto 10 Percent of Profits

Before any dividend is declared or paid by a company for any financial year out of the profits of the company declared or paid by a company for any

financial year out of the profits of the company for that year, certain percentage of profits not exceeding 10 percent, as may be prescribed by Central Government, will be transferred to the reserves of the company. The company may, however, voluntarily transfer a higher percentage of its profits to the reserves.

The percentage of profits which have to be compulsorily transferred to reserves before declaration of dividend have been prescribed as under the Companies (Transfer of Profits to Reserves) Rules 1975:

Rate of proposed dividend as to paid up capital Minimum Amount to be transferred to reserves out of current profits.

- | | | | |
|--|-----|------|--------------------|
| (a) Where it exceeds 10% but does not exceed 12.5% | (a) | 2.5% | of current profits |
| (b) Where it exceeds 12.5% but does not exceed 15% | (b) | 5% | of current profits |
| (c) Where it exceeds 15% but does not exceed 20% | (c) | 7.5% | of current profits |
| (d) Where it exceeds 20%. | (d) | 10% | of current profits |

If the proposed dividend does not exceed 10% then there is no statutory obligation to transfer any amount to reserves out of current profits.

Question 47

A who holds one share certificate of 1000 Equity shares in a company, wants to transfer 300 shares in favour of B. Explain the procedure to be followed for executing the partial transfer under the provisions of the Companies Act, 1956. (May 2003)

Answer

Certification of Transfer:

Where a shareholder wishes to transfer only part of his shareholding or wishes to sell to them to two or more persons, he is required to lodge the share certificate with the company. Where he has already lodged with the company the relevant share certificate, together with an instrument of transfer for part of the shares, he may request the company to certify on the instrument of the transfer that the share certificate for the shares covered by the instrument of transfer has been *lodged* with the company. This is known as certification.

An instrument of transfer shall be deemed to be certified if it bears the words 'certificate lodged' or the words to the like effect. [Section 112(3)(a)]. Certification is, therefore, the act of noting by the secretary etc. stating that the share certificate has been lodged with the company. When only a portion of shares is transferred, the company usually issued him a ticket for the balance of shares which have not been transferred. Such a ticket is called a 'balance ticket'.

The certification by a company of a transfer as above is to be taken as a representation by the company to any person acting on faith of certification that there has been produced to the company such documents as, on the face of them, show prima facie title to the shares in the transfer. It is, however, not a representation that the transferor has any title to the shares. (Section 112(1)).

The company will be responsible for the certification only if:

- (a) the person issuing the installment is authorised to issue such installment on the company's behalf;
- (b) the certificate is signed by any officer or servant of the company or any other person authorised to certify transfer on the company's behalf.

Thus X holding 1000 shares in AJD Co . Limited is advised to act for certification of transfer in accordance with the provisions for partial transfer of his holding.

Question 48

State the conditions of restrictions with which a private company is incorporated under the Companies Act, 1956. (November 2003)

Answer

Restrictive conditions on the basis of which a company may be incorporated as a private company: Following are the restrictive conditions on the basis of which a company may be incorporated as a private company under the provisions of the Companies Act, 1956:

1. Restrictions on the right to transfer its shares.
2. Limitations on the number of members to 50 excluding past and present employees who are the members of the company.

3. Prohibition on inviting public to subscribe to any shares or debentures of the company.
4. Prohibition on invitation or acceptance of deposits from persons other than its members, directors or their relatives, [Section 3(1) (iii): Companies Act, 1956].

It is also necessary that every private company should have paid up capital of Rs. 1 Lac or such higher capital as may be prescribed.

Question 49

Briefly explain the doctrine of “ultravires” under the Companies Act, 1956. What are the consequences of ultravires acts of the company? (November 2003)

Answer

Doctrine of Ultra Vires and its effects: A company can do whatever is authorised by its object clause in the Memorandum of Association. It can also do anything, which is fairly incidental to or consequential upon the objects specified in the Memorandum. Any act done beyond the scope of the object clause, as specified in the Memorandum, is called ultra vires. Ultra means ‘beyond’ or ‘in excess of’ and vires means ‘power’. Thus ultra vires means an act beyond or in excess of the power of the company.

The leading case on the point is *Ashbury Ry. Carriage & Iron Co. Ltd V. Riche*. Where it was held that since the contract entered into by the company was not within the powers of the company as stated in the Memorandum, it was ultra vires the company and void so that even the subsequent assent of the whole body of shareholders could ratify it.

Effect of Ultra Vires transactions:

1. *Injunction:* Whenever a company does or proposes to do something beyond the scope of its activities or objects as laid down in the Memorandum, any of its members can get an injunction from the Court restraining the company from proceeding with the ultra vires act.
2. *Personal liability of directors:* Any member of a company can maintain an action against the directors of the company to compel them to restore to the company the funds of the company that have been employed by them in ultra vires transactions.

3. Breach of *warranty of authority*: When an agent exceeds his authority, he is personally liable for breach of warranty of authority in a suit by the third party.
4. *Ultra vires contract*. A contract of a company which is ultra vires the company is void ab initio and no legal effect.
5. *Ultra vires acquired property*: Although ultra vires transactions are void, yet if a company has acquired some property under an ultra vires transaction it has the right to hold that property and protect it against damage by other persons.
6. *Ultra vires torts*: A company is not liable for torts committed by its agents or servants during the course of ultra vires transactions.

Question 50

The Articles of Association of Mars Company Ltd. provides that documents may be served upon the company only through Fax. Ramesh despatches a document to the company by post, under certificate of posting. The company does not accept it on the ground that it is in violation of the Articles of Association. As a result Ramesh suffers loss. Explain with reference to the provisions of the Companies Act, 1956:

- (i) *What refusal of document by the company is valid?*
- (ii) *Whether Ramesh can claim damages on this basis?* (November 2003)

Answer

Problem on service of document upon a company: The problem as asked in the question is based on the provisions of the Companies Act, 1956 as contained in Section 51. Accordingly a document may be served on a company or on its officer at the registered office of the company. It must be sent either by post or by leaving it at its registered office. If it is sent by post, it must be either by post under a certificate of posting or by registered post. When a notice has been addressed to the company and served on the directors, it constitutes a good service (*Benabo v. Jay (William) and Partners Ltd.*) The articles of a company which contain the provisions contrary to Section 51 cannot be enforced nor can they limit the mode of service to only one of the modes provided by the Statute (*Sadasiv Shankar Dandige V. Gandhi Seva Samaj Ltd.*).

Accordingly in the first case the refusal by the Mars Company Ltd. of the service of the document is not valid.

In the second case Ramesh can claim damages on this account from the Company.

Question 51

State the conditions which are required to be fulfilled before declaration of "Interim Dividend" under the Companies Act, 1956. (November, 2003)

Answer

Interim Dividend; Conditions to be fulfilled: According to section 2(14A) "dividend" includes interim dividend. Board can declare interim dividend, as it is authorized by section 205(1A) unless it is specifically prohibited on the articles. According to Section 205(1C), the provisions contained on (Sections 205, 205A, 205C, 206 206A, and 207) shall, as far as may be, also apply to any "Interim dividend". According to section 205(i), dividend can be paid only out of profits. Hence, before declaring an interim dividend, the directors must satisfy themselves that:

1. the financial position of the company warrants the payment of such dividend out of profits available for distribution.
2. the interim accounts prepared by the company must disclose profits sufficient for the declaration of dividend after making appropriate provisions for depreciation, compulsory transfers to reserves, bad debts and other contingencies, only then the proportion of profits which have to be distributed as interim dividend may be decided.
3. the company must also be in a position to deposit the amount of interim dividend in a separate bank account within 5 days from the date of declaration of interim dividend.

Question 52

Explain the provisions of the Companies Act, 1956 relating to the procedure to be followed for transacting business of the general meeting of members of a company through postal ballot..

(November 2003)

Answer

Procedure for transacting business of the General Meeting through Postal Ballot

The new section 192(A) of the Companies Act 1956, provides for procedures to be followed by the company for ascertaining the views of the members by postal ballot.

Procedure to be followed for conducting business through postal ballot is as under:

- (i) The company may make a note below the notice of general meeting for understanding of members that the transactions) at serial number requires consent of shareholders through postal ballot.
- (ii) The board of directors shall appoint one scrutinizer, who is not in employment of the company, may be a retired judge or any person of repute who, in the opinion of the board can conduct the postal ballot voting process in a fair and transparent manner.
- (iii) The scrutinizer will be in a position for 35 days (excluding holidays) from the date of the issue of notice for annual general meeting. He has to submit his final report on or before the said period.
- (iv) The scrutinizer will be willing to be appointed and he is available at the registered office of the company for the purpose of ascertaining the requisite majority.
- (v) The scrutinizer shall maintain a register to record to consent or otherwise received, including electronic media, mentioning the particulars of name, address, folio number, number of share, nominal value of shares, whether the shares have voting, differential voting or non-voting rights and the scrutinizer shall also maintain record for postal ballot which are received in defaced or mutilated form. The postal ballot and all other papers relating to postal ballot will be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes of the meeting. Thereafter, the scrutinizer shall return the ballot papers and other related papers/registers safely till the resolution is given effect to:
- (iv) Consent or otherwise relating to issue mentioned in notice for annual general meeting received after 35 days from the date of issue will be strictly treated as if the reply from the member has not been received. (Companies (Passing of the resolution by Postal Ballot) Rules, 2001. Notification No. G.S.R. 337 (E), dated 10th May, 2001).

Question 53

A Company was incorporated on 6th October, 2003. The certificate of incorporation of the company was issued by the Registrar on 15th October, 2003. The company on 10th October, 2003 entered into a contract, which created its contractual liability. The company denies from the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide, under the provisions of the Companies Act, 1956, whether the company can be exempted from the said contractual liability.

(November 2003)

Answer

Certificate of Incorporation and the binding effect:

Upon the registration of the documents as required under the Companies Act, 1956 for incorporation of a company, and on payment of the necessary fees, the Registrar of Companies issues a Certificate that the company is incorporated (Section 34).

Section 35 provides that a certificate of incorporation issued by the Registrar is conclusive as to all administrative acts relating to the incorporation and as to the date of incorporation. The facts as given in the problem are similar to those in case of *Jubilee Cotton Mills v. Lewis (1924) A.C. 1958* where it was held that an allotment of shares made on the date after incorporation could not be declared void on the ground that it was made before the company was incorporated when the certificate of incorporation was issued at a later date.

Applying the above principles the contention of the company in this case cannot be tenable. It is immaterial that the certificate of incorporation was issued at a later date. Since the company came into existence on the date of incorporation stated on the certificate, it is quite legal for the company to enter into contracts. To conclude the contracts entered into by the company before the issue of certificate of incorporation shall be binding upon the company. The date of issue of certificate is immaterial.

Question 54

Dinesh, a director in a company, gave in writing to the company that notice for any General Meeting and the Board of Directors' Meeting be sent to him at his address in India only by Registered Mail and for which he paid sufficient money. The company sent two notices to him, of such meetings, by ordinary mail, under certificate of posting. Dinesh did not receive the said notices and

could not attend the meetings and the proceedings thereof on the ground of improper notice. Decide in the light of the provisions of the Companies Act, 1956:

- (i) Whether the contention of Dinesh is valid?*
- (ii) Would your answer be still the same in case Dinesh remained outside India for two months (when such notices were given and meetings held) (November 2003)*

Answer

Problem on notice and validity of proceedings of the meeting: The problem as asked in the question is based on the provisions of the Companies Act, 1956 as contained in Section 172 read with Section 53. Accordingly, the notice may be served personally or sent through post to the registered address of the members and, in the absence of any registered office in India, to the address, if there be any within India furnished by him to the company for the purpose of servicing notice to him. Service through post shall be deemed to have effected by correctly addressing, preparing and posting the notice. If, however, a member wants to notice to be served on him under a certificate or by registered post with or with acknowledgement due and has deposited money with the company to defray the incidental expenditure thereof, the notice must be served accordingly, otherwise service will not be deemed to have been effected.

Accordingly, the questions as asked may be answered as under:

- (i) The contention of Dinesh shall be tenable, for the reason that the notice was not properly served and meetings held by the company shall be invalid.*
- (ii) In view of the provisions of the Companies Act, 1956, as contained in Section 172, the company is not bound to send notice to Dinesh at the address outside India. Therefore, answer in the second case shall differ from the first one.*

Question 55

Explain the provisions of the Companies Act, 1956 relating to holding of Annual General Meeting of the Company with regard to the following:

- (i) Period within which the first and the subsequent Annual General Meetings must be held.*

(ii) *Business which may be transacted at an Annual General Meeting.* (November 2003)

Answer

Annual General Meeting provisions under the Companies Act, 1956:

- (i) *Period Within which first and the subsequent AGM must be held:*
- (a) In accordance with the provisions of the Companies Act, 1956 as contained in incorporation, and so long as the company hold its first annual general meeting within that period, the company need not hold any general meeting in the year of incorporation or in the following year (First proviso to Section 166(1). Further, the date of the first AGM must be within 9 months from the date of the financial year for which profit and loss account has been made,
 - (b) Any subsequent AGM must be held not later than 6 months from the close of the financial year of the company. The gap between the two consecutive AGMs must not be more than 15 months [Section 166(1)]. Further the second proviso to Section 166(1) states that the Registrar may, for any special reason, extend the time within which any AGM (not being the first AGM) shall be held by a period not exceeding 3 months.
- (ii) *Business to be Transacted at an Annual General Meeting:* The following two businesses may be transacted at an annual general meeting:
- 1. Ordinary Business; Viz.
 - (a) Consideration of Annual Accounts, Directors Report etc.
 - (b) Declaration of Dividend.
 - (c) Election of Directors.
 - (d) Appointment of auditors and fixation of their remuneration.
 - 2. Special Business: Any business other than above 4 shall be special business, which may be transacted at any AGM.

Question 56

What are the provisions of the Companies Act, 1956 relating to the appointment of 'Debenture Trustee' by a company? Whether the following can be appointed as 'Debenture Trustee':

- (i) *A shareholder who has no beneficial interest.*

- (ii) A creditor whom the company owes Rs. 499 only.
- (iii) A person who has given a guarantee for repayment of amount of debentures issued by the company. (November 2003)

Answer

Appointment of Debenture Trustee: Section 117 B as introduced by the Companies (Amendment) Act, 2000 deals with the appointment and duties of debenture trustees. It is now provided that before issue of prospectus or letter of offer for the debentures, the company should appoint one or more debenture trustees and disclose their names and also state that they have given their consent. It is also provided that (i) a shareholder who has beneficial interest in shares (ii) creditor or (iii) a person who has given guarantee for repayment of principal and interest in respect of the debentures cannot be appointed as a debenture trustee.

Thus based on the above provisions answers to the given questions are:

- (i) A shareholder who has no beneficial interest can be appointed as a debenture trustee.
- (ii) A creditor whom company owes Rs. 499 cannot be so appointed. The amount owed is immaterial.
- (iv) A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also cannot be appointed as a debenture trustee.

Question 57

Examine the provisions of the Companies Act, 1956 regarding 'nomination' in case of transmission of shares (November 2003)

Answer

Operation of nomination facility in case of transmission of shares under the provisions of Companies Act, 1956: If nominee becomes entitled to any shares by virtue of nomination, he will apply to company along with proof of death of holder/joint-holders. He can either request Board to register himself as the shareholder or he can transfer the shares of deceased shareholder [Section 109B(1)]. Thus, the nominee can either register his name or directly transfer the shares in some others' name.

If he elects to be registered holder of shares, he will have to send a written notice to the company stating that he elects to be the registered holder. Such notice should be accompanied by death certificate of shareholder [Section 109B(2)].

All limitations, restrictions and provisions of the Act relating to the right of transfer and registration of transfer will apply as if the application is for transfer of shares [Section 109B(3)]. In other words, transfer in name of nominee or other person to whom nominee intends to transfer shares can be declined only on the grounds on which any transfer can be declined, and no other grounds.

The nominee is entitled to all rights of deceased member like dividend and bonus. However, he will not be eligible for voting rights or other rights as a member, unless he makes application in writing and is registered as a member in respect of the shares.

The nominee must either register himself as member or transfer the shares in some other's name. If he does neither, company can send him a notice to elect either to become a member or transfer the shares. If the nominee does not comply within 90 days, Board can withhold payment of dividends, bonuses or other money payable, till the requirement of notice is complied with [Section 109B(4)].

Question 58

What do you understand by Pre-incorporation Contracts? Distinguish between Pre-incorporation contracts and Provisional contracts. (May 2004)

Answer

Pre-Incorporation Contracts

The promoters of a company usually enter into contracts to acquire some property or right for the company to be incorporated. Such contracts are called pre-incorporation contracts or preliminary contracts. Since a company comes into existence from the date of its incorporation, it follows that any act purporting to be performed by it prior to that date is of no effect so far as the company is concerned. After incorporation, the company may adopt the preliminary contract and it must be by novation. Further a company may enforce a pre-incorporation contract if it is warranted by the terms of incorporation of the company.

Following are the differences between Pre-incorporation and Provisional Contracts:

- (i) Contracts, which are made before the company comes into existence, are called pre-incorporation contracts, while contracts which are entered into by a public company after obtaining the certificate of incorporation but before getting the certificate to commence business are known as provisional contracts.
- (ii) The company is not bound by the pre-incorporation contract unless the company adopts the same after incorporation. But provisional contracts shall be binding on the company from the date on which the company is entitled to commence business.
- (iii) Pre-incorporation contracts can be enforced against the company if it is warranted by the terms of incorporation of the company and for the purposes of the company, while the provisional contracts cannot be enforced should the company go into liquidation without commencing business.

Question 59

What is the procedure laid down in the provisions of the Companies Act, 1956 for converting a private company into a public company ? (May 2004)

Answer

Conversion of Private Company into a Public Company

Procedure for conversion of a private company into a public company is as follows:

- (i) Take necessary decision in its Board Meeting and fix up time, place and Agenda for convening Annual General Meeting.
- (ii) Amend Memorandum to change its name by removing the word 'Private' by a special resolution. Approval of Central Government is not necessary for change of name.
- (iii) Must pass a special resolution deleting from its articles the requirements of a private company under Section 3(1)(iii). Such other articles which do not apply to a public company should be deleted and those which apply should be inserted. A copy of the special resolution must be filed with the Registrar of Companies within 30 days. It becomes a public company on the date of alteration [Section 44(1)(a)].
- (iv) Increase the number of shareholders to at least 7 and number of directors to at least 3.
- (v) Within 30 days from the passing of the Special Resolution, a prospectus or a statement in lieu of prospectus in the prescribed form must be filed with the Registrar [Section 44(1)].
- (vi) The aforesaid prospectus or the statement in lieu of prospectus must be in conformity with Part I and II of Schedule II or with Part I and II of Schedule IV respectively. The prospectus or statement in lieu of prospectus must be true and not misleading [Section 44(2) and (3)].
- (vii) The company has to apply to the Registrar for the issue of a fresh Certificate of Incorporation, for the changed name, namely, the existing name with the word 'private' deleted.

Question 60

Can a company issue shares at discount? What is the law, in this relation, laid down in the Companies Act, 1956?
(May 2004)

Answer

Issuing shares at discount

A company cannot issue shares in disregard of section 79. It may issue shares at a discount only if all the following conditions are fulfilled.

- (i) The shares must be of a class already issued.
- (ii) The issue must have been authorised by a resolution passed by the company in general meeting, a sanctioned by the Company Law Board/Central Government.
- (iii) The said resolution must specify the maximum rate of discount at which the shares are to be issued. By virtue of the proviso added to Section 79 by the Amendment Act, 1974, no such resolution shall be sanctioned by the Company Law Board/Central Government if the maximum rate of discount specified in the resolution exceeds 10%, unless the Company Law Board/Central Government is of the opinion that a higher percentage of discount may be allowed in the special circumstance of the case.
- (iv) At the date of issue, not less than one year ought to have elapsed since the date on which the company was entitled to commence business.
- (v) Lastly, the shares to be issued at a discount have issued within 2 months after the date of the Company Law Board/Central Government sanction or within the time extended by it.
- (vi) Every prospectus relating to the issue of the shares must contain particulars of the discount allowed on the issue of the shares or so much of that discount as has not been written off at the date of issue of the prospectus.

Unless all the above conditions are fulfilled, a company cannot issue shares at discount.

Question 61

The Articles of Association of a Limited Company provided that 'X' shall be the Law Officer of the company and he shall not be removed except on the ground of proved misconduct. The company removed him even though he was not guilty of misconduct. Decide, whether company's action is valid? (May 2004)

Answer

Removal of Law Officer

The Memorandum and Articles of Association of a company are binding upon company and its members and they are bound to observe all the provisions of

memorandum and articles as if they have signed the same [Section 36(1)]
However, company and members are not bound to outsiders in respect of anything contained in memorandum/articles. This is based on the general rule of law that a stranger to a contract cannot acquire any right under the contract.

In this case, Articles conferred a right on 'X', the law officer that he shall not be removed except on the ground of proved misconduct. In view of the legal position explained above, 'X' cannot enforce the right conferred on him by the articles against the company. Hence the action taken by the company (i.e. removal of 'X' even though he was not guilty of misconduct) is valid. (*Eley V Positive Govt. Security Life Assurance Co., Major General Shanta Shamsher jung V Kamani Bros. P. Ltd.*)

Question 62

"Diminution of capital does not constitute reduction of capital within the provisions of the Companies Act, 1956," – Comment. (May 2004)

Answer

Diminution/Reduction of Capital

Section 94(3) of the Companies Act, 1956 specifically states that diminution does not constitute a reduction of capital within the meaning of the Companies Act. Distinction can be made between the two on the following grounds:

- (i) Diminution of capital is the cancellation of the unsubscribed part of the issued capital while reduction of capital involves reduction of subscribed capital or paid-up capital.
- (ii) Both require authorisation by articles but whereas diminution can be effected by an ordinary resolution, while reduction can be effected by a special resolution.
- (iii) Diminution needs no confirmation by the Court/Tribunal [Section 94(2)], but reduction needs such confirmation (Section 101).
- (iv) A Company may be ordered to add the words 'and reduced' after its name in case of reduction but no such order can be passed in case of diminution.

Question 63

A company issued a prospectus. All the statements contained therein were literally true. It also stated that the company had paid dividends for a number of years, but did not disclose the fact that the dividends were not paid out of trading profits, but out of capital profits. An allottee of shares wants to avoid the contract on the ground that the prospectus was false in material particulars. Decide. (May 2004)

Answer

Mis-leading Prospectus

Any person who takes shares on the faith of statement of facts contained in a prospectus can rescind the contract if those statements are false or untrue. The words 'untrue statement' have to be construed as explained in Section 65(1)(a), which says that a statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included. Again, where the omission from a prospectus of any matter is calculated to mislead, the prospectus is deemed, in respect of such

omission to be a prospectus in which an untrue statement is included [Section 65(1)(b)].

In this case, the fact that dividends were paid out of capital profit and not out of trading profits was not disclosed in the prospectus and to that extent the prospectus contained a material misrepresentation of a fact giving a false impression that the company was a profitable one. Hence the allottee can avoid the contract of allotment of shares. (Rex V. Lord Kylsant).

Question 64

Which of the institutions are regarded as “Public Financial Institutions” under the Companies Act, 1956?
(May 2004)

Answer**Public Financial Institutions**

By virtue of Section 4A of the Companies Act, 1956 the following institutions are to be regarded as public financial institutions:

- (i) The Industrial Credit and Investment Corporation of India Ltd.
- (ii) The Industrial Finance Corporation of India
- (iii) The Life Insurance Corporation of India
- (iv) The Industrial Development Bank of India
- (v) The Unit Trust of India
- (vi) The Infrastructure Development Finance Company Ltd.
- (viii) The Securitisation Co., or The Reconstruction Co. which has been registered under The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

The Central Government is empowered under Section 4A(2) to add any other institution to the above list. This addition has to be made through a notification, in the Official Gazette. Secondly, the institution for being added to the existing list, (i) must have been established or constituted by or under any Central Act; or (ii) at least 51% of the paid-up share capital of such new institution is held or controlled by the Central Government. In exercise of this power, the Central Government has notified more than 30 institutions as Public Financial Institutions.

Question 65

What is the concept of “charge” under the provisions of the Companies Act, 1956? Point out the circumstances where under a floating charge becomes a fixed charge.
(May 2004)

Answer**Meaning of Charge**

The word 'charge' has not been adequately defined in the Companies Act, 1956 except that Section 124 provides that the expression charge shall include a mortgage. However, it can be understood that where in transaction for value, both parties' evidence the intention that property existing or future shall be made available as security for the payment of a debt and that the creditor/mortgage shall have a present right to have it made available, there is a charge.

The conditions of borrowing, as they normally do confer charge on the company's assets (movables as well as immovables). It is thus important for those dealing with the company to know how much of its assets are subjected to charges or actually charged. To this end, Section 125 of the Act contain provisions whereby particulars of charges which encumber company's properties without actually delivering possession thereof to be filed and registered on the company's file at the office of the registry i.e. Registrar of Companies.

Under Section 125 of the Act certain charges are required to be registered with the Registrar of Companies. If any of these charges are not registered, then the unregistered charge shall be void against the liquidators and creditors of the company. (*Monolithic Building (Co.)*). The money secured thereby becomes immediately payable. [Section 125(3)].

Crystallisation of a Floating Charge

Floating charge crystallizes under the following circumstances:

1. When the company goes into liquidation, or
2. When the company ceases to carry on business, or
3. When a receiver is appointed, or
4. When default is made in paying the principal and/or interest and the holder of the charge brings an action to enforce his security.

Question 66

Explain the provisions of the Companies Act, 1956 relating to registration of a non-profit organisation as a company. What procedure is required to be adopted for the said purpose?

(May 2004)

Answer

Associations not for Profit

According to Section 13, the name of a limited company must end with the word 'Limited' in the case of a Public Company, and with the words "Private Limited" in the case of a private company. Section 25 of the Companies Act, 1956, however, permits the registration, under a licence granted by the Central Government, of an association not for profit with limited liability without adding the word "Limited" or the words "Private Limited" to its name.

Conditions for grant of licence

The Central Government may grant such a licence to an association where it is proved to the satisfaction of the Central Government that it-

- (a) Is about to be formed as a limited company for promoting commerce, science, religion, charity or any other useful object; and
- (b) Intends to apply its profits, if any, or other income in promoting its objects and to prohibit the payment of any dividend to its members.

The Central Government may, by licence, direct that the association may be registered as a company with limited liability, without the addition to its name of the word "Limited" or the words "Private Limited". The association may thereupon be registered accordingly. On registration it enjoys all the privileges, and is subject to all the obligations of limited companies.

A licence may be granted by the Central Government on such conditions and subject to such regulations, as it thinks fit. The condition and regulations are binding on the body to which the licence is granted. The licence may be revoked at any time by Central Government after giving an opportunity to the company for being heard.

Procedure for Registration of a Company under Section 25

The promoters must apply to the Central Government for a licence under Section 25 for registration of the company without the word 'limited' or 'Private Limited' as part of its name. The promoters must comply with the conditions subject to which the licence is issued. Thereafter apply to Registrar of Companies for incorporation of the company in the manner in which any other company is registered i.e., filing of documents like Memorandum of Association, Articles of Association, list of first directors, declaration in the prescribed form.

Question 67

What are the purposes for which “objects” can be altered by a company under the Companies Act, 1956? Briefly explain the procedure to be applied to such matters. (May 2004)

Answer

Alteration of Objects

Section 17 of the Companies Act, 1956 permits the alteration of the objects, only so far as is considered necessary for specified purpose. Such purposes are as under [Section 17(1)]:

- (a) to carry on business more economically.
- (b) to attain the main purpose of the company by new or more improved means.
- (c) to carry on some business which under the existing circumstances may conveniently or advantageously be combined with the existing business.
- (d) to change and enlarge the local areas of operations.
- (e) to restrict or abandon any of the existing objects.
- (f) to sell or dispose of the whole or any part of the undertaking.
- (g) to amalgamate with any other object or body of persons.

Procedure

Companies are now under liberty to alter the object clause of the memorandum of association without the confirmation from Company Law Board. However, alteration can be made only on the grounds stated above.

Object clause can be altered simply by passing a special resolution in general meeting of members. The special resolution should be filed with the Registrar of Companies within one month from the date of resolution along with a printed copy of the memorandum as altered. The Registrar will register the document and issue a certificate, which will be conclusive evidence that all the requirements with respective alterations have been complied with and memorandum so altered shall be the memorandum of the company.

If the documents required to be filed with the Registrar under Section 18 are not filed within the prescribed time, the alteration shall at the expiry of such period, become void and inoperative (Section 19).

Question 68

Explain the concept of “Deemed Prospectus” under the Companies Act, 1956. Point out the circumstances where under issuing the prospectus is not mandatory.
(May 2004)

Answer

Deemed Prospectus

In order to avoid the rigorous requirements of prospectus, one practice was to issue shares to another person. Such other person (often called 'Issue House') would then make further offer of sale of their shares to public by advertisements, etc. In order to curb this tendency Section 64 provides that 'offer of sale' or advertisement of such 'Issue House' will be deemed to be prospectus issued by the company. This is called deemed prospectus. All enactments and rules of law as to the contents of prospectus and as to the liability in respect of statements, omissions from prospectus under Section 60, the persons making the offer of sale to the public are to be deemed as directors of the company [Section 64(4)].

The 'offer of sale' by Issue House will not be considered as 'Prospectus' only when (a) company receives full consideration in respect of shares/debentures allotted to Issue House or agreed to be allotted to them and (b) offer of sale is made at least 6 months after the shares were allotted to them [Section 64(2)].

Additional information to be stated in such documents are (1) net amount of consideration received or to be received by the company in respect of shares or debentures to which offer relates and (2) place and time at which the contract under which the shares or debentures have been allotted or are to be allotted may be inspected [Section 64(3)].

When Prospectus need not be issued

The issue of prospectus under Section 56 of the Companies Act, 1956 is not necessary in the following circumstances even though the shares are offered and applications forms issued to the public by the company:

- (i) Where a person is a bona fide invitee to enter into an underwriting agreement with regard to shares or debentures. (Section 56(3)(a)).
- (ii) Where shares or debentures are not offered to the public (Section 56(3)(b)).

- (iii) Where shares or debentures offered are in all respects uniform with shares or debentures already issued and quoted at a recognised Stock Exchange. (Section 56(5)).
- (iv) Where the shares or debentures are offered to the existing shareholders or debenture-holders respectively [Section 56(5)].

Question 69

Some of the creditors of M/s Get Rich Quick Ltd. have complained that the company was formed by the promoters only to defraud the creditors and circumvent the compliance of legal provisions of the Companies Act, 1956. In this context they seek your advice as to the meaning of corporate veil and when the promoters can be made personally liable for the debts of the company.
(November 2004)

Answer

Corporate Veil

After incorporation the company in the eyes of law is a different person altogether from the shareholders who have formed the company. The company has its own existence and as a result the shareholders cannot be held liable for the acts of the company even though the shareholders control the entire share capital of the company. This is popularly known as Corporate Veil and in certain circumstances the courts are empowered to lift or pierce the corporate veil by ignoring the company and directly examine the promoters and others who have managed the affairs of the company after its incorporation. Thus, when the corporate veil is lifted by the courts, (i.e., the courts have disregarded the company as an entity), the promoters can be made personally liable for the debts of the company. In the following circumstances, corporate veil can be lifted by the courts and promoters can be held personally liable for the debts of the company.

- (i) Trading with enemy country.
- (ii) Evasion of taxes.
- (iii) Forming a subsidiary company to act as its agent.
- (iv) The benefit of limited liability is destroyed by reducing the number of members below 7 in the case of public company and 2 in the case of private company for more than six months.
- (v) Under law relating to exchange control.

(vi) Device of incorporation is adopted to defraud creditors or to avoid legal obligations.

Question 70

M/s ABC Ltd. a company registered in the State of West Bengal desires to shift its registered office to the State of Maharashtra. Explain briefly the steps to be taken to achieve the purpose.

Would it make a difference, if the Registered Office is transferred from the Jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the same State? (November 2004)

Answer

Transfer of Registered Office of a Company

In order to shift the registered office from the State of West Bengal to the State of Maharashtra, M/s ABC Ltd has to take the following steps:

- (i) To pass a special resolution and thereafter file the same with the Registrar of Companies.
- (ii) To file a Petition before the Company Law Board (Central Government)* under Section 17, of the Companies Act, 1956.
- (iii) To give an advertisement in two newspapers one in English language and the other in local language indicating the change and any member/creditor having objection can write to the Company Law Board (Central Government)*.
- (iv) To give notice to the State Government of West Bengal.
- (v) To submit all the required documents along with the fee to Company Law Board (Central Government)*.

The Company Law Board (Central Government)* after hearing the petition passes an order confirming the alteration in the memorandum of association of the company regarding the shifting of the registered office. The Company Law Board's (Central Government)* order should be filed by ABC Ltd with both the Registrars of Companies West Bengal and Maharashtra. After registration of the said order the Registrar of Companies Maharashtra will issue a certificate which is the conclusive proof that all the formalities have been complied with.

Change of registered office from the jurisdiction of one Registrar to the other Registrar within the same State: The procedure and law pertaining to the change of registered office from the jurisdiction of one Registrar to the other Registrar within the same State is contained in Section 17A of the Companies Act, 1956 as amended upto date is as follows:

- (i) Company can do so only if the Regional Director permits to it.
- (ii) Application for permission has to be made on a prescribed form.
- (iii) The Regional Directors are required to confirm the Company's application and inform it accordingly within a period of four weeks.
- (iv) After getting the confirmation of the Regional Director, the company must file a copy of the same with the Registrar of Companies within two

months from the date of the confirmation together with a copy of the altered memorandum.

- (v) The Registrar is required to register the same and inform the company within one month from the date of filing.
- (vi) The Registrar's certificate is a conclusive evidence of the fact of alteration and of compliance with the requirements (Section 17-A).

(*Note: Students may kindly note that, all Sections of the Companies (Second Amendment) Act, 2002 have not come into force. Till such time, jurisdiction of Company Law Board will continue to remain unchanged.)

Question 71

M/s Honest Cycles Ltd. has received an application for transfer of 1,000 equity shares of Rs. 10 each fully paid up in favour of Mr. Balak. On scrutiny of the application form it was found that the applicant is minor. Advise the company regarding the contractual liability of a minor and whether shares can be allotted to the Balak by way of transfer. (November 2004)

Answer

The Companies Act, 1956 does not prescribe any qualification for membership. Membership entails an agreement enforceable in a court of law. Therefore, the contractual capacity as envisaged by the Indian Contract Act, 1872 should be taken into consideration. It was held in the case of *Mohri Bibi Vs. Dharmadas Ghose (1930) 30 Cal. 531 (P.O.)* that since minor has no contractual capacity, the agreement with a minor is void. Therefore, a minor or a lunatic cannot enter into an agreement to become a member of the company. However, the Punjab High Court held in the case of *Diwan Singh vs. Minerva Films Ltd (AIR 1956 Punjab 106)* that there is no legal bar to a minor becoming a member of a company by acquiring shares by way of transfer provided the shares are fully paid up and no further obligation or liability is attached to these. The same view was upheld by the Company Law Board in the case of *S.L. Bagree Vs. Britannia Industries Ltd (1980)*.

In view of the above, M/s Honest Cycles Ltd can give membership to Balak through 1000 shares, received by way of transfer, in favour of Mr. Balak a minor because the shares are fully paid up and no further liability is attached to these.

Question 72

Explain briefly the distinction between shares and debentures and state whether a company can issue debentures with voting rights. (November 2004)

Answer

The distinction between a share and a debenture is as under:

- (i) Shares are a part of the capital of a company whereas debentures constitute a loan.
- (ii) The shareholders are the owners of the company whereas debenture holders are creditors.
- (iii) Shareholders generally enjoy voting right whereas debenture holders do not have any voting right.
- (iv) Interest on debentures is payable even if there are no profits. Dividend can be paid to shareholders only out of the profits of the company.
- (v) Debentures have generally a charge on the assets of the company but shares do not carry any such charge.
- (vi) The rate of interest is fixed in the case of debentures whereas on equity shares the dividend may vary from year to year.
- (vii) Debentures get priority over shares in the matter of repayment in the event of liquidation of the company.

Issue of Debentures with voting rights

No company can issue any debentures carrying voting rights at any meeting (i.e., members' general meeting) of the company, whether generally or in respect of any particular class of shares (Section 117). This provision applies to debentures issued after the commencement of the Companies Act (Section 117 of 1956 Act).

Question 73

What is meant by "Abridged prospectus". Under what circumstances a company issuing abridged prospectus need not accompany the prescribed details along with the application form for issue of shares? (November 2004)

Answer

Abridged Prospectus: As per Section 2(1) of the Companies (Amendment) Act, 2000 "abridged prospectus means a memorandum containing such salient features of a prospectus as may be prescribed." By the Amendment

Act of 1988 the company was permitted to furnish an abridged form of prospectus along with the application for shares or debentures instead of the full prospectus. The Government has revised the format of abridged prospectus to provide for greater disclosure of information to prospective investors so as to enable them to take an informed decision regarding investment in shares and debentures.

The abridged prospectus (in Form 2A) and the share application form should bear the same printed number. The investor may detach the share application form along the perforated line after he has had an opportunity to study the contents of the abridged prospectus, before submitting the same to the company or its designated bankers.

Circumstances where details are not required in the abridged prospectus:

- (1) Where the offer is made in connection with a bona fide invitation to a person to enter into an undertaking agreement with respect to the shares or debentures.
- (2) Where the shares or debentures are not offered to the public.
- (3) Where the offer is made only to the existing members or debenture holders of the company.
- (4) Where the shares or debentures offered are in all respects uniform with shares or debentures already issued and quoted on a recognized stock exchange.
- (5) Where a prospectus is issued as a newspaper advertisement, it is not necessary to specify the contents of the memorandum, or the names etc., of the signatories to the memorandum or the number of shares subscribed for by them.

Question 74

M/s Low Esteem Infotech Ltd. was incorporated on 1.4.2003. No General Meeting of the company has been held so far. Explain the provisions of the Companies Act, 1956 regarding the time limit for holding the first annual general meeting of the Company and the power of the Registrar to grant extension of time for the First Annual General Meeting. (November 2004)

Answer

According to Section 166 of the Companies Act, 1956, every company shall hold its first annual general meeting within a period of 18 months from the

date of incorporation. Since M/s Low Esteem Infotech Ltd was incorporated on 1.4.2003, the first annual general meeting of the company should be held on or before 30th September, 2004. Even though the Registrar of Companies is empowered to grant extension of time for a period not exceeding 3 months for holding the annual general meeting, such a power is not available to the Registrar in the case of the first annual general meeting. Thus, the company and its directors will be liable for the default if the annual general meeting was held after 30th September, 2004.

Question 75

Annual General Meeting of a Public Company was scheduled to be held on 15.12.2003. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him in favour of Mr. 'X' and Mr. T. The proxy in favour of 'Y' was lodged on 12.12.2003 and the one in favour of Mr. X was lodged on 15.12.2003. The company rejected the proxy in favour of Mr. X as the proxy in favour of Mr. Y was of dated 12.12.2003 and thus in favour of Mr. X was of dated 13.12.2003. Is the rejection by the company in order? (November 2004)

Answer

In case more than one proxies have been appointed by a member in respect of the same meeting, one which is later time shall prevail and the earlier one shall be deemed to have been revoked. Thus, in the normal course, the proxy in favour of Mr. X, being later in time, should be upheld as valid.

But, as per Section 176 of the Companies Act, 1956, a proxy should be deposited 48 hours before the time of the meeting. In the given case, the proxies should have, therefore, been deposited on or before 13.12.2003 (the date of the meeting being 15.12.2003). X deposited the proxy on 15.12.2003. Therefore, proxy in favour of Mr. X has become invalid. Thus, rejecting the proxy in favour of Mr. Y is unsustainable. Proxy in favour of Y is valid since it is deposited in time.

Question 76

The Board of Directors of M/s Reckless Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus or filing a statement in lieu of prospectus with the Registrar of Companies, Mumbai. Explain the remedies available to the investors in this regard. (November 2003)

Answer

According to the provisions of Section 70 and 71 of the Companies Act, 1956, any allotment of shares by a company without filing a prospectus or statement in lieu of prospectus will become irregular allotment. The effect of it is that the allotment made by M/s Reckless Investment Ltd will become voidable at the instance of the allottee i.e., the applicant for the shares within a period of two months from the date of allotment. The allotment is voidable at the option of the investor applicant even if the company is in the course of winding up. Further, the directors liable for the default are also liable to compensate the company and the allottee respectively for any loss to which the company may have sustained or incurred thereby. There is a time limit of two years for claiming damages for loss. etc., by the investors.

Question 77

What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital.
(November 2004)

Answer

Meaning of Guarantee Company: Where it is proposed to register a company with limited liability, the choice is to limit liability by shares or by guarantee. Section 12(2)(b) of the Companies Act, 1956 defines it as a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the member of a guarantee company is limited by a stipulated amount mentioned in the memorandum. The members cannot be called upon to contribute more than the stipulated amount for which they have guaranteed in the memorandum of association of that company. The articles of association of such company shall state the number of members with which the company is to be registered.

Similarities and dis-similarities between the Guarantee Company and the Company having share capital: The common features between a “guarantee company” and the “company having share capital” are legal personality and limited liability. In case of the later company, the members’ liability is limited by the amount remaining unpaid on the shares, which each member holds. Both of them have to state this fact in their memorandum that the members’ liability is limited.

However, the dissimilarities between a 'guarantee company' and 'company having share capital' is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in latter case, they may be called upon to do so at any time, either during the company's life or during its winding up.

Further to note, the Supreme Court in *Narendra Kumar Agarwal vs. Saroj Maloo* (1995) 6 SC C 114 has laid down that 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.

It is also clear from the definition of the guarantee company that it 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 these funds can be had from other sources like endowment, fees, charges, donations etc.

Question 78

The Board of Directors of M/s Optimistic Company Ltd. propose to pay interim dividend of Rs.2 per equity share of Rs. 10 each. Advise the Board regarding:

- (i) the time limit for payment of interim dividend to the shareholders, and*
- (ii) steps to be taken in case any dividend amount remains unpaid in the books of the company.* *(November 2004)*

Answer

The Board of directors of M/s Optimistic Company Ltd should take the following steps for declaration and payment of interim dividend;

- (i) The Board should carefully assess the adequacy of profits since in the event of absence or inadequacy of profits, the distribution would amount to reduction of capital.
- (ii) The interim dividend amount should be deposited in a special bank account.
- (iii) Depreciation on assets should be provided for the full year.
- (iv) If there is a carry forward loss from past years, the same should be adjusted against the estimated profits.

- (v) The company should transfer to reserves the prescribed percentage of the estimated profits of the period arrived at after providing for current year's depreciation and arrears of depreciation/loss.

Time Limit:

Interim dividend should be paid within 30 days. If any amount of interim dividend remains unpaid or unclaimed, for more than 30 days, the same should be transferred to a special account in a Scheduled Bank called 'Unpaid Interim Dividend Account of M/s Optimistic Company Ltd. Any amount remaining in the said bank account for a period of seven years should be transferred to the Investor Education and Protection Fund established under Section 205C of the Companies Act, 1956.

Question 79

The management of Ambitious Properties Ltd., has decided to take up the business of food processing activity because of the downward trend in real estate business. There is no provision in the object clauses of the Memorandum of Association to enable the company to carry on such business. State with reasons whether its object clause can be amended. State briefly the procedure to be adopted for change in the object clause. (May 2005)

Answer

Section 17(1) of the Companies Act, 1956 permits a company to alter its objects for the under mentioned purposes:

- (1) to carry on business more economically;
- (2) to attain the main purpose of the company by new and improved means;
- (3) to carry on some business which the existing circumstances may conveniently or advantageously be combined with the existing business;
- (4) to change and enlarge the local area of operations;
- (5) to restrict or abandon any of the existing objects;
- (6) to sell or dispose of the whole or any part of the undertaking;
- (7) to amalgamate with any other company or body of persons.

The case of the company is covered under point No. 3 above and therefore the company can amend its object clause to take up the business of Food Processing activity.

PROCEDURE

The company should amend the object clause by passing a special resolution in a general meeting.

File with the Registrar of companies, a copy of the special resolution within one month from the date of passing of such resolution together with a printed copy of the memorandum as altered and the Registrar shall register the same and certify the registration under his hand written one month from the date of filing of such documents. The certificate is a conclusive evidence that all the requirements with respect to the alteration have been complied with and the memorandum so altered shall be the Memorandum of Association of the company.

Question 80

Several small depositors of Overtrading Company Ltd., have made complaints about non-refund of the deposits after due date. Explain briefly (1) the meaning of small depositor and (2) the duty of the company after the default has taken place in the matter of repayment of the deposits.

(May 2005)

Answer

Meaning of Small Depositor: According to Section 58AA of the Companies Act, 1956, a small depositor means a depositor who has deposited in a financial year a sum not exceeding Rs. 20,000/- in a company and includes his successors, nominees and legal representatives.

Duty of company in case of default in repayment of deposits: Every company accepting deposits from small depositors should intimate the Company Law Board/Tribunal within 60 days of the date of default the name and address of each small depositor to whom it had defaulted in repayment of deposit or interest thereon. Thereafter, the company should also give intimation to the Company Law Board/ Tribunal on a monthly basis.

Question 81

*Explain briefly the meaning of sweat equity shares and the steps that a company has to take for issue of such shares.
(May 2005)*

Answer

Meaning of Sweat Equity Shares: According to Section 79A of the Companies Act, 1956, Sweat Equity Shares means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions by whatever name called.

Steps for issue of Sweat Equity Shares: The company has to take the following steps for issue of sweat equity shares:

- (i) A special resolution is to be passed authorising the issue of sweat equity shares.
- (ii) The special resolution should specify the number of shares, current market price, consideration, if any, and the class or classes of directors or employees.
- (iii) At least one year should have elapsed since the date on which the company was entitled to commence business.
- (iv) In the case of a listed company, the sweat equity shares can be issued in accordance with the regulations made by SEBI in this behalf. In the case of unlisted company, the shares are to be issued in accordance with the guidelines as may be prescribed. (Unlisted companies issue of sweat equity share Rules, 2003).

Question 82

*A company is required to pay dividend to its shareholders within 30 days of its declaration. State the circumstances when a company will not be deemed to have committed any offence even if it does not pay within 30 days.
(May 2005)*

Answer

Section 207 of the Companies Act, 1956 provides for the following cases when failure to pay dividend within 30 days of its declaration is not deemed to be an offence:

- (i) Where dividend could not be paid due to operation of any law;

- (ii) Where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with;
- (iii) Where there is a dispute regarding the right to receive dividend;
- (iv) Where the dividend has been lawfully adjusted by the company against any sum due to it (company) from the shareholder; or
- (v) Where for any reason, the failure to pay the dividend or to post the dividend warrant within the period of 30 days from the date of declaration was not due to any default on the part of the company.

Question 83

The Articles of Association of a private limited company contain provisions restricting the right to transfer shares and limiting the number of members to fifty. What restrictions are generally incorporated in the articles in restricting the right to transfer shares? (May 2005)

Answer

The right of transfer of shares and limiting the number of members to 50 is generally restricted in the following manner:

- (i) By authorising the directors to refuse transfer of shares to persons whom they do not approve or by compelling the shareholder to offer his shareholding to the existing shareholders first. It may be noted that it can only restrict the right of sale to a member. On this consideration, the articles usually provide that before selling or transferring his share by the shareholder, the directors must be communicated in writing of such intention of the shareholder.
- (ii) By specifying the method for calculating the price at which the shares may be sold by one member to another. Generally, it is left to be determined either by the auditor of the company or by the company at a general meeting.
- (iii) By providing that the shareholders who are employees of the company shall offer the shares to specified persons or class of persons when they leave the company's service or from other sources in case of under-subscribed issues, within 60 days from the date of closure of the issue, the company shall refund forthwith the subscription amount in full without interest and with interest @15% p.a. if not paid within 10 days after expiry of the said 60 days.

Question 84

State briefly the provisions relating to minimum subscription and consequence of non-receipt of minimum subscription as per the Companies Act, 1956 and the provisions as per SEBI guidelines.

(May 2005)

Answer

In terms of Section 69(1) of the Companies Act, 1956 every prospectus for shares must contain an indication as to the minimum amount which in the opinion of the Board of directors must be raised. The amount so stated in the prospectus which shall be reckoned exclusively of any amount otherwise than in money is referred to as the 'minimum subscription'. The amount payable on application of each share shall not be less than 5% of the nominal amount of the shares.

If the applications are not received by the company for such quantum of shares for making minimum subscription within 120 days of the issue of prospectus, all moneys received from the applicants for shares shall be repaid without interest. If such money is not repaid within 130 days after the issue of prospectus, money will be repaid with interest @6% p.a. after the expiry of 130 days.

POSITION AS PER SEBI GUIDELINES: As per SEBI guidelines, the minimum subscription in respect of public and rights issue shall be 90% of the issue amount. The requirement of 90% minimum subscription shall not be mandatory in case of offer for sale of securities. In case of non-receipt by the company of 90% of the issued amount from public subscription plus accepted development from underwriters or from other sources in case of under-subscribed issues, within 60 days from the date of closure of the issue, the company shall refund forthwith the subscription amount in full without interest and with interest @15% p.a. if not paid within 10 days after expiry of the said 60 days.

Question 85

Write a note on the powers of the Central Government in regard to conversion

of debentures and loans into shares of the company under the following heads:

- (i) When terms of issue of such debenture or terms of loan do not include term providing for an option of conversion;*
- (ii) Matters considered in determining the terms and conditions of such conversion.*
- (iii) Remedy available to the company if conversion or terms of conversion is not acceptable to it.*

(May 2005)

Answer

- (i)** Under Section 81 of the Companies Act, 1956 where any debentures have been issued to or loans have been obtained from the Government by a company, whether such debentures have been issued or loans have obtained before or after the commencement of Companies Amendment Act, 1963 (w.e.f. 1.1.1964), the Central Government may, if in its opinion it is necessary in the public interest so to do, by order direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to that Government to be reasonable in the circumstances of the case, even if the terms of issue of such debentures or the terms of such loans do not include term providing for an option for such conversion.
- (ii)** In determining the terms and conditions of such conversion, the Central Government shall have due regard to the following circumstances:
 - (i) The financial position of the company;
 - (ii) The terms of issue of the debentures or the terms of the loans, as the case may be;
 - (iii) The rate of interest payable on the debentures or the loans;
 - (iv) The capital of the company, its loan liability, its reserves, its profits during the preceding five years; and
 - (v) The current market price of the shares in the company.

A copy of every order proposed to be issued by the Central Government shall be laid in draft before each House of Parliament.

The above powers of the Central Government are exercised notwithstanding anything contained in sub-sections (1), (2) and (3) of Section 81 of the Companies Act, 1956.

(iii) Remedies open to the company

If the terms and conditions of such conversion are not acceptable to the company, the company may, within 30 days from the date of communication of such order or within such further time as may be granted by the Court, prefer an appeal to the court in regard to such terms and conditions and the decision of the Court on such appeal and, subject only to such decision, the order of the Central Government shall be final and conclusive

Question 86

*State the procedure for passing a resolution by Postal Ballot.
(May 2005)*

Answer

A listed public company and in case of resolutions relating to such business as the Central Government may, by notification, declare to be conducted only by postal ballot, shall get any resolution passed by means of a postal ballot, instead of transacting the business in general meeting of the company. The procedure laid down in Section 192A is as under:

- (i) Where a company decides to pass any resolution by resorting to postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefore and requesting them to send their assent within a period of 30 days from the date of posting of the letter;
- (ii) The notice shall be sent by registered post acknowledgement due or by any other method as may be prescribed by the Central Government in this behalf, and shall be annexed with the notice a postage pre-paid envelope for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period;
- (iii) The board of directors shall appoint one scrutinizer, who is not in employment of the company, may be a retired judge or any person of repute, who, in the opinion of the board can conduct the postal ballot voting process in a fair and transparent manner;

- (iv) The scrutinizer will be in position for 35 days (excluding holidays) from the date of issue of notice for annual general meeting. He is required to submit his final report on or before the said period.
- (v) If a resolution is assented to by a requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been passed at a general meeting convened in that behalf.

For this purpose the scrutinizer willing to be appointed is available at the registered office of the company for ascertaining the requisite majority.

- (vi) If a shareholder sends his assent or dissent in writing on a postal ballot and thereafter any person fraudulently defences or destroys the ballot paper or declaration of the identity of shareholder, such person shall be punishable with imprisonment for a term which may extend to six months or with fine or both;
- (vii) The scrutinizer shall maintain a register to record the consent received, including electronic media, mentioning the particulars of name, address, folio number, number of shares, nominal value of shares, whether the shares have voting, differential voting or non-rights and the scrutinizer shall also maintain record for postal ballot which are received in defaced or mutilated form. The postal ballot and all other papers relating to postal ballot will be under the safe custody of the scrutinizer till the Chairman considers, approves and signs the minutes of the meeting. Thereafter, the scrutinizer shall return the ballot papers and other related papers/register to the company so as to preserve such ballot papers and other related papers/registers safely till the resolution is given effect to.

As per the Explanation, 'Postal Ballot' includes voting by electronic mode.

Question 87

State what is meant by "Quorum" and when does quorum be considered immaterial under the provisions of the Companies Act, 1956.

(May 2005)

Answer

Quorum means the minimum number of members that must be present in order to constitute a meeting and transact business thereat. Thus quorum represents the number of members on whose presence the meeting of a company can commence its deliberations. Under the articles provide for a

larger number, 5 members personally present in the case of a public company (other than a public company which became public by virtue of Section 43A, now deleted) and 2 members in case of a private company constitute the quorum for a general meeting as given in Section 174 of the Companies Act, 1956. The words 'personally present' excludes proxies. However, the representative of a body corporate appointed under Section 187 or the representative of the President or Governor of a State appointed under Section 187A is a member personally present for the purpose of counting quorum.

If all the members are present, it is immaterial that the quorum required is more than the total number of members. If for example, the articles of a private company provide that 4 members personally present shall be a quorum and the number of members is reduced to 3, the question of quorum will not arise when all the 3 members attend the meeting.

Question 88

State the provisions of the Companies Act regarding calling and holding an extraordinary general meeting with respect to:

- (i) Number of members entitled to requisition a meeting.*
- (ii) Power of the tribunal to order meeting to be called under Section 186.*
(May 2005)

Answer

(i) Number of members entitled to requisition an extraordinary general meeting:

- (a) in the case of a company having a share capital, such number of members who hold at the date of requisition, not less than 1/10th of such of the paid up capital of the company as at that date carries the right of voting in regard to that matter;
- (b) in the case of a company not having a share capital, such number of members who have at the date of deposit of requisition not less than 1/10th of the total voting power of all the members having at the said date a right to vote in regard to that matter.

(ii) Power of Tribunal to order meeting to be called under Section 186:

If for any reason it is impractical to call a meeting, other than an annual general meeting, in any manner in which meetings of the company may

be called, or hold or conduct the meeting of the company in the manner prescribed by the Act or the articles, the Tribunal may, either on its own motion or on the requisition of:

- (a) any director of the company or (b) of any member of the company who would be entitled to vote at the meeting;
- (b) Order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and
- (c) Give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying, or supplementing in relation to the calling holding and conducting of the meeting, the operations of the provisions of the Companies Act, 1956 and of the company's articles. The Tribunal may give direction that one member present in person or by proxy shall be deemed to constitute a meeting with such order shall, for all purposes, be deemed to be a meeting of the company duly called, held and conducted.

Question 89

The minutes of the meeting must contain fair and correct summary of the proceedings thereat. Can the Chairman direct exclusion of any matter from the minutes? Some of the shareholders insist on inclusion of certain matters which are regarded as defamatory of a Director of the company. The Chairman declines to do so. State how the matter can be resolved.

(May 2005)

Answer

Under Section 193(5) of the Companies Act, 1956 any matter which in the opinion of the Chairman of the meeting:

- (i) is or could reasonably be regarded as defamatory of any person;
- (ii) is irrelevant or immaterial to the proceedings, or
- (iii) is detrimental to the interests of the company,

the Chairman shall exercise an absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds specified above.

Since the Chairman has absolute discretion on the inclusion or exclusion of any matter in the minutes, the insistence of the shareholders will be of no avail.

Question 90

*Distinguish between 'share warrant' and 'share certificate'. State whether a private company can issue share warrants.
(November 2005)*

Answer

Share certificate and Share Warrant:

- (1) A share certificate is a prima facie evidence of document of title, stating that the holder is entitled to specified number of shares. Share warrant is a bearer document stating that the holder is entitled to certain number of shares specified therein.
- (2) The holder of a share certificate is a member of the company, but whereas the bearer of a share warrant can be a member only if the articles provide.
- (3) A share warrant is a negotiable instrument, where as a share certificate is not so.
- (4) A public company can only issue a share warrant, whereas, a share certificate can be issued by a public and private company.
- (5) In order to qualify as a director, the person should acquire a share certificate instead of a share warrant.
- (6) A share certificate can be issued for a fully paid and partly paid up shares. A share warrant can be issued in respect of only full paid up share.

Private Company issuing Share Warrant:

A Private Company cannot issue share warrant under the provisions of the Company Act, 1956.

Question 91

*When is a company required to issue a 'shelf prospectus' under the provisions of the Companies (Amendment) Act, 2000? Explain the provisions of the Act relating to the issue of 'shelf prospectus' and filing it with the Registrar of Companies.
(November 2005)*

Answer

Meaning: According to Section 60A as inserted by the Companies (Amendment) Act, 2000 'Shelf Prospectus' means a prospectus issued by any Financial Institutions or bank for one or more issues of the Securities or class of securities specified in that prospectus.

Organization required to issue and file Shelf Prospectus: Any Public Financial Institution, a public sector bank or schedule bank whose main object is financing, shall file a shelf prospectus. 'Financing Means Making loans to or subscribing in the capital of, a private industrial enterprise engaged in infrastructure financing, or such, other company as the Central Government may notify in this behalf.

A company filing a shelf prospectus with the registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus. It shall be required to file an information memorandum on all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and the succeeding offer of securities within the time prescribed by the Central Government prior to making of a second or subsequent offer of securities under the shelf prospectus.

An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the First offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue securities under that prospectus.

Where an update of information memorandum is filed every time on offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

Question 92

Dev Limited issued a notice for holding of its Annual General Meeting on 7th November, 2005. The notice was posted to the members on 16.10.2005. Some members of the company allege that the company had not complied with the provisions of the Companies Act, 1956 with regard to the period of notice and as such the meeting was not validly called. Referring to the provisions of the Act, decide:

(i) Whether the meeting has been validly called?

- (ii) *If there is a short fall in the number of days by which the notice falls short of the statutory requirement, state and explain by how many days does the notice fall short of the statutory requirement?*
- (iii) *Can the short fall, if any, be condoned?*
(November 2005)

Answer

- (i) 21 Days clear notice of an AGM must be given [Section 171, Companies Act, 1956]: In case of notice by post, section 53(2) provides that the notice shall be deemed to have been received on expiry of 48 hours from the time of its posting. Besides, for working out clear 21 days, the day of the notice and the day of the meeting shall be excluded. Accordingly, 21 clear days notice has not been served (only 19 clear days notice is served) and the meeting is, therefore, not validly convened.
- (ii) worked as per (i) above, notice falls short by 2 days.
- (iii) according to Section 171(2), on AGM called at a notice shorter than 21 clear days shall be valid if consent is accorded thereto by all the members entitled to vote thereat. Thus, if all the members of the company approve the shorter notice, shortfall may be condoned.

Question 93

XYZ Limited realised on 3rd November, 2005 that particulars of charge created on 11th September, 2005 in favour of a bank were not filed with the Registrar of Companies for registration. What procedure should the company follow to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created on 11th August, 2005 instead of 11th September, 2005? Explain with reference to the relevant provisions of the Companies Act, 1956.
(November 2005)

Answer

Section 125(1) of the Companies Act, 1956 provides that the prescribed particulars of the charge together with the instrument of any, by which the charge is created or evidenced, or a copy thereof, shall be filed with the Registrar within 30 days after the date of the creation of charge. In the given case particulars of charge have not been filed within the prescribed period of 30 days of its creation.

However, the Registrar of Companies is empowered under the proviso to Section 125(1) to extend the period of 30 days by another 30 days on payment of such additional fee not exceeding 10 times the amount of fee specified in Schedule X as the registrar may determine. Taking advantage of this provision, XYZ Limited should immediately file the particulars of charge with the Registrar and satisfy the Registrar that it had sufficient cause for not filing the particulars of charge within 30 days of creation of charge.

If the charge was created on 11th August, 2005, then the company has to apply to the Company Law Board u/s 141 (now Tribunal) and seek extension of time for filing the particulars for registration. The company must satisfy the Company Law Board (now Tribunal).

- (a) that the omission was accidental or due to inadvertence or due to some other sufficient cause or was not of the nature of prejudice the position of creditors or shareholders of the company or.
- (b) that it is just and equitable to grant relief on other grounds. On such satisfaction, the Company Law Board (now Tribunal) may extend the time for registration of charge on such terms and conditions as it may think expedient. Once the time is extended and it is made out that the particulars have been filed within the extended time, the Registrar is bound to register the charge.

Question 94

“Every shareholder of a company is also known as a member, while every member may not be known as a shareholder.” Examine the validity of the statement and point out the distinction between a ‘member’ and a ‘shareholder’.
(November 2005)

Answer

‘Member’ or ‘Shareholders’ of a company are the persons who collectively constitute the company as a corporate. Entry, the terms ‘Member’ and ‘Shareholder’ and ‘holder of a share’ are used interchangeably. (*Balkrishan Gupta v. Swadeshi Polytex Ltd.*) They are synonymous in the case of a company limited by shares, a company limited by guarantee and having a share capital and on unlimited company whose capital is held in definite shares. But in the case of an unlimited company or a company limited by guarantee, a Member may not be a shareholder, for such a company may not have a share capital.

A shareholder may be distinguished from a Member as follows:

- (1) A registered shareholder is a member but a registered member may not be a shareholder because the company may not have a share capital.
- (2) A person who owns a bearer share warrant is a shareholder but he is not a member as his name is struck off the register of members. [Section 115(i)]. This means that a person can be a holder of shares without being a member.
- (3) A legal Representative of a deceased Member is not a member until he applies for registration. He is, however, a shareholder even though his name does not appear on the register of members.
- (4) A person who subscribes to the Memorandum of Association immediately becomes the member, even though no shares are allotted to him. Till shares are allotted to the subscriber, he is a member but not a shareholder of the company.
- (5) A person who has transferred his shares ceases to be a holder of those shares from the date of the transfer, but he continues to be a member till such time the transfer is registered in the name of the transfers in the books of the company.

Question 95

M/s India Computers Ltd. was registered as a Public Company on 1st July, 2005 in the State of Maharashtra. Another company by name M/s All India Computers Ltd. was registered in Delhi on 15th July, 2005. The promoters of India Computers Ltd. have failed to persuade the management of All India Computers Ltd. to change the company's name, as it closely resembles with the name of the first registered company.

Advise the Management of India Computers Ltd. about the remedies available to them under the provisions of the Companies Act, 1956.

(November 2005)

Answer

Since the name of M/s India Computer Ltd., was registered earlier, on 1st July, 2005, the promoters have a right to ask the management of M/s All India Computers Ltd to change its name suitably as the said name closely resembles with that of the first registered company. Since the management of M/s All India Computers Ltd has not agreed, the promoters of India

computers Ltd can approach the Central Government under Section 22 of the Companies Act, 1956 for rectification of the name of the company registered subsequently. The Central Government can direct the second registered company for correction. This direction can be given within 12 months from the date of registration of the latter company and the said company has to comply with the direction within 3 months by changing its name suitably failing which penal provisions will become applicable. The power of the Central Government under Section 22 has been delegated to the Regional Director.

Question 96

State the procedure for inspection of Minutes Book of General Meetings of a company, by the members.
(November 2005)

Answer

Inspection of Minutes Books of General Meetings: Following are the provisions relating to the procedure for inspection of minutes books of general meetings of a company by the members:

- (1) The books containing the Minutes of the proceedings of any general meeting of a company shall-
 - (a) be kept at the registered office of the company, and
 - (b) be open, during business hours, to the inspection of any member without charge, subject to such reasonable restrictions as the company may, by its articles or in general meeting impose, so however that not less than two hours in each day are allowed for inspection.
- (2) Any member shall be entitled to be furnished, within seven days after he has made a request in that behalf to the company, with a copy of any minutes referred to in sub-section (1), on payment of such sum as may be prescribed for every one hundred words or fractional part thereof required to be copied.
- (3) If any inspection required under sub-section (1) is refused, or if any copy required under sub-section (2) is not furnished within the time specified therein, the company, and every officer of the company who is in default,

shall be punishable with fine which may extend to five thousand rupees in respect of each offence.

- (4) In the case of any such refusal or default, the Central Government may, by order, compel on immediate inspection of the Minute books or direct that the copy required shall forthwith be sent to the person requiring it.

Question 97

“Moonstar Ltd” is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. ‘A’, a shareholder of the Moonstar Ltd., deposits in advance the remaining amount due on his shares without any calls made by “Moonstar Ltd.”.

Referring to the provisions of the Companies Act, 1956, state the rights and liabilities of Mr. A, which will arise on the payment of calls made in advance.
(November 2005)

Answer

Mr.. A, a shareholder of the ‘Moon Star Ltd’., deposited in Advance the remaining amount due on his shares without any calls made by ‘Moon Star Ltd’. ‘Moon Star Ltd’ was authorized to accept the unpaid calls by its articles. According to section 92(1) of the Companies Act, 1956, a company may, if so authorized by the articles, accept from any member the whole or a part of the amount remaining unpaid or any shares by him although no part of that amount has been called up. The amount so received or accepted is described as payment in advance of calls. When a company receives payment in advance of calls, the rights and liabilities of the shareholder will be as follows:

- (i) The shareholder is not entitled to voting rights in respect of the moneys so paid by him until the same would, but for such payment become presently payable. [Section 92(2)].
- (ii) The shareholder’s liability to the company in respect of the call for which the amount is paid is distinguished.
- (iii) The shareholder is entitled to claim interest on the amount of the call to the extent payable according to the articles of association. If there are no profits, it must be paid out of capital, because shareholder becomes the creditor of the company in respect of this amount.
- (iv) The amount received in advance of calls is not refundable.

- (v) In the event of winding up the shareholder ranks after the creditors, but must be paid his amount with interest, if any before the other shareholders are paid off.
- (vi) The power to receive the payment in advance of calls must be exercised in the general interest and for the benefit of the company.

Question 98

C, a member of LS & Co. Ltd., holding some shares in his own name on which Final call money has not been paid, is denied by the company voting right at a general meeting on the ground that the articles of association do not permit a member to vote if he has not paid the calls on the shares held by him.

*With reference to the provisions of the Companies Act, 1956, examine the validity of company's denial to C of his voting right.
(November 2005)*

Answer

Section 181 of the Companies Act, 1956 lays down the grounds on which right of a shareholder to vote at the general meeting may be excluded. These are:

- (a) Non-payment of calls by a member;
- (b) Non-payment of other sums due against a member;
- (c) Where company has exercised the right of lien on his shares.

Since the stipulation in the Articles relates to one of the grounds permitted under Section 181, the same is valid C's protest is not valid.

Question 99

In what way does the Companies Act, 1956 regulate the payment of 'underwriting commission'? Explain the provisions of the Act, state the conditions to be complied with before payment of such commission can be made to underwriters of the company.

*(November
2005)*

Answer

Payment of underwriting commission is regulated by the provisions of Companies Act, 1956 stating certain conditions as contained in Section 76. The conditions to be fulfilled are:

- (i) The payment of commission should be authorized by the articles.
- (ii) The names and addresses of the underwriters and the number of shares or debentures underwriter by each of them should be disclosed in the prospectus.
- (iii) The amount of commission should not exceed, in the case of shares, 5% of the price at which the shares have been issued or the amount or rate authorized by the articles, whichever is less and in the case of debentures it should not exceed 2½%.
- (iv) The rate should be disclosed in the prospectus, or in the statement in lieu of prospectus (or in a statement in prescribed form signed in the like manner as the statement in the lieu of prospectus) and should be filed with the Registrar along with a copy of the underwriting contract before the payment of the commission.
- (v) The number of shares or debentures, which persons have agreed to subscribe absolutely or conditionally for commission, should be disclosed in the manner aforesaid.
- (vi) A copy of the contract for the payment of the commission should be delivered to the Registrar along with the prospectus or the statement in lieu of prospectus for registration.

Section 76(4A) clarifies that commission to the underwriter is payable only in respect of those shares or debentures which are offered to the public for subscription. However, where, (i) a person, who for a commission has subscribed (or agreed to subscribe) for shares or debentures of a company and before the issue of the prospectus (or statement in lieu of prospectus) for such shares or debentures, some other person (or persons) has subscribed for any or all of them, and (ii) such a fact together with the aggregate amount of commission payable to the underwriter is disclosed in such prospectus (or statement in lieu of prospectus), then the company may pay commission to the underwriter in respect of his subscription irrespective of the fact that the shares or debentures have already been subscribed.

Question 100

At a General meeting of a company, a matter was to be passed by a special resolution. Out of 40 members present, 20 voted in favour of the resolution, 5 voted against it and 5 votes were found invalid. The remaining 10 members abstained from voting. The Chairman of the meeting declared the resolution as passed.

With reference to the provisions of the Companies Act, 1956, examine the validity of the Chairman's declaration.
(November 2005)

Answer

Under Section 189(2) of the Companies Act, 1956, for a valid special resolution, the following conditions need to be satisfied:

- (i) The intention to propose the resolution, as a special resolution must have been specified in the notice calling the general meeting or other intimation given to the members;
- (ii) The notice required under the Companies Act must have been duly given of the general meeting;
- (iii) The votes cast in favour of the resolution (whether by show of hands or on poll) by members present in person or by proxy are not less than 3 times the number of votes, if any, cast against the resolution.

Thus, in terms of the requisite majority, votes cast in favour have to be compared with votes cast against the resolution. Abstentions or in valued, if any, are not to be taken into account. Accordingly, in the given problem, the votes cast in favour (20) being more than 3 times of the votes cast against (5), if other conditions of Section 189(2) are satisfied, the decision of the Chairman is in order.

Question101

Mars India Ltd. owed to Sunil Rs. 1,000. On becoming this debt payable, the company offered Sunil 10 shares of Rs. 100 each in full settlement of the debt. The said shares were fully paid and were allotted to Sunil.

Examine the validity of theses allotment in the light of the provisions of the Companies Act, 1956.
(November 2005)

Answer

Allotment of Shares: As per the Section 75 of the Companies Act, 1956 when shares are allowed to a person by a company, payment may be made – (i) in cash, or (ii) in kind (with the consent of the company).

'Cash' here does not necessarily mean the current coin of the country. It means "such transaction as would in an action at law for calls, support a plea of payment."

On the basis of the above provision and decision of the related case *Coregam Gold Mining Co. of India V. Roper*, (1892), A.C. 125, the allotment of fully paid up shares in full satisfaction of Sunil's debt is valid.

Question 102

What is the meaning of "Certificate of Incorporation" under the provisions of the Companies Act, 1956?
(November 2005)

Answer

Certificate of incorporation: Upon the registration of the documents required for registration of a proposed company and filed by such company along with the necessary fee, the Registrar of Companies issues a certificate that the company is incorporated and in the case of a limited company, that it is limited (Section 34 of the Companies Act, 1956).

Section 35 provides that the certificate of incorporation given by the Registrar in respect of all the requirements of this Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorized to be registered and duly registered under this Act. A certificate of incorporation is conclusive as to all administrative acts relating to incorporation and as to the date of incorporation (*Jubilee Cotton Mills vs. Leuris*)

Commencement of Business: A private company can commence its business as soon as it gets certificate of incorporation. But a company having a share capital which has issued a prospectus inviting the public to subscribe for its shares cannot commence any business or exercise borrowing power unless:

- (a) The minimum number of shares which have to be paid for in cash has been subscribed and allotted.
- (b) Every director has paid, in respect of share for which he is bound to pay an amount equal to what is payable on shares offered to the public on application and allotment.
- (c) No money is or may become liable to be paid to application of any shares or debentures offered for public subscription by reason of any failure to apply for or to obtain permission for the shares or debentures to be dealt in any recognised stock exchange; and
- (d) A statutory declaration by the secretary or one of the directors that the aforesaid requirements have been complied with is filed with the Registrar.

If, however, a company having a share capital has not issued a prospectus inviting the public to subscribe for its shares, it cannot commence any business or exercise borrowing powers unless it has issued a statement in lieu of prospectus and the conditions contained in paragraph (b) and (d) aforesaid have been complied with.

The Registrar of Companies shall examine them and if satisfied, shall issue to the company a certificate to commence business.

Question 103

What are the provisions relating to "Information Memorandum" contained in Section 60B of the Companies Act, 1956 [inserted by the Companies (Amendment) Act, 2000]? (May 2006)

Answer

Information Memorandum: Section 60B of the Companies Act, 1956 (inserted by the Companies Amendment Act, 2000) provides the following regarding information memorandum:

1. A public company making an issue of securities may circulate information memorandum to the public prior to filing of a prospectus.
2. A company inviting subscription by an information memorandum shall be bound to file a prospectus prior to the opening of the subscription lists and the offer as a red-herring prospectus, at least three days before the opening of the offer.

3. The information memorandum and red-herring prospectus shall carry same obligations as are applicable in the case of a prospectus.
4. Any variation between the information memorandum and the red-herring prospectus shall be highlighted as variations by the issuing company.

Explanation – For the purposes of Sub-sections (2), (3) and (4), “red-herring prospectus’ means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered.

5. Every variation as made and highlighted in accordance with sub-section (4) above shall be individually intimated to the persons invited to subscribe to the issue of securities.
6. In the event of the issuing company or the underwriters to the issue have invited or received advance subscription by way of cash or post-dated cheques or stock-invest, the company or such underwriters or bankers to the issue shall not encash such subscription moneys or post-dated cheques or stock invest before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock-invest or return of subscription paid.
7. The applicant or proposed subscriber shall exercise his right to withdraw from the application on any intimation of variation within seven days from the date of such intimation and shall indicate such withdrawal in writing to the company and the underwriters.
8. Any application for subscription which is acted upon by the company or underwriters or bankers to the issue without having given enough information of any variations, or the particulars of withdrawing of offer or opportunity for cancelling the post-dated cheques or stock invest or stop payments for such payments shall be void and the applicants shall be entitled to receive a refund, or return of its post-dated cheques or stock-invest or subscription monies or cancellation of its application, as if the said application had never been made and the applicants are entitled to receive back their original application and interest at the rate of fifteen per cent from the date of encashment till payment of realisation.

9. Upon the closing of the offer of securities, a final prospectus stating therein the total capital raised whether by way, of debt or share capital and the closing price of the securities and any other details as were not complete in the red-herring prospectus shall be filed in a case of a listed public company with the Securities and Exchange Board and Registrar, and in any other case with the Registrar only.

Question 104

The Directors of "Sunrise Computers Ltd." desire to change the Company's name to "Royal Computers Ltd." and seek your advice. Explain the procedure to be followed, for the said purpose, under the Companies Act, 1956.
(May 2006)

Answer

Change of name of the company: 'Sunrise Computers Ltd.' may change its name to 'Royal Computers Ltd.' as per section 21 of the Companies Act, 1956.

A company may by special resolution, and with the approval of the Central Government, signified in writing, change its name [Section 21]. Power under Section 21 has been delegated to the Registrar of Companies vide notification GSR 507(E) dated 24-6-85]. The application for change of name is required to pay a fee of Rs. 500/- to ascertain whether the proposed name is available and thereafter pass the required special resolution and thereafter submit the necessary documents to the Registrar. If the Registrar is satisfied that the relevant procedures have been complied with by the Company, in this regard, the Registrar shall issue fresh certificate with the change embodied therein. The change in name shall not affect any of the company's rights or obligations of the company or render any legal proceedings by / or against it. Any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by its new name [Section 23].

Question 105

Explain the meaning of "transmission of Shares" under the Companies Act, 1956. In what ways is "transmission of shares" different from "Transfer of Shares"?
(May 2006)

Answer

Transmission and transfer of shares: Under Section 109B of the Companies Act, 1956, transmission of shares takes place when shares are transferred under the operation of law, either on the death of the registered shareholder or on his being adjudged as insolvent. It also takes place where the holder is a company if it goes into liquidation. Upon the death, the shares of the deceased vest in his executors or administrators and the estate becomes liable for calls if the shares are not fully paid up. In the like manner the official assignee or the receiver, as the case may be, is also entitled to be registered as a member in the place of shareholder who has been adjudged as insolvent *[R. W. Key and Sons (1902) IC, 467]*. However, the executors or administrators may decline to be registered as members for various reasons. In that event the legal representatives, by virtue of Section 109, shall be entitled to transfer the shares of the deceased irrespective of whether they are partly paid or fully paid. Similarly, the official assignee has the statutory power to transfer the shares under Section 58(1) of the Presidency Towns Insolvency Act.

Distinction between transfer and transmission of shares

Transfer of shares	Transmission of shares
1. It is affected by a voluntary/deliberate act of the parties.	1. It takes place by operation of law e.g. due to death, insolvency or lunacy of a member.
2. It takes place for consideration.	2. No consideration is involved.
3. The transferor has to execute a valid instrument of transfer.	3. There is no prescribed instrument of transfer.
4. As soon as the transfer is complete, the liability of the transferor ceases.	4. Shares continue to be subject to the original liabilities.

Question 106

The Registrar of Companies on examining the statutory report filed with him by M/s Jyothi Company Ltd., finds that the report has been certified as correct, by all the directors of the Company, except the Managing Director.

The Registrar refuses to register the said document on the ground that it was not signed by the Managing Director of the Company.

Answer the following in the light of the Companies Act, 1956:

- (i) Whether the Registrar of Companies can hold the officers of the Company liable?*
- (ii) What provisions of the Companies Act have not been complied with by the company and its officers?*
- (iii) To what penalties are the Company and its officers liable?*
(May 2006)

Answer

FILING REPORT WITHOUT SIGNATURE:

- (i) Yes, the Registrar can hold the officers of the company liable.
- (ii) Section 165(4) of the Companies Act, 1956 requires the statutory report to be certified as correct by at least two directors of the company one of whom must be a managing director, where there is one. Thus, the aforesaid provision of Section 165(4) has not been complied with.
- (iii) Sub –Section (9) of Section 165 provides for penalties for non-compliance of Sub-section (4). It makes every director or other officer of the Company who is in default punishable with fine upto Rs. 5,000/-.

Question 107

To remove the Managing Director, 40% members of Global Ltd. submitted requisition for holding extra-ordinary general meeting. The company failed to call the said meeting and hence the requisitionists held the meeting. Since the Managing Director did not allow the holding of meeting at the registered office of the Company, the said meeting was held at some other place and a resolution for removal of the Managing Director was passed.

Examine the validity of the said meeting and resolution passed therein in the light of the companies Act, 1956.
(May 2006)

Answer

Extraordinary meeting: Every shareholder of a company has a right to requisition for an extraordinary general meeting. He is not bound to disclose

the reasons for the resolution to be proposed at the meeting [Life Insurance Corporation of India vs. Escorts Ltd., (1986) 59 Comp. Cas. 548].

Section 169 of the companies Act contains provisions regarding holding of extraordinary general meetings. It provides that if directors fail to call a properly requisitioned meeting, the requisitionists or such of the requisitionists as represent not less than 1/10th of the total voting rights of all the members (or a majority of them) may call a meeting to be held on a date fixed within 3 months of the date of the requisition.

Where a meeting is called by the requisitionists and the registered office is not made available to them, it was decided in R. Chettiar v. M. Chettiar that the meeting may be held anywhere else.

Further, resolutions properly passed at such a meeting, are binding on the company.

Thus, in the given case, since all the above mentioned provisions are duly complied with. Hence the meeting with the resolution removing the managing director shall be valid.

Question 108

*What do you understand by "Charge" under the Companies Act, 1956? Distinguish between "fixed Charge" and "Floating charge".
(May 2006)*

Answer

Charge: The term 'charge' has not been adequately defined in the Companies Act, 1956 except that section 124 provides that the expression charge shall include a mortgage. However, it can be understood that where in transaction for value, both parties evidence the intention that property existing or future shall be made available as security for the payment of a debt and that the creditor/mortgagee shall have a pleasant right to have it made available, there is a charge.

Distinction between fixed charge and floating charge:

Fixed charge	Floating charge
1. It is a legal charge.	1. It is an equitable charge.
2. It is a charge on specific, ascertained and existing	2. It is a charge on present and future assets. No specific

	asset.		assets.
3.	Company cannot deal with the assets except with the consent of the charge holder.	3.	Company is free to use or deal with the assets the way it likes until the charge becomes fixed.
4.	Registration of fixed charge on movable assets is not compulsory.	4.	Registration of all floating charge on all kinds of assets is compulsory by law.
5.	Fixed charge has always priority over floating charge.	5.	Ambulatory and shifting in character.

Question 109

The Articles of Association of X Ltd. require the personal presence of 7 members to constitute quorum of General Meetings. The following persons were present in the extra-ordinary meeting to consider the appointment of Managing Director:

- (i) A, the representative of Governor of Madhya Pradesh.*
- (ii) B and C, shareholders of preference shares,*
- (iii) D, representing Y Ltd. and Z Ltd.*
- (iv) E, F, G and H as proxies of shareholders.*

Can it be said that the quorum was present in the meeting?

(May 2006)

Answer

Quorum: In this case the quorum for a general meeting is 7 members to be personally present. For the purpose of quorum, only those members are counted who are entitled to vote on resolution proposed to be passed in the meeting.

Again, only members present in person and not by proxy are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purposes of quorum.

If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of a latter company, then such a person shall be deemed to be a member

present in person and counted for the purpose of quorum (Section 187)

Where two or more companies which are members of another company, appoint a single person as their representative then each such company will be counted as quorum at a meeting of the latter company.

Again Section 187A of the Companies Act, 1956 provides that the President of India or Governor of a State, if he is a member of a company, may appoint such a person as he thinks fit, to act as its representative at any meeting of the company. A person so appointed shall be deemed to be a member of such a company and thus considered as member personally present.

In view of the above there are only three members personally present.

'A' will be included for the purpose of quorum. B & C have to be excluded for the purpose of quorum because they represent the preference shares and since the agenda being the appointment of Managing Director, their rights cannot be said to be directly affected and therefore, they shall not have voting rights. D will have two votes for the purpose of quorum as he represents two companies 'Y Ltd.' and 'Z Ltd.' E, F, G and H are not to be included as they are not members but representing as proxies for the members.

Thus it can be said that the requirements of quorum being 7, 3 members personally present shall not constitute a valid quorum for the meeting.

Question 110

A Company served a notice of General Meeting upon its members. The notice stated that a resolution to increase the share capital of the Company would be considered at such meeting. A shareholder complains that the amount of the proposed increase was not specified in the notice. Is the notice valid?

(May 2006)

Answer

Notice of Meeting: Section 173 of the Companies Act, 1956 requires a company to annex an explanatory statement to every notice for a

meeting of company, at which some 'special business' is to be transacted. This explanatory statement is to bring to the notice of members all material facts relating to each item of special business. Section 173 further specifies that all business in case of any meeting other than the annual general meeting is regarded as special business. Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section 173 of the Companies Act, 1956.

Question 111

Answer the following in relation to the provisions of the Companies Act, 1956:

- (i) Can the declaration of Board of Directors of interim dividend be revoked?*
- (ii) Who is empowered to declare final dividend ?*
(May 2006)

Answer

- (i) Till the passing of the Companies (Amendment) Act, 2000, there was no provision in the Companies Act (except reg. 86 of Table A) relating to interim dividend. The Companies (Amendment) Act, 2000 has introduced sub-section (14A) in section 2 whereby 'interim dividend' is now part of 'dividend' and accordingly all provisions of the Companies Act relating to 'dividends' have become applicable to 'interim dividend' also.

To put things beyond doubt, section 205 has also been amended to provide for the following:

- ◆ The Board of Directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend.
- ◆ The amount of dividend including interim dividend so deposited above shall be used for payment of interim dividend.
- ◆ The provisions contained in sections 205, 205A, 205C, 206, 206A and 207, as far as may be, also apply to any interim dividend.

Another view is there that the decision on interim dividend can be revoked only before transfer of the amount to the separate bank account pursuant to section 205(1A) of the Act. Further, according to Secretarial Standard 3 of the ICSI, interim dividend once declared cannot be revoked. A judicial decision in this regard can only remove the confusion.

Accordingly, it seems that the interim dividend, like final dividend, should be considered as a debt due and thus cannot be revoked.

Question 112

The principal business of XYZ Company Ltd. was the acquisition of vacant plots of land and to erect the houses. In the course of transacting the business, the Chairman of the Company acquired the knowledge of arranging finance for the development of land. The XYZ Company introduced a financier to another company ABC Ltd. and received an agreed fee of Rs. 2 lakhs for arranging the finance. The Memorandum of Association of the company authorises the company to carry on any other trade or business which can in the opinion of the board of directors, be advantageously carried on by the company in connection with the company's general business. referring to the provisions of the Companies Act, 1956 examine the validity of the contract carried out by XYZ Company Ltd. with ABC L (November 2006)

Answer

Under the provision of Companies Act, 1956 as contained in Section 17(1) a company is permitted to alter the objects to carry on some business which come under the existing circumstances may conveniently advantageously be combined with the existing law of the company.

In the light of the clause in the Memorandum of Association of the company which authorizes the company to carry on any other trade or business which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with the general business. Since the directors honestly believes that the transaction could be advantageously carried on an ancillary to the company's main objects, therefore, it was not ultra vires. (Bell Houses Ltd. Vs. City Wall Properties Ltd.)

Question 113

Explain the Provisions of Companies Act, 1956 relating to the establishment of Investor Education and Protection Fund. (November 2006)

Answer

Investor Education and Protection Fund (Section 205C)

Companies Act, 1956 vide Section 205C provides for the establishment of Investor Education and Protection Fund. There shall be credited to the fund the following accounts:

- (i) Amounts in the unpaid dividend of the company's unclaimed for 7 years.
- (ii) The application money received by companies for allotment of any securities and due forefund.
- (iii) Matured deposits with companies.
- (iv) Matured debentures with companies.
- (v) Interest accrued on the amount stated in (i) to (iv) above.
- (vi) Grants and donations given to the fund by the Central Government / State Government, companies or any other institutions for the purposes of the fund; and
- (vii) Interest or other income received out of the investments made from the Fund (Section 205C(2)). The fund shall be utilized for promotion of investor awareness and protection of interest of investor in accordance with the rules as may be prescribed.

Question 114

XY Ltd. has its registered office at Mumbai in the State of Maharashtra. For better administrative conveniences the company wants to shift its registered office from Mumbai to Pune (State of Maharashtra). What formalities the company has to comply with under the provisions of the Companies Act, 1956 for shifting its registered office as stated above ? Explain. (November 2006)

Answer

According to Section 17A read with Section 146 of the Companies Act, 1956, the following procedure is to be followed by the company for shifting of the registered office of the company:

- (i) A special resolution is required to be passed at a general meeting of the share holders.
- (ii) Confirmation of Regional Director is to be obtained and for this company has to apply in the prescribed form.

- (iii) The Regional Director shall convey his confirmation within four weeks from the date of receipt of the application.
- (iv) Copy of the special resolution within 30 days and certified copy of the confirmation along with a printed copy of the altered memorandum of association must be filed with the Registrar of companies within 2 months from the date of confirmation.
- (v) *Within one month of the filing, the Registrar of companies shall certify registration, which shall be the conclusive evidence that all requirements with respect to alteration and conformation have been complied with.*

Question 115

With a view to issue shares to the general public a prospectus containing some false information was issued by a company. Mr. X received copy of the prospectus from the company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the company within the stipulated period. A few months later, Mr. X bought 2000 shares through the stock exchange at a higher price which later on fell sharply. X sold these shares at a heavy loss. Mr. X claims damages from the company for the loss suffered on the ground the prospectus issued by the company contained a false statement. Referring to the provisions of the Companies Act, 1956 examine whether X's claim for damages is justified.

(November 2006)

Answer

According to Section 62 of the Companies Act, 1956, every director, promoter and every person who is responsible for the issue of the prospectus containing false or untrue information are liable to compensate all those persons who subscribe to the shares on the faith of prospectus. It was held in the case of *Peek Vs. Gurney* that the above-mentioned remedy by way of damage will not be available to a person if he has not purchased the shares on the basis of prospectus. Since X purchased shares through the stock exchange open market which cannot be said to have bought shares on the basis of prospectus. X cannot bring action for deceit against the directors. X will not succeed.

Question 116

Explain the provisions of the Companies Act, 1956 relating to 'Resolutions requiring Special Notice'. State the resolutions that require 'Special Notice' under the Act. (November 2006)

Answer

Special Notice (Section 190)

Section 190 of the Companies Act, 1956 deals with resolutions requiring special notice. Accordingly the section provides that where under any provision contained the Company Act or in the Acts, special notice is required to be given of any resolution, notice of intention to move the resolution should be given to the company, not less than 14 days clear days before the meeting at which it is to be moved.

Special notice is required to move, besides the resolution mentioned in the Articles, the following resolutions:

- (i) a resolution appointing an auditor other than the retiring one. (Section 225)
- (ii) a resolution providing expressly that the retiring auditor shall not be reappointed. (Section 225)
- (iii) a resolution purporting to remove a director before the expiry of his period of office. (Section 284).
- (iv) a resolution to appoint another director in place of the removed director. (Section 284)

Question 117

Distinguish between 'Reduction of Share Capital' and Diminution of Share Capital'.

(November 2006)

Answer

- (i) Reduction of capital may be a reduction in nominal capital, subscribed capital or paid up capital whereas diminution denotes a cancellation of that portion of the issued capital which has not been subscribed [Section 94(1) (e)]

- (ii) Both require authorization by Articles but reduction of capital can be effected only by a special resolution whereas diminution can be effected by an ordinary resolution.
- (iii) Reduction of capital needs confirmation by the court [Section 101] whereas diminution needs no such confirmation [Section 94(2)]
- (iv) In case of reduction, Court (now Tribunal) may order the company to add the words 'and reduce' after its name [Section 102(3)] but no such order can be passed in case of diminution [Section 94]
- (v) *In case of diminution notice is to be given to the Registrar within 30 days from the date of cancellation, whereas in the case of reduction more detailed procedure regarding notice to the Registrar has been prescribed by section 103, though there is no such time limit as aforesaid.*

Question 118

X had applied for the allotment of 1,000 shares in a company. No allotment of shares was made to him by the company. Later on, without any further application from X, the company transferred 1,000 partly-paid shares to him and placed his name in the Register of Members. X, knowing that his name was placed in the Register of Members, took no steps to get his name removed from the Register of members. The company later on made final call. X refuses to pay for this call. Referring to the provisions of the Companies Act, 1956, examine whether his (X's) refusal to pay for the call is tenable and whether he can escape himself from the liability as a member of the company.
(November 2006)

Answer

According to Section 164 of the Companies Act, 1956, the register of member is a prima facie evidence of the truth of its contents. The contents of the register of members are of decisive importance in determining as to who were the shareholders of the company at a crucial time. Accordingly, if a person's name, to his knowledge, is there in the register, he shall be deemed to be a member. In the given case X knows that his name is included in the register of shareholders and stands by and allows his name to remain, he is holding out to the public that he is shareholder and thereby he will be liable as shareholder.

Question 119

DJA Company Ltd. has only 50 preference shareholders. A meeting of the preference shareholders was called by the company for amending the terms of these shares. Mr. A, was the only preference shareholder who attended the meeting. He, however, held proxies from all other shareholders. He took the Chair, conducted the meeting and passed a resolution for amending the terms of the issue of these shares. Referring to the provisions of the Companies Act, 1956, examine the validity of the meeting and the resolution passed thereat.

(November 2006)

Answer

This question was decided in *Sharp Vs., Dawes* case which provides that "The word meeting prima facie means coming together of more than one person." In this given case, only one shareholder present. This was not a meeting within the meaning of the Companies Act, 1956. According to Section 174 another requirement of valid meeting is the presence of a required quorum. Moreover, the section also says that "the members actually present shall be the quorum." The presence of one member may not be enough. This was not a valid meeting.

In *East Vs. Bennet Brothers Ltd.* (1911) it has been held that in case of a class meeting of all the shares of a particular class are held by one person, one person shall form the quorum. In the given case, since all the shares are not held by one person, no quorum is therefore present. The meeting and the resolution passed there shall not be valid.

Question 120

Who are entitled to get notice for the general meeting called by a Public Limited Company registered under the Companies Act, 1956 ? Does the non-receipt of a notice of the meeting by any one entitled to such notice invalidate the meeting and the resolution passed thereat ? What would be your answer in case the omission to give notice to a member is only accidental omission ?

(November 2006)

Answer

Notice of meeting shall be given -

- (i) to every member of the company;

(ii) to the persons entitled to a share in consequence of the death or insolvency of a member;

(iii) to a auditor or auditors [Section 172(2)] and,

The company cannot take notice of the beneficial owners of shares who are, therefore, not entitled to notice, where, however, anyone is legally entitled to represent the members, such representative is entitled to receive the notice.

The private company, which is not, a subsidiary of a public company may prescribe, by its articles, persons to whom the notice should be given.

The non-receipt of notice or accidental omission go given notice to any member shall not invalidate the proceedings in the meeting [Section 172(3)]. However, omission to serve notice of meeting on a member on the mistaken ground that he is not a shareholder cannot be said to be an accidental omission. Accidental omission means that the omission must be not only designed but also not deliberate. [Maharaja Export Vs. Apparels Exports Promotion Council (1986)].

Question 121

When is an expert not liable for untrue statements in the prospectus issued by a company ?

(November 2006)

Answer

According to Section 62(3) of the Companies Act, 1956, an expert who would be liable by reason of having given his consent under Section 58 to the issue of the prospectus containing a statement made by him wouldn't be liable if he can prove:

- (i) that having given his consent to the issue of the prospectus, withdrew it in writing before the delivery of a copy of the prospectus for registration, or
- (ii) that after the delivery of a copy of the prospectus for registration but before allotment, he on becoming aware of the untrue statement withdrew his consent in writing and gave reasonable public notice thereof and the reasons therefore; or

(iii) that he was competent to make the statement and he had reasonable ground to believe, and did up to the time of allotment of the shares and debentures believe that the statement was true.

Question 122

Referring to the provisions of the Companies Act, 1956 state the matters relating to 'Ordinary Business' which may be transacted at the Annual General Meeting of a Company. What kinds of resolutions need to be passed to transact the 'ordinary Business' and the 'Special Business' at the Annual General Meeting of the Company ? Explain. (November 2006)

Answer

Ordinary Business (Section 173)

In accordance with the provision of Companies Act, 1956 as contained in Section 172, the business to be transacted at an AGM may comprise of:

- (i) Ordinary Business:** Which relate to the following matters:
- (a) Consideration of accounts, balance sheet and the report of the Board of Directors and auditors.
 - (b) Declaration of dividend.
 - (c) Appointment of Directors in place of those retiring; and
 - (d) appointment of auditors and fixation of their remuneration.
- (ii) Special Business:** Any other business scheduled to be transacted at the meeting shall be deemed to be special business.

Ordinary business can be passed by an ordinary resolution. However, special business may be transacted either by passing ordinary resolution or special resolution, depending upon the requirements of Companies Act, 1956.

Question 123

The object clause of the Memorandum of Association of LSR Private Ltd, Lucknow authorized it to do trading in fruits and vegetables. The company, however, entered into a Partnership with Mr. J and traded in steel and incurred liabilities to Mr. J. The Company, subsequently, refused to admit the liability to J on the ground that the deal was 'Ultra Vires' the company. Examine the validity of the company's refusal to admit the liability to J. Give reasons in support of your answer. (May 2007)

Answer

In terms of Companies Act, 1956, the powers of the company are limited to:

- (i) Powers expressly given by the Memorandum (which is popularly known as 'express' power or conferred by the Companies Act 1956, or other statute and
- (ii) powers reasonably incidental or necessary to the company's main purpose (termed as "Implied' powers). The Act further provides that the acts beyond the powers of a company are ultra vires and void and cannot

be ratified even though every member of the company may give his consent [*Ashbury Railway Carriage Company Vs Richee*]

The object clause enable shareholders, creditors or others to know what its powers are and what is the range of its activities and enterprises. The objects clause therefore is of fundamental importance to the share holder, creditors and others.

M/s LSR Pvt. Ltd is authorised to trade directly on fruits and vegetables. It has no power to enter into a partnership for Iron and steel with Mr. J. Such act can never be treated as 'express' or 'implied' powers of the company. Mr J who entered into partnership is deemed to be aware of the lack of powers of M/s LSR (Pvt) Ltd. In the light of the above, Mr, J cannot enforce the agreement or liability against M/s LSR Pvt. Ltd. Mr. J should be advised accordingly. This conclusion is supported by the decision reported in the case of '*The Ganga Mata Refinery Company (Pvt) Ltd CIT*'.

Question 124

VRS Company Ltd. is holding 45% of total equity shares in SV Company Ltd. The Board of Directors of SV Company Ltd. (incorporated on January 1, 2004) decided to raise the share capital by issuing further Equity shares. The Board of Directors resolved not to offer any shares to VRS Company Ltd, on the ground that it was already holding a high percentage of the total number of shares already issued, in SV Company Ltd. The Articles of Association of SV Company Ltd. provide that the new shares be offered to the existing shareholders of the company. On March 1, 2007 new shares were offered to all the shareholders except VRS Company Ltd. Referring to the provisions of the Companies Act, 1956 examine the validity of the decision of the Board of Directors of SV Company Limited of not offering any further shares to VRS Company Limited.(May 2007)

Answer

The problem as asked in the question is based on the application of the provisions of the Companies Act, 1956 as contained in Section 81 and the ruling given in *Gas Meter Co. Ltd. Vs Diaphragm & General leather co. Ltd.*

According to Sec 81, if at any time after the expiry of two years from the formation of the company or after the expiry of one year from the first allotment of shares, whichever is earlier, it is proposed to raise subscribed capital by allotment of further shares, it should be offered to the existing equity share holders of the company in proportion to the capital paid upon

those shares. Further in case of Gas Meter Ltd. Vs Diaphragm, & General; leather Co. Ltd where the facts of the case were similar to those given in the problems asked in the question, the articles of Diaphragm Co. provided that the new shares should first be offered to the existing share holders. The company offered new shares to all shareholders excepting Gas Co., which held its controlling shares. It was held that D company could be sustained from doing this.

In the given case applying the provisions and the ruling in the above case, SV Ltd.'s decision not to offer any further shares to VRS Co. Ltd on the ground that VRS Co. Ltd already held a high percentage of shareholding in SV Co. Ltd. is not valid for the reason that it is violative of the provisions of Section 81 and against the ruling in the above case.

Secondly, the offer for issue of the shares was made on 1st March 2007, i.e. after two years of the formation of the company. Therefore Board of Directors of SV Ltd cannot take a decision not to allot shares to VRS Company, unless the same is approved by the Co. in general meeting by means of special resolution as required under Section 81 (A).

Question 125

X, a registered shareholder of Y Limited left his share certificates with his broker. A forged the transfer deed in favour of Z, accompanied by these share certificates lodged the transfer deed alongwith the share certificates with the company for registration. The Company Secretary who had certain doubts, wrote to X informing him of the proposed transfer and in the absence of a reply from him (X) within the stipulated time, registered the transfer of shares in the name of Z. Subsequently, Z sold the shares to J and J's name was placed in the register of shareholders. Later on, X discovered that forgery has taken place.

Referring to the provisions of the Companies Act, 1956, state the remedy available to X and Z in the given case. Explain. (May 2007)

Answer

In the given case, there is a forged transfer of shares. The company in such a case should first inquire into the validity of the instrument of transfer. It should also send a notice to the transfer or of his address and inform him that such a transfer has been lodged and if no objection is made before this specified date, it would be registered.

Remedies available to X:

Since a forged transfer is a nullity, it does not pass any legal title to the transferee. The true owner can have his name restored on the register of member. A forged document can never have any legal effect.

- (1) Can also claim any dividend, which may not have been paid to him during the intervening period. (*Barton V North Staffordshire*)

Remedy to Z:

- (2) If by forgery a person obtains a certificate of transfer of shares from a company and transfers the shares to a purchaser for value acting in good faith i.e. without the knowledge of forgery, such purchaser does not get good title to the shares so transferred because a forged transfer is a nullity and cannot be a source of a valid transfer of title. But the company shall be liable to compensate the purchaser in so far as the company had issued a certificate to transfer and was therefore, estopped from denying the liability accruing from his own act. Therefore, if Z has suffered any loss, he can claim it from the company in this case.

Question 126

The paid-up Share Capital of AVS Private Limited is Rs. 1 crore, consisting of 8 lacs Equity Shares of Rs. 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of Rs. 10 each, fully paid-up. XYZ Private Limited and BCL Private Limited are holding 3 lacs Equity Shares and 1,50,000 Equity Shares respectively in AVS Private Limited.

XYZ Private Limited and BCL Private Limited are the subsidiaries of TSR Private Limited.

With reference to the provisions of the Companies Act, 1956, examines whether AVS Private Limited is a subsidiary of TSR Private Limited ? Would your answer be different if TSR Private Limited has 8 out of total 10 directors on the Board of Directors of AVS Private Limited? (May 2007)

Answer

Holding, subsidiary relationship: For the purpose of determining whether a company is subsidiary of another company, only equity shares issued by the first mentioned company are to be taken into account [Section 4 (1) (b) (ii), Companies Act, 1956]. Again, shares held by a subsidiary company shall be treated as held by its holding company [Section 4 (3) (b) (ii)] If a company by

itself or along with its subsidiaries holds more than half in nominal value of the equity shares capital of another company, it will be considered as the holding company of the other company [Section 4(3) (b) (ii)]

In this case, the equity share capital of AVS Pvt. Ltd. is Rs. 80,00,000 consisting of 8,00,000 equity shares of Rs 10 each fully paid up XYZ and BCL Pvt. Ltd. are holding 4,50,000 (3,00,000+1,50,000) equity shares in AVS Pvt Ltd., TSR Pvt, Ltd will be treated as holding more than half in nominal value of the equity share capital of AVS Pvt Ltd.

If TSR Pvt. Ltd. controls the composition of the Board of Directors of AVS Pvt. Ltd; it will also be treated as holding company by virtue of Section 4 (1) (a). Hence the answer will not be different.

Question 127

State the purposes for which the object clause of the Memorandum of Association of a public limited company, registered under the Companies Act, 1956, can be altered. (May 2007)

Answer

The members of a company may rightly expect that their money would be employed only for the objects for which the company has been established. Accordingly, the Act permits alteration of the object, only so far as is considered necessary for specified purposes. Section 17 (1) permits a company to alter its objects for the undermentioned purposes:

- (a) to carry on business more economically;
- (b) to attain the main purpose of the company by new or improved means;
- (c) To carry on some business which under the existing circumstance may conveniently or advantageously be combined with the existing business.
- (d) To change and enlarge the local area of operations;
- (e) To restrict or abandon any of the existing objects;
- (f) To sell or dispose of the whole or any part of the undertaking;
- (g) To amalgamate with any other objects or body or person.

Question 128

Explain the provisions of the Companies Act, 1956 relating to the 'Service of Documents' on a company and the members of the company. When is service

of document deemed to be effective in case the document is sent by post ?Explain.
(May 2007)

Answer

According to Section 53 of the Companies Act, 1956, a company may serve a document on its member either personally, or by sending it by post to him to his registered address, or if he has no registered address in India, to the address, if any, within India supplied by him to the company for the giving of notices to him [Section 53 (1)]. If a person residing abroad has not supplied to the company an address within India for the purpose of giving notice to him, then a document advertised in a newspaper circulating in the neighbourhood of the registered office of the company shall be deemed to be duly served on him on the day on which the advertisement appears [Section 53 (3)]. In the case of joint holders of a share, notice may be served on the joint holder named first [Section 53(4)]. When a share holder dies, it becomes the duty of the legal representative to furnish their address for a notice to be sent and if they fail to send the intimation to the company, the company is entitled to serve at the address which is recorded with it. The same rule applies in the case of insolvent member, when the assignees have not furnished their address [Section 53 (5)].

Where a document is sent by post, it is enough if the letter containing the document is properly addressed and sent by ordinary post. But at the request of any member, notice may be served by registered post or under certificate of posting, provided the member has deposited adequate money to meet the expenses [Section 53 (2) (a)].

Where a document is served by post, service shall be deemed to have been effected:

- (1) In the case of notice of a meeting at the expiration of 48 hours after the letter containing the same is posted, and
- (2) In any other case at the time at which the letter would be delivered on the ordinary course of post.

Question 129

State any six charges which are required to be registered under the provisions of the Companies Act, 1956. What is the effect of non-registration of a charge required to be registered under the Act ? Explain.
(May 2007)

Answer

As per Section 125, Companies Act, 1956, the following are the charges required to be registered with the registrar of companies within 30 days after the date of its creation:

- (i) a charge for the purpose of securing any issue of debentures;
- (ii) a charge on uncalled share capital of the companies;
- (iii) a charge on any immovable property, wherever situated, or any interest therein;
- (iv) a charge on any book debt of the company;
- (v) a charge not being a pledge, on any movable property of the company;
- (vi) a floating charge on the undertaking or any property of the company including stock-in-trade;
- (vii) a charge on calls made but not paid,
- (viii) a charge on a ship or any share in ship;
- (ix) a charge on goodwill on a patent or licence under a patent, on a trademark or on a copyright or a license under a copy right.

Effect of non registration of charge: -

If any of the charges is not registered, it shall be void against the liquidators and any creditor of the company [Section 125 (1)] (*Monolithic Building Co.*)

When the charge becomes void, the money secured thereby shall immediately become payable (Section 125 (3)). The company and every officer of the company may be subjected to a penalty up to Rs. 5000 for every day during which the default continues. In the event of the charge being void for non registration no right of lien can be claimed on the documents of title, as they are only ancillary to the charge and were delivered pursuant to the charge (*In re Moltan Ltd*) Though the charge becomes void for non-registration, but the debt is good as a simple debt (*C. Padam ji Co. V Moose*)

Question 130

Though six out of seven signatures to the Memorandum of Association of a company were forged, the company was registered and the Certificate of Incorporation was issued. Can the registration of the company be challenged subsequently on the ground of forged signatures ?

(May 2007)

Answer

No. Registration cannot be challenged. Section 35 of the Companies Act 1956 declares that certificate of incorporation given by the Registrar in respect of any company shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is company authorized to be registered and duly registered under the Act. (*Peel's Case*)

Question 131

Who are the persons entitled to receive notice of a general meeting of a company, registered under the Companies Act, 1956 ? Shall the non-receipt of notice of the general meeting by any member invalidate the proceedings of the meeting ? Explain. (May 2007)

Answer

Persons entitled to notice: Notice of the meeting shall be given:

- (a) To every member of the company;
- (b) To the persons entitled to a share in consequence of the death or insolvency of a member;
- (c) To an auditor or auditors [Section 172 (a); and

The company cannot take notice of the beneficial owner of shares who are, therefore, not entitled to receive notice. Where, however, anyone is legally entitled to represent the member, such representative is entitled to receive the notice.

A private company, which is not, a subsidiary of a public company may prescribe, by its Articles, persons to whom the notice should be given. It does not always follow that all the members of a company are entitled to receive notice of meetings of the company; the Articles frequently provide that preference shareholders shall not be entitled to receive notice of and vote at general meeting of the company, except in certain circumstances. There is a statutory obligation to send notice to preference shareholders when their dividend is in arrears for more than a certain period [section 87(2) (b)]. This obligation arises from the fact that preference shareholders whose dividends are in arrears are entitled to attend and vote at the meeting.

The non-receipt of notice or accidental omission to give notice to any member shall not invalidate the proceeding in the meeting [Section 172 (3)]. However, omission to serve notice of meeting on a member on the mistaken ground that he is not a shareholder cannot be said to be an accidental omission [*Musselwhite Vs. C.H. Musselwhite & Sons Ltd.* (1962) 32 Comp. Cas 804]. 'Accidental omission' means that the omission must be not only designed but also not deliberate [*Maharaja Export Vs. Apparels Exports Promotion Council* (1986) 60 Comp. Cas 353.].

Question 132

ABC Limited served a notice of a general meeting upon its members. The notice stated that a resolution to increase the Share Capital of the company would be considered at the meeting. A member complains to the company that the amount of the proposed increase was not specified in the notice. In the light of the provisions of the Companies Act, 1956, examine the validity of the notice.
(May 2007)

Answer

Section 173 of the Companies Act, 1956 requires a company to annex an explanatory statement to every notice for a meeting of company, at which some 'special business' is to be transacted. This explanatory statement is to bring to the notice of members all material facts relating to each item of special business. Section 173 further specifies that all business in case of any meeting is regarded as special business. Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section 173.

Question 133

XYZ Limited held its Annual General Meeting on September 15, 2006. The meeting was presided over by Mr. V, the Chairman of the Company's Board of Directors. On September 17, 2006, Mr. V, the Chairman, without signing the minutes of the meeting, left India to look after his father who fell sick in London. Referring to the provisions of the Companies Act, 1956, state the manner in which the minutes of the above meeting are to be signed in the absence of Mr. V and by whom.
(May 2007)

Answer

By virtue of Section 193 (1A) (b) of the Companies Act, 1956, minutes of proceeding of general meeting can be signed and dated within a period of 30 days, by a director duly authorized by the board for the purpose. In the circumstances contemplated by the question, therefore, a Board meeting has to be convened and one of the directors present thereat be authorized to sign and date the minutes of the annual general meeting.

Question 134

A limited company is formed with its Articles stating that one Mr. X shall be the solicitor for the company, and that he shall not be removed except on the ground of misconduct. Can the company remove Mr. X from the position of solicitor even though he is not guilty of misconduct? (November 2007)

Answer

The Articles of Association of a company are its bye-laws that govern the management of its internal affairs. As between outsiders and the company, Articles do not give any right to outsiders against the company even though their names might have been mentioned in the Articles. An outsider cannot take advantage of the Articles to found claim thereon against the company. Thus, in the given case, the company shall succeed in removing Mr. X as solicitor of the company (*Eley V Positive Government Security Life Assurance Co.*)

Question 135

For a special resolution in a Company's general meeting, 10 voted in favour, 2 against and 4 abstained. The chairman declared the resolution as passed. Is it a valid resolution as per the provisions of the Companies Act, 1956. (November 2007)

Answer

Yes, it is a valid resolution. Section 189 (2) (c) of the Companies Act, 1956 provides that the votes cast in favor of resolution (whether on a show of hands, or on a poll as the case may be) by members who, being entitled so to do, vote in person or where proxies are allowed, by proxy, are not less than three times the number of votes, if any, cast against resolution by members so entitled and voting.

Question 136

While sanctioning working capital limit of a company, the rate of interest has been fixed at a specified percentage above the bank rate as notified by the Reserve Bank of India. There was a change in the interest rate due to RBI

notification issued later. The bank insisted on filing a return of modification of charges. Is the stand of the bank correct? Discuss this in the light of the provisions of the Companies Act, 1956. (November 2007)

Answer

Section 135 of the Companies Act, 1956 provides that whenever the terms or conditions or the extent or operation of any charge registered under this part are or is modified, it shall be the duty of the company to send to the Registrar the particulars of such modifications and the provisions of this part as to registration of a charge shall apply to modification of the charge. In the light of this provision the changes in the rate of interest constitute modification; therefore, the stand of bank is correct.

Question 137

Under what circumstances a company can reduce its share capital? (November 2007)

Answer

Section 100 of the Companies Act, provides that a company, limited by shares or guarantee and having share capital, if so authorised by the articles, may by special resolution and with the confirmation of the Court, reduce its share capital in any way and in particular by:

- (a) extinguishing or reducing the liability of members in respect of the capital not paid up:
- (b) writing off or cancelling any paid-up capital which is in excess of the needs of the company.
- (c) paying off any paid-up share capital which is in excess of the needs of the company.

Reduction in (b) and (c) may be made either in addition or without extinguishing or reducing the liability of the members for uncalled capital. Reduction of share capital may in reality take three forms, namely, (i) reducing the value of shares in order to absorb the accumulated losses suffered by the company without any payment to the shareholders; (ii) extinction of liability of capital not paid; (iii) paying off any paid-up share capital. Only in the circumstances referred to in (ii) and (iii) is the interest of creditors really involved.

Question 138

What is the concept of proxy in relation to the meetings of a Company? Decide the appointment and rights of a proxy, under the Companies Act, 1956, in the following cases:

- (i) *When a body corporate is a member in the company.*
- (ii) *When a foreign company is a member in the company. (November 2007)*

Answer

- (e)** A proxy is a person, being a representative of a share holder at a meeting company who may be described as his agent to carry out which the shareholder has himself decided upon. [*Cousin vs. International Brick Co, 1931*].

The appointment of a proxy must be made by a written instrument signed by the appointer or his duly authorised attorney. The instrument of proxy has to be in the prescribed form set out in Schedule IX.

Section 187 of the Companies Act, 1956 provides that where a company is a member of another company it may attend the meeting of any other company through a representative. The representative must be appointed by a resolution of the Board of directors or the other governing body, the person so appointed is entitled to exercise the same rights and powers (including the right to vote by proxy) on behalf of the company as the individual member of the company may exercise.

Foreign company can also make the use of this provision or it may by means of power of attorney. [CEPT v. Jeevanlal Ltd., (1951)]

Question 139

X, a chemical manufacturing company distributed 20 lac (Rs. Twenty Lac) to scientific institutions for furtherance of scientific education and research. Referring to the provisions of the Companies Act, 1956 decide whether the said distribution of money was "Ultra vires" the company? (November 2007)

Answer

Distribution of Rupees Twenty Lac by a company engaged in Chemical manufacturing is not 'Ultra Vires' the company since it was conducive to the continued growth of the company as chemical manufacturers (*Evans v. Brunnner, Mood & Co. Ltd. 1921*).

Question 140

How nomination facility shall operate in case of transmission of shares under the provisions of the Companies Act, 1956? (November 2007)

Answer

Section 109 of the Act provides that any person who becomes a nominee by virtue of the provisions of Section 109 A, upon the production of such evidence as may be required by the Board and subject as hereinafter provided, elect, either

- (a) to be registered himself as holder of the share or debenture, as the case may be; or
- (b) to make such transfer of the share or debenture, as the case may be as the deceased shareholder or debenture holder, as the case may be, could have made.

If the person being a nominee, so becoming entitled, elects to be registered as holder of the share or debenture, himself as the case may be, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and such notice shall be accompanied with the death certificate of the deceased shareholder or debenture holder, as the case may be. (Sub-section 2).

Question 141

Sunrise Limited submitted the documents for incorporation on 5th October, 2006. It was incorporated and certificate of incorporation of the company was issued by the Registrar on 20th October, 2006. The company on 14th October, 2006 entered into a contract which created its contractual liabilities. The company denies the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide under the provisions of the Companies Act, 1956, whether the company can be exempted from the said contractual liability. (November 2007)

Answer

Sometimes contracts are made on behalf of a company even before it is incorporated. But no contracts can bind a company before it becomes capable of contracting by incorporation. Two consenting parties are

necessary to a contract, whereas the company before incorporation is a non-entity [*Kelner v. Baxter 1866*].

Pre-incorporation contracts in general are void ab initio and hence not binding on the company. However, under section 19 (e) of the Specific Relief Act, 1963 the party to the contract can enforce the contracts against the company if the company had adopted the same after incorporation and the contract is warranted by the terms of incorporation. Thus unless the company adopts the contract, the other party cannot enforce the same against the company. However, promoters can be held personally liable. The problem is based on above case i.e. *Kelner v. Baxter*. After application of above provisions it is clear that the company can be exempted from the said contractual liability .

Question 142

P the secretary of a XYZ Limited issues a Share certificate in favour of A purporting to be signed by the directors and the secretary and the seal of the company affixed to it. In fact the secretary forged the signature of the directors and has affixed the seal without authority. Can A hold the company liable for the shares covered by the share certificate, under the provisions of the Companies Act, 1956?
(November 2007)

Answer

Share certificate is a document under the common seal of the company specifying that a member is the holder of specified number of shares of the company. The company is estopped from denying the title of the shareholder on number of shares in the share certificate. Hence share certificate is a prima facie evidence of the title of member to such shares.

Facts given in the problem are based on the facts of *Rubben v. Great Fingall Consolidated Co. [1906]*. In this case it was held that the company is liable if an officer of the company, who has no authority to issue a certificate, issues a forged certificate. Hence A can hold the company liable for the shares covered by the forged share certificate issued by P, the secretary of XYZ Limited.

Question 143

Examine the validity of the following with reference to the relevant provisions of the Companies Act, 1956:

- (i) *The Board of Directors of a company refuse to convene the extraordinary general meeting of the members on the ground that the requisitionists have not given reasons for the resolution proposed to be passed at the meeting.*
- (ii) *The Board of Directors refuse to convene the extraordinary general meeting on the ground that the requisitions have not been signed by the joint holder of the shares.*
- (iii) *Adjournment of extraordinary general meeting called upon the requisition of members on the*

Answer

As per Section 169 of the Companies Act 1956, the Board of directors must convene a general meeting upon request or requisition if certain conditions are satisfied.

- (i) The requisitions must state the objects of the meeting, i.e., it must set out the matters for the consideration of which the meeting is to be called [Section 169 (2)]. However, the requisitionists are under no obligation to attach the explanatory statement to the requisition. It is for the Board of directors, on receipt of the requisition, to include in the notice convening the meeting, the necessary explanatory statement (*Life Insurance Corporation of India v. Escorts Ltd. 1986.*).

In given problem (i) the Board of Directors may refuse to convene the meeting because reasons for the resolution is not given.

- (ii) Where two or more persons hold any shares or interest in a company jointly, a requisition, or notice calling a meeting, signed by one or some of them shall, for the purposes of this section, have the same force and effect as if it had been signed by all of them [Section 169 (8)].

On the basis of above section the Board of Directors has no right to refuse to convene the meeting in the given problem (ii).

- (iii) As per Section 147 of the Companies Act, 1956, if in a requisitioned meeting, there is no quorum present within half an hour, the meeting stands dissolved.

The stand taken by the Board of Directors is proper in the given problem (iii).

Question 144

What are the differences between "Share certificate and Share warrant"? (November 2007)

Answer

The difference between share certificate and share warrant may be as follows

1. A share certificate is a prima facie evidence of title whereas a share warrant is a bearer document, stating that the holder is entitled to certain number of shares specified therein.
2. The holder of share certificate is a member of the company whereas the holder of share warrant may be a member (Provided by Articles).
3. A share warrant is a negotiable instrument whereas a share certificate is not so.
4. In order to qualify as director a person should acquire a share certificate instead of a share warrant.
5. A share certificate can be issued for a fully or partly paid up shares. On the other hand a share warrant can be issued in respect of fully paid up share only.

Question 145

ABC Pvt. Ltd., Company is a Private Company having five members only. All the members of the company were going by car to Mumbai in relation to some business. An accident took place and all of them died. Answer with reasons, under the Companies Act, 1956 whether existence of the company has also come to the end? (May 2008)

Answer

Death of all members of a Private Limited Company, The Companies Act, 1956

A joint stock company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder(s) or director(s). The provision for transferability or transmission of the shares helps to preserve the perpetual existence of a company. Law creates it and law alone can dissolve it. Members may come and go but the company can go on forever. So in such case, the ABC Pvt. Ltd. Co. does not cease to exist. By way of transmission of shares, shares are transmitted to their legal representatives. The company ceases to exist only on the winding up of the company. Therefore, even with the death of all members (i.e. 5), ABC (P) Ltd. does not cease to exist.

Question 146

Before the incorporation of the company, the promoters of the company entered into an agreement with Mr. Jainson to buy an immovable property on behalf of the company. After incorporation, the company refused to buy the said property. Advise Mr. Jainson whether he has any remedy under the provisions of the Companies Act, 1956? (May 2008)

Answer**Pre-Incorporation Contracts, The Companies Act, 1956**

The present case is related to the pre-incorporation contract. The promoters of the company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated. As such contracts are a nullity and the company cannot sue or be sued on such contract when company comes into existence. So in such case 'A' has remedy against the promoters only. They are liable personally for those contracts that are made on behalf of the company before it comes into existence. Even the company cannot ratify such contracts after its registration. Such contracts are deemed to have been entered into personally by the promoters.

Question 147

Explain the doctrine of "Ultra-vires". What are the legal effects of ultra-vires transactions under the Companies Act, 1956? (May 2008)

Answer**Doctrine of Ultra Vires, The Companies Act, 1956**

A company has the power to do all such things as are:

1. Authorised to be done by the Companies Act, 1956;
2. Essential to the attainment of its objects specified in the Memorandum.
3. Reasonably and fairly incident to its objects.

Everything else is ultra vires the company. The term 'ultra vires' means that the doing of the act is beyond the legal power and authority of the company. If an act is ultra vires the company, no legal relationship or effect ensues there from. Such an act is absolutely void and even the whole body of shareholders cannot ratify it and make it binding on the company. The leading case on the point is *Ashbury Rly. Carriage & Iron Co. Ltd. Vs. Riche* where it was held that a company being a corporate person should not be

fined or punished for its own acts or an act of its agent, if it is beyond its powers and privileges. Main features of the doctrine of ultra vires are:

1. when an act is performed or a transaction is carried out which, though legal itself, is not authorized by the objects clause in the memorandum or by Statute, it is said to be ultra vires the company.
2. if an act is ultra vires the company, it cannot be ratified even by the whole body of shareholders.
3. if an act is ultra vires the directors, but intra vires the company, it can be ratified by the whole body of shareholders.
4. if an act is ultra vires the Articles, it can be ratified by altering the Articles by a special resolution at a general meeting.

Effect of ultra vires transaction and borrowing: An ultra vires transaction being void does not vest the transferee with any right; nor does it divest the transferor. It means the transferor does not lose any right and the transferee does not get any right.

Question 148

Under the Articles of Association of Sunshine Ltd. Company, directors had power to borrow up to Rs.10,000 without the consent of the general meeting. The Directors themselves lent Rs.35,000 to the company without such consent and took debentures of the Company. Decide under the provisions of the Companies Act, 1956, whether the company is liable? If so, what is the extent of liability of the company in this case? (May 2008)

Answer

Directors' Power to Borrow, The Companies Act, 1956

An outsider is presumed to know the constitution of company, but not what may or may not have taken place within the doors that are closed to him. However, where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he cannot claim the benefit under the rule of indoor management.

In this case, the directors of a company could borrow any amount up to Rs. 10,000/- without the resolution of the company in a general meeting. But for any amount beyond Rs. 10,000/- they had to obtain the consent of the shareholders in a general meeting. The directors themselves lent Rs. 35,000/- to the company without such consent and took debentures. The directors

had the notice of the internal irregularity and hence the company was liable to them only for Rs. 10,000/-

Question 149

Explain the provisions and main contents of "Return of Allotment" under the Companies Act, 1956.
(May 2008)

Answer

Return of Allotment (Section 75, Companies Act, 1956): Within thirty days of allotment of shares, a company is required to send the Registrar a report, known as the "return as to allotment". It must contain the following particulars:

1. The number of nominal amount of shares allotted; the names, addresses, the occupation of the allottees; the amount, if any, paid or payable on each share. No share should be shown as allotted for cash unless cash has actually been received in respect of the allotment.
2. Contracts in writing under which shares have been allotted for any consideration other than cash, must be produced for examination of the Registrar.
3. Where bonus shares have been issued, the returns must show the nominal amount of the shares allotted; names and addresses and occupations of the allottees and a copy of the resolution authorizing the issue of such shares.
4. Where the shares have been issued at a discount, the return must include a copy of the resolution authorizing such an issue, a copy of the Tribunal's order sanctioning the issue, and where the rate of discount is more than ten percent, a copy of the order of the Central government permitting the issue.

Question 150

Explain the concept of "Sweat Equity Shares". Point out, under provisions of the Companies Act, 1956, the conditions of issuing of such shares and their position in the Share-capital of the Company.
(May 2008)

Answer

Sweat Equity Shares, The Companies Act, 1956

The expression 'Sweat Equity Shares' means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called. (Explanation II to Section 79A, Companies Act, 1956)

Conditions for issue of Sweat Equity Shares:

- (a) The shares should be of a class which has already been once issued.
- (b) The issue should be authorized by a special resolution at a general meeting of the company.
- (c) The resolution should specify the number of shares and their current market price and also the class or classes of directors or employees to whom they are to be issued and consideration for the sweat equity shares proposed to be issued.
- (d) At least one year must have elapsed between the commencement of business by the company and the date of such issue.
- (e) Such shares shall be issued in accordance with SEBI Regulations. Where the shares are not listed at a stock exchange, they can be issued as sweat equity.

Shares issued as sweat equity shares are to be treated for all purposes like other shares and, therefore, all the limitations, restrictions and provisions relating to equity shares will be applicable to them.

Question 151

Peek Ltd. Co. issued and published its prospectus to invite the investors to purchase its shares. The said prospectus contained false statement. Mr. X purchased some partly paid shares of the company in good faith on the Stock Exchange. Subsequently, the company was wound up and the name of Mr. X was in the list of contributors. Decide:

- (i) *Whether Mr. X is liable to pay the unpaid amount?*
- (ii) *Can Mr. X sue the directors of the company to recover damages?(May 2008)*

Answer

False Statement in Prospectus, the Companies Act, 1956

- (i) Yes, X is liable to pay the unpaid amount on the shares. As X has purchased partly paid shares, so he is liable for the remaining part of the shares. At the time of winding up he is liable to contribute a contributory.

The related case law in this subject matter is *Peak vs. Gurney*.

- (ii) No, X cannot sue the directors to recover damages for the misstatement. The shareholder must have relied on the statement in the prospectus in applying for shares. If a person purchases shares in open market, the prospectus ceases to be operative. In the present case, Mr. X purchased shares in good faith on the stock exchange. He had not relied on the statement in prospectus. So he cannot sue.

Question 152

The Articles Association of PQR Ltd. provided that documents upon the company may be served only through E-mail. Arvind sent a document to the company by registered post. The company did not accept the document on the ground that sending documents to the company by post was in violation of the Articles. As a result Arvind suffered loss. Decide the validity of argument of the company and claim of Arvind for damages in the light of provisions of the Companies Act, 1956. (May 2008)

Answer

Service of Documents, the Companies Act, 1956

Section 51 of the Companies Act, 1956 contains the law relating to service of documents on company. The Section provides that a document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post, or by leaving it at its registered office.

Since, as per Section 9 of the Companies Act, any provision in the Articles of Association contrary to the provisions of the Act shall be void, the requirement in the Articles that documents shall be served on the company only through E-mail is not valid. Accordingly, company's refusal to accept the document is not valid and company shall be held liable in damages to Arvind.

Question 153

The Directors of Mars India Ltd. desire to alter capital clause of Memorandum of Association of their company. Advise them, under the provisions of the Companies Act, 1956 about the ways in which the said clause may be altered and the procedure to be followed for the said alteration. (May 2008)

Answer

Alteration of Capital (Section 94) the Companies Act, 1956

A limited company with a share capital can alter the capital clause of its memorandum of association in any of the following ways, provided authority to alter is given by the articles.

- (i) it may increase its capital by issuing new shares
- (ii) consolidated the whole or any part of its shares capital into shares of larger amount
- (iii) convert shares into stock or vice versa
- (iv) sub-divide the whole or any part of its share capital into shares of smaller amount
- (v) cancel those shares which have not been taken up and reduce its capital accordingly.

Provisions regarding confirmation, resolution and notices: Any of the above things can be done by the company by passing a resolution at general meeting, but do not require to be confirmed by the National Company Law Tribunal. Within thirty days of alteration notice must be given to the Registrar who will record the same and make necessary alteration in the company's memorandum and articles. Notice to the Registrar has similarly to be given when redeemable preference shares have been redeemed. Similar information is also required to be sent where the capital has been increased beyond the authorized limit, or where a company, being not limited by shares, has increased the number of its members.

Question 154

The Chairman of the meeting of a company received a Proxy 54 hours before the time fixed for the start of the meeting. He refused to accept the Proxy on the ground that the Articles of the company provided that a Proxy must be filed 60 hours before the start of the meeting. Decide, under the provisions of the Companies Act, 1956 whether the Proxy holder can compel the Chairman to admit the Proxy?
(May 2008)

Answer

Proxy, the Companies Act, 1956

Yes. The holder of proxy can compel. As per Section 176(3) of the Companies Act, 1956 proxy shall be deposited with the company within 48 hours before

the meeting. Any provisions contained in the Articles of a company that requires a longer period than 48 hours before a meeting of the company for depositing a proxy, shall have effect as if a period of 48 hours had been required by such provision for such deposit.

Question 155

Ramesh, who is a resident of New Delhi, sent a transfer deed, for registration of transfer of shares to the company at the address of its Registered Office in Mumbai. He did not receive the shares certificates even after the expiry of four months from the date of dispatch of transfer deed. He lodged a criminal complaint in the Court at New Delhi. Decide, under the provisions of the Companies Act, 1956, whether the Court at New Delhi is competent to take action in the said matter? (May 2008)

Answer

Jurisdiction of Court, now Tribunal, the Companies Act, 1956

According to Section 113(1) of the Companies Act, 1956 every company, unless prohibited by any provision of law or of any order of court, Tribunal or other authority, shall within two months after the application for the registration of transfer of any such shares, deliver the certificates of all shares transferred. In the case of a listed company under the listing agreement this period has been reduced to 30 days.

The facts of the given case are similar to *H.V. Jaya Ram Vs. ICICI Ltd., 1998*. In this case the Special Court for Economic Offences in the State of Karnataka rejected the appellant's complaint against the respondent company on the ground that since the company had its registered office at Mumbai it is only the court which has territorial jurisdiction over the registered office of the company that can entertain the petition and not the court located in the State of Karnataka where the shareholder is residing. The High Court also upheld the order of the Special Court. On appeal Supreme Court held that cause of action for failure to deliver share certificate arises where the registered office of the company is situated and not in the jurisdiction of the Court located in the place where the complaint resides.

Accordingly in the present case also, the Court in New Delhi cannot entertain the complaint against a company having its registered office in Mumbai.

Question 156

A company was started with the object of building 'A mall with shops'. The building was destroyed by fire and the company wanted to alter the objects

clause in the memorandum by substituting the words 'A mall with shops' with the words "Shops, Residential buildings and Warehouses for letting purposes." Will this alteration of the memorandum for the purpose be permissible? Decide referring to the provisions of the companies Act, 1956. (November 2008)

Answer

Alteration of objects

Section 17 (1) of the Companies Act, 1956, permits a company to alter its objects in the memorandum to carry on some business which under the existing circumstances may conveniently or advantageously be combined with the existing business.

Thus, in the given problem the new object of "shops, residential buildings and warehouses for letting purposes" can be conveniently and advantageously combined with the existing object of building a "mall with shops" which is obviously for letting purposes. Accordingly, alteration is permissible.

Question 157

The Memorandum of Association of a company was presented to the Registrar of Companies for registration and the Registrar issued the certificate of incorporation. After complying with all the legal formalities a company started a business according to the object clause, which was clearly an illegal business. The company contends that the nature of the business cannot be gone into as the certificate of incorporation is conclusive. Answer the question whether company's contention is correct or not. (November 2008)

Answer

Object clause

The subscribers to the memorandum may choose any object or objects for the purpose of their company. However there are two restrictions on the selection of "object" for a company:

- (i) the object should not include anything which is illegal or contrary to law or public policy.
- (ii) the objects should not also contemplate doing anything which is prohibited by the Companies Act.

On applying the above provision in the present problem, the company's contention is wrong. Though a certificate of incorporation is a conclusive

evidence of its registration, that is, it is conclusive evidence as to the fact that all requirements of the Companies Act for the incorporation of a company have been complied with, and that now company is a legal entity but, it does not mean that all its objects are legal. In *Bowman v. Secular Society Ltd.*, the court held that the statute does not provide that all or any of the objects specified in the memorandum, if otherwise illegal, would be rendered legal by the certificate. Therefore, the contention of the company that the nature of business cannot be gone into after the certificate of incorporation has been obtained is not tenable.

Question 158

M applies for share on the basis of a prospectus which contains mis-statement. The shares are allotted to him, who afterwards transfers them to N. Can N bring an action for a rescission on the ground of mis-statement? Decide under the provisions of the Companies Act, 1956.

(November 2008)

Answer

Mis-statement in prospectus

No, N cannot bring an action for rescission on the ground of mis-statement as N had not contracted with the company on the basis of prospectus containing mis-statement. The right to rescind the contract is available only to original allottees (*Peek vs Gurney*)

Question 159

What is meant by a floating charge? State the characteristics of a floating charge. When does a floating charge crystallise? *(November 2008)*

Answer

Floating charge

A floating charge is an equitable charge which is not a specific charge on any property of the company. Thus, the company may, despite the charge, deal with any of the assets in the ordinary course of business. It is of the essence of a floating charge that it remains dormant until the undertaking charged ceases to be a going concern or until the person in whose favour the charge is created, intervenes.

The main characteristics of a floating charge as described in *Re. Yorkshire wool combers Association* are as follows:

- (i) It is a charge on a class of the company's assets, present and future, that class being one which, in the ordinary course of the business is changing from time to time.
- (ii) Generally, it is contemplated that the company carry on its business in an ordinary way with such a class of assets till some event occurs on which the charge is to settle down on the property as then existing and the charge becomes fixed. The moment the charge crystallises, it becomes a fixed charge.

A floating charge crystallises or gets fixed when:

- (i) The company goes into liquidation or
- (ii) The company ceases to carry on business
- (iii) A receiver is appointed or
- (iv) A default is made in paying the principal and/ or interest and the holder of the charge brings an action to enforce his security.

Question 160

Discuss the concept of shelf prospectus, the provisions for issue and filing of such prospectus under the Companies (Amendment) Act, 2000 (November 2008)

Answer

Shelf prospectus

The Companies (Amendment) Act, 2000 introduced a new section 60 A relating to the issue of Shelf Prospectus. Shelf Prospectus means a Prospectus issued by any financial institution or bank for one or more issues of securities or class of securities specified in that Prospectus.

1. Any public financial institution, public sector bank or scheduled bank whose main object is financing shall file a Shelf Prospectus.

Financing means making loans to or subscribing in the capital of a private industrial enterprise engaged in infrastructural financing or such other company to be notified by the central government.

2. A company filing a Shelf Prospectus with the Registrar is not required to file Prospectus every time it seeks to make a public issue.

3. A company filing a Shelf Prospectus is required to file an Information Memorandum on all material facts relating to
 - (i) New charges created;
 - (ii) Changes in the financial position as have occurred between the first offer of securities
 - (iii) Previous offer of securities and the succeeding offer of securities within the time to be prescribed by the central government.
4. An Information Memorandum shall be issued to the public along with the Shelf Prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of the opening of the first issue of securities under the Prospectus.

Where an update of Information Memorandum is filed every time an offer of securities is made, such memorandum together with the shelf Prospectus shall constitute the Prospectus.

Question 161

A public limited company has only seven shareholders, all the shares being fully paid-up. All the shares of one such shareholder are sold by the court in an auction and purchased by another shareholder. The company continues to carry on business thereafter. Discuss the liabilities of the shareholders of the company under the Companies Act, 1956.

(November 2008)

Answer

Consequences of membership falling below legal minimum

The problem in the question relates to reduction of membership below the statutory minimum. Section 12 of the Companies Act, 1956 requires a public company to have a minimum of seven members. If at any time the membership of a public company falls below seven and it continues its business for more than six months, then according to Section 45 of the Act every such member who was aware of this fact would be personally and severally liable for all debts contracted by the company during the period and may be severally sued for all debts contracted after six months.

Accordingly, in the given problem, the remaining six members shall incur personal liability for the debts contracted by the company,

- (i) If they continued to carry on the business of the company with that reduced membership beyond the six month period.
- (ii) Only those members who knew of this fact of reduced membership shall be liable.
- (iii) The liability shall extend only to the debts contracted after six months from the date of auction of that member's shares.

Question 162

What are the conditions for the company for the buy-back of its own shares? Whether there is any time limit for the completion of buy-back of its shares?(November 2008)

Answer

Conditions of Buy Back

Section 77A of the Companies Act, 1956 provides for a company to purchase its own shares or other specified securities subject to certain conditions and regulations. Thus the Act says that no company shall purchase its own shares or other specified securities unless-

- (a) the buy-back is authorised by its articles;
- (b) a special resolution has been passed in the general meeting of the company authorizing the buy-back;

Provided that nothing contained in this clause shall apply in any case where:-

- (1) The buy-back is of less than 10% of the total equity paid up capital and free reserves of the company; and
 - (2) Such buy-back has been authorised by the board by means of resolution passed at its meeting;
- (c) the buy-back is or less than 25% of the total paid up capital or free reserves of the company
 - (d) the ratio of the debt owned by the company is not more than twice the capital and its free reserves after such buy-back;
 - (e) all the shares or the specified securities for buy-back are fully paid up;
 - (f) the buy-back of the shares or other specified securities listed on any stock exchange is in accordance with the regulations made by Securities Exchange Board of India in this behalf;

- (g) the buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed.

Time limit for completion of buy-back: Every buy-back shall be completed within 12 months from the date of passing the special resolution or a resolution passed by the Board under the clause (b) of sub-section (2) of Section 77A.

Question 163

Apex Metals Limited wants to provide financial assistance to its employees, to enable them to subscribe for certain number of fully paid shares. Considering the provision of the Companies Act, 1956, what advice would you give to the company in this regard?
(November 2008)

Answer

Financial assistance for purchase of own shares

Section 77 of the Companies Act, 1956 provides that no public company and no private company being a subsidiary of a public company, can give financial aid to any person, either directly or indirectly and whether by way of loan, guarantee or surety or otherwise, for or in connection with purchase or subscription made or to be made of any of its own shares or of its holding company.

There are, however, certain exceptions to this rule, namely-

- (a) a banking company may lend money for the purpose in the ordinary course of its business but not on the security of its own shares, or
- (b) The company in pursuance of a scheme for the purchase of or subscription for fully paid shares of the company (or those of its holding company) to be held by trustees for the benefit of the employees of the company, may advance loan for the purpose.
- (c) The company may advance a loan to a person bonafide in its employment (other than directors or managers) to enable them to purchase or subscribe for fully paid shares for an amount not exceeding their salary or wages for a period of six months. (section 77)

However, the exception to this rule allows making of loans by a company, to its bonafide employees for purchasing or subscribing to the fully paid shares

of the company. Section 77(3) provided that such financial assistance should not exceed six months' wages or salary of the employee.

Question 164

State whether the following statements are correct or incorrect. Give reasons:

- (i) Right shares means shares which are issued by a newly formed company.*
- (ii) A company should file its annual return within six month of the close of the financial year.*
- (iii) A bearer of a share warrant of a company is not member of the company.*
- (iv) The shareholder of the company is general meeting can increase the rate of dividend recommended by the Board of Directors.*
- (v) Debenture with voting rights can be issued only if permitted by the Articles of Association.*

(November 2008)

Answer

(i) Right shares

According to section 81 of the Companies Act, 1956 where the shares are offered to the existing shareholders who have pre-emptive right to purchase the additional shares of the company to expand its activities or it may stand in need of more financial resources, it is called right issue.

Hence the given statement is incorrect.

(ii) Filing of annual return

Section 159 of the Companies Act, 1956 states that a company should file its annual return within sixty days from the date the Annual General Meeting is held.

Hence the given statement is incorrect.

(iii) Share warrant

According to the provision relevant to share warrant, it has been mentioned that the bearer of a share warrant of a company can be a member only if the articles so provide. This says that the bearer is not a member of the company unless and until the articles of a company may provide that the bearer of a share warrant shall be deemed to be a member of the company for the purposes defined by the articles.

So the given statement is correct.

(iv) Dividend

The shareholders can decrease the rate of the dividend but cannot increase in the general meeting. Hence the given statement is incorrect.

(v) Debentures with voting rights

As given under section 117 of the Companies Act, 1956 no company can issue any debentures carrying voting rights at any meeting of the company, whether generally or in respect of any particular classes of business.

Hence the given statement is incorrect.

Question 165

State the legal position in the following circumstances with reference to the provisions in the Companies Act, 1956.

At an adjourned extraordinary general meeting of a Public Ltd. Company adjourned for want of quorum, only 3 members are personally present. (November 2008)

Answer

Quorum

Quorum means the minimum number of members who must be present in order to constitute a meeting and transact business thereat. Thus the meeting cannot proceed with business in the absence of quorum unless the articles of the company provide otherwise.

As per Section 174(5) of the Companies Act, 1956, if a meeting is adjourned for want of quorum and at the adjourned meeting also quorum is not present, within half an hour from the time appointed for holding the meeting, the members present shall be quorum. Assuming here, that the adjournment of meeting is called because of absence of quorum, the above-stated provision will prevail. Accordingly, three members who are personally present can validly conduct the meeting. But if the adjournment has taken place for any reason other than absence of quorum, the quorum as per articles or at least five members as per Section 174(1), must be present.

Question 166

What do you mean by Transmission of shares? Differentiate between Transfer of shares and Transmission of shares. (November 2008)

Answer

Transmission of shares

Transmission of shares takes place: (i) When the registered shareholder dies, or (ii) When he is adjudged insolvent (iii) and where holder is a company, if it goes in to liquidation.

Distinction between transfer and transmission.

The following are the points of distinction between transfer and transmission of shares.

- (i) Transfer takes place by a voluntary and deliberate act of the transferor, while transmission is the result of operation of law.
- (ii) In case of transfer, the transferor and the transferee have to execute an instrument of transfer while in the case of transmission shares are transmitted on the death, insolvency of a member and instrument of transfer is not required; only a proof of his title to the shares is required.
- (iii) Transfer is the normal method of transferring property in the shares, whereas transmission of shares takes place on the death, or insolvency of a shareholder.