SYLLABUS

Class – M.Com. II Sem.

Subject – Corporate Legal Framework

UNIT – I	The Companies Act, 1956 (Relevant Provisions): Definitions, types of companies, Memorandum of association, Articles of associations, Prospectus, share capital and membership, Meetings and Resolutions, Company Management, Managerial Remuneration, winding up and dissolution of companies.
UNIT – II	The Negotiable Instruments Act, 1881: Definition, Types and Negotiable Instruments, Negotiation Holder and holder in due course, Payment in duel; endorsement and Crossing of cheque; Presentation of negotiable instruments.
UNIT – III	MRTP Act [illegible] [illegible]olistic trade practices; Restrictive trade practices; unfair trade [illegible]tice[illegible]
UNIT – IV	The [illegible]tection Act, 1986 features; Definition of Consum[illegible] [illegible] of [illegible]er; [illegible]ievance Redressal Machinery.
UNIT – V	[illegible]gula[illegible]y Environment for International Business: FEMA[illegible] WTO; Reg[illegible]tory [illegible]work of WTO, basic principles and its charact[illegible] [illegible]s relating to preferential treatment to developing countries; [illegible]ona[illegible] [illegible]ou[illegible]gs, technical standard, anti-dumping duties and other N[illegible]ff [illegible]rie[illegible] custom valuation and dispute settlement, Trip and Trims.

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UNIT — I

Company

The word 'company' in its literary sense, conveys the idea of togetherness. In the business world, the word 'company' may be found being used loosely for any large business concern. In the legal sense the word 'company' point towards a very specific form of business set-up, floated and run by more than one person. This is the body corporate form of business organization.

Definition of a Company

Company : sec.3 (1)(i)- " Company means a company formed and registered under this Act or an existing company"

clause (ii) of Sec.3 (1) defines an existing company as follows :

"**E**xisting company" means a company formed and registered under any of the previous companies laws..."

Thus, every such organization would be a company which is registered under the relevant law as a company before or after the enactment of the companies Act, 1956.

Lord Justice Lindley: "A company is an association of persons who contribute money to a common stock and employed in some trade or business and who share the profit and loss arising there from. The common stock so contributed is denoted in money in money and is the capital of the company".

Haney : "A Company is an artificial person created by law having separate entity with a perpetual succession and common seal."

SPECIAL FEATURES OF A COMPANY

1. Incorporated entity
2. Artificial person
3. Separate legal identity
4. Limited liability
5. Perpetual succession
6. Transferable shares
7. Separate property
8. Common Seal
9. Capacity to sue and be sued
10. Governance by majority

LIFTING OR PIERCING CORPORATE VEIL

Lifting of corporate veil is a fiction of law which means disregarding the separate legal entity of a company and identifying the realities which lay behind the legal façade. In applying this doctrine, the court ignores the company and concerns itself directly with the members or directors.

The various cases in which the corporate veil is lifted may be put under two categories:

I. Statutory Exceptions-

1. When the number of members falls below statutory minimum (Sec. 45)
2. Misdiscription in prospectus (Sec. 62)
3. Failure to refund application money [Sec.69 (5)]
4. Misdiscription representation of name (Sec. 147)
5. Subsidiary company (Sec. 212 & 214)
6. For investigation into affairs of related companies (Sec. 239)
7. for investigation of ownership of a company (Sec. 247)
8. Fraudulent conduct (Sec. 542)
9. Liability for pre-incorporation contracts

II. Judicial Exceptions –

1. Determination of character of company
2. For protection of revenue
3. Prevention of fraud
4. Where the company is acting as the agent of the shareholders
5. Avoidance of welfare laws
6. To punish for contempt of court

KINDS OF COMPANIES

The incorporated bodies or the companies may be put in various classes on the basis of following aspects :

A. Mode of formation.
B. Permitted number of members.
C. Liability of members
D. Control of management.

A. **ON THE BASIS OF MODE OF FORMATION**

There are two modes under which a corporate body may be formed; one, through a special Act of parliament, and two, through registration under the Companies Act.

1. **Statutory Companies**: Corporations created under the special legislations of parliament or state legislatures may be called statutory companies; examples: Life Insurance Corporation of India, Food Corporation of India etc. The Acts creating such corporations would include in them all necessary rules and regulations for the corporate bodies so created.
2. **Registered Companies**: A corporate body registered under the Companies Act, 1956 would be called the registered company.

B. **ON THE BASIS OF PERMITTED NUMBER OF MEMBERS**

1. Private company

Sec. 3 (iii) has defined a private company as follows :

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.
  (i) persons who are in the employment of the company; and
  (ii) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased.
(c) Prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company; and
(d) Prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

2. **Public company**

Sec. 3 (1) (iv) has defined a public company as follows :

Public Company ; A public company means a company which –

(a) is not a private company;
(b) has a minimum paid-up capital of five lakh rupees or such higher paid-up capital, as may be prescribed;
(c) is a private company which is a subsidiary of a company which is not a private company.

(C) ON THE BASIS OF LIABILITY OF MEMBERS

(a) Limited liability companies
  (i) Limited by shares
  (ii) Limited by guarantee
(b) Unlimited companies

1. **Company limited by shares**. In the matter of members liability, this is the most common type of company. Such a company must have a share capital. The members liability is limited up to the amount of shares held. Sec. 12(2) (a) states that such a company would be:
2. **Guarantee company**. This is also called a company limited by guarantee. The guarantee is received from the members. Such a company may or may not have share capital. This is also a limited liability company but the amount of members liability is based not on the shares held but on the guarantee given by the members. Sec. 12(2) (b) states that this is 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 would up.

3. **Unlimited company**. The unlimited company may or may not have share capital. The members liability being unlimited, the quantum of share capital is not a very crucial mater. If it has share capital, it can be easily increased or reduced by altering the Articles. The restrictions on changes in capital are not relevant for an unlimited liability company. Such a company may purchase its own shares and is free from the restrictions provided by Sec. 77.

(D) **ON THE BASIS OF CONTROL OVER MANAGEMENT**

A company is supposed to be autonomous in running its affairs but working under the supervision of law. Sometimes, however, a company may exercise control over another company. The former would be called a holding company and the latter its subsidiary company.

1. **Holding company**. A company would be a holding company in relation to another company if it possesses control over the other company. Sec 4(4) states that a company shall be deemed to be the holding company of another if, but only if, that other is its subsidiary.
2. **Subsidiary company**. Sec. 4(1) describes a subsidiary company as follows:

Subsidiary company: A company shall be deemed to be a subsidiary of another if, but only if,

(a) that other controls the composition of its Board of directors; or

(b) that other -

(i) where the first mentioned company is an existing company in respect of which the holders of preference shares issued before the commencement of this Act have the same voting rights in all respects as the holders of equity shares, exercises or controls more than half of the total voting power of such company;

(ii) where the first mentioned company is any other company, holds more than half in nominal value of its equity share capital; or

(c) the first mentioned company is a subsidiary of any company which is that other's subsidiary.

Company M holds share capital of Rs. 5,00,000 out of Rs. 18,00,000 share capital in company R. Its subsidiary company N holds Rs. 4,50,000 capital in company R. Company R world be the subsidiary of company M since company M and its subsidiary company N together hold a majority share capital in company R.

CERTAIN OTHER KINDS OF COMPANIES

1. Non profit companies or Section 25 companies

It is not uncommon for people to form organizations or associations to pursue non business objectives, such as promotion of art, culture, science and commerce etc. Such associations may or may not be registered. If members do desire registration, then one of the options would be to get the registration under the Companies Act, 1956. Sec. 25 of the Act facilitates the registration of such non business associations as a company under the Act. For this reason, these associations are called Section 25 companies.

2. Government companies

A Government company is such a company registered under the Act in which not less than 50% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary of a Government company as thus defined (Sec. 617).

3. Foreign companies

Foreign companies are defined in Sec. 59(1) as follows:

Foreign company: Foreign companies are the companies falling under the following two categories:

(a) Companies incorporated outside India which, after the commencement of this Act, establish a place of business within India; and

(b) Companies incorporated outside India which have, before the commencement of this Act, established a place of business within India and continue to have an established place of business within India at the commencement of this Act.

4. One-man company

Where almost the entire shareholding in a company is under the ownership of a single person, while a few more members, usually the family members, are there in the company to comply with the requirements of minimum number of members, such a company is commonly called a one-man company or a family company.

PRIVILEGES AND EXEMPTIONS AVAILABLE TO PRIVATE COMPANIES

The following privileges and exemptions are available to a private company:

1. The provisions of Sec. 81 dealing with the further issue of shares do not apply to a private company. So, the shares of a private company, in the event of further issue of capital, need not first be offered to the existing shareholders.
2. A certificate for commencement of business is not necessary for a private company (Sec. 149). It can commence its business as soon as the certificate of incorporation is obtained.
3. A private company need not hold a statutory meeting and file a statutory report [Sec. 165(10)].
4. In case of a private company, under Sec. 179, in a general meeting of the company, a demand for poll on a resolution, may be made by only one member.
5. At the time of getting the company incorporated with the Registrar of companies, the directors of a private company are not required to file with the Registrar their consent in writing to act in that capacity and the undertaking to take up qualification shares.
6. It can proceed to allot shares without having to wait for any such thing as minimum subscription.
7. A life director appointed by a private company on or before April 1, 1952, cannot be removed by the company in general meeting.
8. A private company need not keep an index of members (Sec. 151).
9. Financial assistance to acquire own shares. A private company is not prohibited from giving financial assistance to any one for purchasing or subscribing for its own shares (Sec. 77).
10. Share capital and voting rights. The provisions that there should be only two kinds of share capital i.e. equity share capital and preference share capital, and that voting rights should be proportionate to the capital paid-up, are not applicable to a private company.
11. Provisions as to general meetings. The provisions of sections 171 to 186 relating to the holding of general meetings do not apply on a private company.
12. Managerial remuneration. A private company is exempted from the provisions of Sec. 198 which fixes the overall limit to the managerial remuneration at 11% of net profits.
13. Appointment of firm or body corporate. A private company may appoint a firm or body corporate to any office or place of profit under it for any period.
14. Restriction on disclosure of profit and loss. No person other than a member of the company is entitled to inspect the profit and loss account of a private company in the office of the Registrar (Sec. 220).

Distinction between Private and Public Company

1. **Paid-up capital**. A private company must have a minimum paid-up capital of Rs. 1 lakh whereas the public company should have at least Rs. 5 lakhs.
2. **Minimum number of members**. In the case of a private company, minimum number of persons to form a company is two while it is seven in the case of a public company (Sec. 12).

3. **Maximum number of members**. In case of private company the membership must not exceed 50 whereas there is no such restriction on the maximum number of members for a public company (Sec. 3).
4. Transferability of shares. In a private company, the right to transfer shares is restricted, whereas in the case of public company the shares are freely transferable (Secs. 3 and 82).
5. **Prospectus**. A private company cannot issue a prospectus; while a public company may issue a prospectus to invite the general public to subscribe for its shares or debentures.
6. **Statement in lieu of prospectus**. A public company, if it does not issue a prospectus, is required to file a Statement in lieu of prospectus with the Registrar of Companies at least 3 days before allotment. A private company is not required to do this.
7. **Minimum number of directors**. A private company must have at least two directors, whereas a public company must have at least three directors (Sec. 252).
8. **Increase in number of directors**. The number of directors in a private company may be increased to any extent but in case of a public company if the maximum number of directors is more than twelve, then the approval of the Central Government is necessary for any increase in the number of directors (Secs 258 and 259).
9. **Appointment of directors**. Directors of a private company may be appointed by a single resolution, but it is not so in case of a public company where each director is to be appointed by a separate resolution (Sec. 255).
10. **Retirement of directors**. Directors of a private company are not required to retire by rotation, but in case of a public company at least 2/3rds of the directors must retire by rotation at each annual general meeting (Sec. 256).
11. **Quorum for general meetings**. Two members personally present form the quorum in a private company but in a public company the number is five members (Sec. 174).

When does a private company become a public company?

1. **Conversion by default (Sec. 43).** Where a default is made by a private company in complying with the essential requirements of a private company (viz., restriction on transfer of shares, limitation of the number of members to 50 and prohibition of invitation to the public to buy shares or debentures), the company ceases to enjoy the privileges and exemptions conferred on a private company. In such a case, the provisions of the Companies Act apply to it as if it were not a private company.

2. **Conversion by operation of law (deemed public company)** The Companies (Amendment) Act, 1960 introduced a new Sec. 43-A with a view to deal with those private companies which employed public money to a large extent but escaped the restrictions and limitations as to disclosure as apply to public companies J
The Companies (Amendment) Act, 2000 abolished Sec. 43-A with effe from 13th December, 2000.

3. **Conversion by choice or volition** (Sec. 44). If a private company so alters its Articles that they do not contain the provisions which make it a private company, it shall cease to be a private company as on the date of the alteration. Il shall then file with the Registrar, within 30 days, either a prospectus or a statement in lieu of prospect us..

A private company which becomes a public company shall also

1. File a copy of the resolution altering the Articles
2. Take steps to raise its membership to at least 7 if it is below that number
3. Alter the regulations contained in the Articles which are inconsistent with those of a public company

Conversion of a public company into a private company
A public company may be converted into a private company by passing a special resolution. The special resolution should be to change the Articles of the company so as to include the conditions as prescribed in Sec. 3 (!) (iii) Which make a company a private company? An alteration made in the Articles which has the effect of converting a public company into a private company shall have effect only when such alteration has been approved by the Central Government. Where the alteration has been approved by the Central Government a printed copy of the Articles as altered shall be filed by the company with the Registrar within 1 month of the date of receipt of approval.

FORMATION OF A COMPANY
The process of formation of a company can be divided and discuss under the following four stages:

1. Promotion;
2. Incorporation or Registration:
3. Capital Subscription;
4. Commencement of Business

Of these stages only the first two are necessary for the formation of a private company, and of a public company not having any share capital. A public company having a share capital has to pass through all the four stages mentioned above before it can commence business or exercise any borrowing powers. (Sec. 149)

PROMOTION
Before a company can be formed, there must be some persons who intended to form a company and who take the necessary steps to carry that intention into operation. Such persons are called promoters. The promotion of a company is a comprehensive terms denoting that process by which a company is incorporated and floated, or established financially as a joint concern, by the issue of a prospectus.

The 'promotion' is the first stage in the formation of a company. Promotion may be defined as "the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profit there from."

The Promoter
"A person who originates a scheme for the formation of the company, has the memorandum and articles prepared, executed and registered and finds the first directors and settles the terms of the preliminary contracts and prospectus (if any) and making arrangement for advertising and circulating the prospectus and placing the capital is a promoter."

A person may be a promoter even if the undertakes a lesser active role in the formation of a company. Section 62(6) makes it clear that person who acts in a professional capacity is not a promoter, like an advocate, solicitor and auditor.

Who can be a promoter:- A promoter may be a natural person or a company, firm or association of persons, whether a person is or is not a promoter depends upon the nature of the role played by him in the promotion of business.

Functions/Role of a Promoter

1. **To originate the scheme for formation of the company:** Promoter conceives the idea of forming a company after a through study of the business world and identify the business fields which are unexplored or may be explored further.
2. **To secure the cooperation of the required number of persons willing to associate themselves with the project:** In fact, the minimum number of members required to join a private company is two and in case of a public company seven.
3. **Nomenclature:** The promoters have to verify from Registrar of Companies whether the proposed name is available. Promoters usually give three names in order of preference.
4. **To get the documents of the proposed company prepared:** No company can be incorporated unless the M.O.A. and A.O.A. and other documents are not field with the Registrar. Since the company takes birth from the date when certificate of incorporation is issued.

5. **To appoint bankers, legal advisors of the company:**
6. **Arrangement of capital:** If a company is to be incorporated as a private company, it has to make arrangement of its capital through private sources as a private cannot invite public to subscribe for its shares.

However, if the company is to be incorporated as a public company and it intends to invite public for subscribing its shares, then the promoters have to prepare the prospectus.

Consent of Directors: Since the first directors are to be appointed by the promoters so they must get the consent of such persons who are to be so appointed.

7. **To enter into preliminary Contracts with the Vendors:**
8. **To arrange for filing of the necessary documents with the Registrar:**

Legal Position of Promoters

While the accurate description of a promoter may be difficult, his legal position is quite clear.

A Promoter is neither a trustee nor an agent:- The reason is that a person cannot act as an agent or trustee for a person who is non-existent and the company is non-existent at the time when the promoters act for it.

Fiduciary relations with the company: - It does not mean that the promoters do not have any legal relationship with the proposed company. The legal position of a promoter can be correctly described by saying that he stands in a fiduciary position (relationship of trust and confidence) in relation to the company be promoted.

Duties of Promoters

Since the promoters occupies a position of total trust and confidence in relation to the company promoted by him. The promoters in their fiduciary capacity have the following duties:

1. **Duty not to make any secret profit:** A promoter cannot make either directly or indirectly any profits at the expenses of the company he promotes, without the knowledge and consent of the company and that if he does so, in disregard of this rule, the company can compel him to account for it.

   In case, a promoter makes a secret profit, the company has the following remedies against him:
   (a) **Rescission of the contract:-** The Company may rescind the contract, in which the promoter has made secret profits.
   (b) Order for repayment of secret profits.
2. **Duty to make full disclosure to the company o all relevant facts:** It is the duty of the promoter to disclose to the company all relevant facts including any profit made from the sale of his own property to the company and his personal interest in a transaction with the company.

   Erlanger vs. New Sombrero Phosphate Co. (1878) 3 A.C. 1218.
3. **Duty towards future allotttees:** It is a study of the promoters to ensure that the real truth is disclosed to those who are induced by the promoters to join the company and the future allottees of the shares.

Liability of Promoters:-

(1) Selection 56 lays down matters to be stated and reports to be set out in the prospectus. Promoter may be held liable for the non-compliance of the provisions of this section.
(2) Under section 62, a promoter is liable for any untrue statement in the prospectus to a person who has subscribed for any shares or debentures on the faith of the prospectus.
(3) Section 63 specifies the criminal liabilities for issuing a prospectus which contains untrue statement. The punishment prescribed, is imprisonment for a term which may extend to two years or with fine which may extend to Rs. 50,000 or with both.
(4) A promoter can be held liable if he had mis-applied or retained any of the property of the company or is found guilty of breach of trust or misfeasance in relation to the company.

Remuneration to Promoters:-

The promoters cannot claim as a matter right any remuneration from the company for the service rendered for a company that is yet in existence. Even where the articles of a company

specifically provide that a specified sum may be paid to the promoters for their services, it does not give the promoters a right to claim remuneration or to sue the company for the same.
However, the normal ways of rewarding the promoters for their valuable services are as follows:

(i) They may be paid a lump sum either in cash or in the form of shares or debentures of the company.
(ii) They may be given commission on the purchase price of the business taken over by the company.
(iii) They may be inducted into the Board of Directors.
(iv) He may be allowed to sell his own property to the company for cash at an inflated price, after he has made a full disclosure about the valuation and the profit earned to an independent Board of Directors.
(v) The company may give him an option to subscribe for a certain number of the company's unissued shares at par when their market price is higher.

Preliminary Contracts and Pre-incorporation Contracts
The promoters of a company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated, such contracts are called pre-incorporation or preliminary contracts.

Provisional Contracts
The provisional contracts are those contracts which are entered by a public company after incorporation but before the company becomes entitled to commence business.

INCORPORATION OF A COMPANY
"Any seven or more persons or where the company to be formed will be a private company, any two or more persons, associated for any lawful purpose may, by subscribing their name to a memorandum of associations and otherwise complying with the requirement of this Act in respect of registration, form an incorporated company, with or without limited liability." [Sec. 12]

Disqualifications of subscribers of MOA: The 'person' who subscribes to the memorandum of association of the company should not be an infant, an undischarged insolvent, an alien enemy, a lunatic and a person disqualified by law from entering into a contract.

Procedure of Incorporation of a Company
Before proceeding to register a company, the promoters have to decide the following aspects:

(a) Type of company: the promoters must decide whether they want to incorporate a private company or a public company.
(b) Availability of Name: A company is identified by the name with which it is registered.
As per section 13, the memorandum of association of a company should state the name of the company.

Promoters of a company under a proposed name may make an application to Registrar of Companies in e-Form No. 1A, accompanied with a fee of Rs. 500.

Corporate Identity Number: Registrar of Companies is to allot a Corporate Identity Number (CIN) to each company registered on or after Nov. 1, 2000.

Documents to be filed with the Registrar:-

1. Memorandum of Association
2. Articles of Association
3. Copy of Proposed Agreement
4. Power of Attorney
5. Consent of the Directors
6. Particulars of Directors
7. Notice of Registered Address
8. Statutory Declaration
9. Filing of Document with the Registrar for Registration

On registration, the Registrar will issue a certificate of incorporation whereby he certifies that the company is incorporated and in the case of a limited company, that the company is limited. **(Sec. 39**

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(1)

This certificate contains the name of the company, the date of its issue, and the signature of the Registrar with his seal.

Effect of Certificate of Incorporation

From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum.

Conclusiveness of the Certificate of Incorporation:-

The certificate of incorporation shall be conclusive evidence that:

(i) all the requirements of the Act have been complied with in respect of registration.
(ii) The company is duly registered, and
(iii) that the company has come into existence on the date of the certificate.
(iv)

CAPITAL SUBSCRIPTION

After being registered and receiving the Certificate of Incorporation, Company is ready for flotation. It can go ahead with raising capital from the public to commence its operation satisfactorily.

Since private company is prohibited from inviting public to subscribe, it can raise the necessary capital from friends and relatives.

Section 70 of the Companies Act requires every public company to take either of the following two steps:

(i) Issue a Prospectus if public is to be invited to subscribe to its share capital, or
(ii) File 'A Statme In Lieu of Prospectus', in case capital has been arranged privately.

COMMENCEMENT OF BUSINESS

A private company can commence business immediately after incorporation. However, in the case of companies other than the private company and a company having no share capital, further requirement is to be complied with, namely, obtaining 'a certificate of commencement of businesses before it commence its business.

No public company can commence any business on exercise any borrowing power unless the Certificate to Commence Business is obtained.

Penalty: If any public company having share capital commences business or exercises borrowing power without obtaining the certificate to commerce business, then every person at fault shall be liable to fine which may extend to Rs. 5,000 for every day of default. **(Sec. 149 (b))**

It should be noted that the company commences business within one year of its incorporation or otherwise it is liable to be wound up by the Tribunal. **(Sec. 433 (c))**

Procedure for the Incorporation of a Private Company: The procedure for the incorporation of a private company is the same as that of a public limited company with the following charges:

(a) There should be at least two subscribers in place of seven.
(b) e-Form No. 29 (relating to consent of directors) need not be prepared and filed.
(c) Registration of articles of association in compulsory.

MEMORANDUM OF ASSOCIATION

Definition

Memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act.
Palmer,….. It contains the objects for which the company is formed and therefore, identifies the possible scope of its operations beyond which its actions cannot go. It defines as well as confines the powers of the company.

Significance

1. It determines some basic features of the company being formed, such as its name, registered office, capital etc.
2. It determines the area of activity for the company.
3. It lays down the basic parameters to guide the relationship between the company and the outsiders who deal with the company.

Sec. 13 refers to the contents of the Memorandum

1. **Name clause** :
   Every company has to adopt its corporate name carefully. This name has to be stated in the Memorandum. The name of the company as approved by the Registrar would need to be given sufficient display as per the rules, such as outside every office, on the letters, notices etc. In the case of a limited liability company, the word Limited Private limited must be there as the last words of the name.
2. **Registered office clause** :
   This clause requires the mention of the state in which the registered office of the company is to be situate. A company must have a registered office as a stable place for its location and as its domicile.
3. **Object clause** :
   The memorandum must state the objects for which the company is being formed. This clause defines the area of activities for which the company is being formed. Any activity outside the limits defined by this clause would be ultra vires (beyond the powers) for the company and the company can neither do it nor ratify it if it is done by any agent without its sanction.
4. **Liability clause** :
   The nature of liability of the members of the company being formed must be indicated by the memorandum. The memorandum of a company limited by shares or by guarantee shall also state that the liability of its members is limited [Sec. 13(2)]
5. **Capital clause** :
   The capital clause lays down the maximum limit of the capital beyond which the company cannot issue shares. This amount is described as registered capital or authorized capital or nominal capital.
6. **Subscription or association clause**
   This clause contains the declaration by the signatories to the Memorandum about their desire to be formed into a company, about their commitment to acquire the qualification shares, if any, and the personal details about the subscribers with their signatures attested by a witness.

ALTERATION OF MEMORANDUM

(A) **Alteration of name clause**

A company may, be special resolution and with the approval of the Central Government signified in writing change its name : If a company makes default in complying with any direction given by the government. Shall be punishable with fine which may extend to Rs. 1000 for every day during which the default continues (Sec. 22).

(B) Alteration of registered office clause

(i) Change of office within the same city. The rule contained in Sec. 146(2) implies that a company can make a change in the registered office within the local limits of the same city, town or village through a resolution of the Board of directors. Such a change must be brought to the notice of the Registrar within 30 days of the change.

(ii) Change from one city to another within the same state. This situation attracts the provisions of sec. 17A and Sec. 146. Sec. 146(2) lays down that a change in the registered office from one city to another within the same state would require the passing of a special resolution in the general meeting of the company and filing its copy with the Registrar within 30 days.

(iii) Change of registered office from one state to another.

The office is shifted to the new state and the address notified to the new Registrar within 30 days of shifting to the new office.

(C) **Alteration of liability clause**

A company can alter its objects clause also, but, since it is a very vital clause in the Memorandum.

a) passing a special resolution in the general meeting [Sec. 17(1)]
b) Filing the resolution with the Registrar with 1 month together with the printed copy of the altered Memorandum.

(D) Alternation of liability clause

The liability of members of the company may be altered only to increase it. The liability cannot be decreased. And the liability can be increased only if the members give their consent in writing either before or after the alteration.

This will require the following :

Authorization of the articles of association; (b) A special resolution of the company. (c) A written consent of the affected officer of the company if he was holding the office before the date of alteration.

(E) **Alteration of capital clause**

The alteration in the capital clause may take many forms :

(a) Alteration of share capital (Sec. 94,95,97) (b)Reduction of share capital (Sec. 100 to 1004) (c) Variation of the rights of shareholders (Sec. 106,107) (d) Re-arrangement of share capital (Sec. 391).

This alteration requires :

(i) Authorization by the Articles of Association. (ii) An ordinary resolution in the general meeting. (iii) No confirmation by court or any other authority. (iv) A notice has to be given to the Registrar of the alteration made within 30 days of the resolution.

DOCTRINE OF ULTRA VIRES

The doctrine of ultra vires is one of the most important principles of company law.

The word ultra means beyond, and the word vires means powers. So, the doctrine of ultra vires means that it is beyond a company's powers to do those activities which have been kept outside the scope of the objects clause in the Memorandum. If any such act is undertaken by the company or any of its agents on its behalf, the act shall not be deemed to be done by the company. Even the entire Board or the body of the shareholders cannot approve or ratify it.

Effects of ultra vires Transactions

(i) Contact are void ab initial. A contract which is ultra vires the company is void ab initial. Under such a contract, the company cannot sue or be sued upon.

(ii) Personal liability of directors to the company. If the directors of the company utilize funds of the company in ultra vires transactions, they would be personally liable to compensate the company for any loss suffered by the company.

(iii) Personal liability of directors to third parties. As the agent of the company, the directors are expected to act within the authority available to them. If they act outside the scope of

this authority by presenting themselves to the possessing the authority, this will be a breach of warranty of their authority.

(iv) Property acquired ultra vires. The funds of the company may be spent in acquiring a property ultra vires. The company's right over the acquired property shall be secure and intact.

(v) Injection. In case a company has done is about to do an act ultra vires its Memorandum, any shareholder may seek an order of injunction from the court restraining the company from doing so.

Where the Doctrine does not Apply under some circumstances as mentioned below:

(i) Where the act is ultra vires only the directors, it may be ratified by the company.

(ii) Where the act is ultra vires only the Articles of Association, the Articles may be altered to make the action intra vires the articles.

(iii) Where the act is intra vires but has been done in violation of some bye-laws of the company, the Board or the general meeting may condone it.

ARTICLES OF ASSOCIATION

The Articles of Association is the second important document to be prepared by the promoter and then submitted at the time of registration. The Articles contain the rules and regulations and the bye-laws of the company to govern its internal affairs and functioning.

Definition: According Sec. 2(2) of the Act

"Articles means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act, including, so far as they apply t the company the regulations contained in Table A in Schedule I annexed to this Act".

A public company limited by shares may either frame its own Articles and get them registered or may adopt Table A of Schedule I as its Articles.

Form

Regarding the form of the articles Sec. 30 states that the Articles shall be printed, be divided into paragraphs numbered consecutively, and be signed by each subscriber of the memorandum of association.

Contents

1) Various classes of shares the company shall issue and their rights.
2) Procedure for issue of shares and their allotment.
3) Procedure for issuing share certificates and share warrants.
4) Forfeiture of shares and the procedure for their re-issue.
5) Procedure for transfer and transmission of shares.
6) Calls on shares.
7) Conversion of shares into stock.
8) Payment of commission on shares and debentures to underwriters.
9) Borrowing powers of directors.
10) Rules for adoption for preliminary contracts, if any,
11) Re-organization and consolidation of share capital.
12) Alteration of shares capital.
13) Payment of dividends and creation of reserves.
14) General meetings, proxies and polls.
15) Voting rights of members.
16) Keeping of books of account and their audit.
17) Rules regarding use of the Common Seal of the company.
18) Appointment, powers, duties, qualifications and remuneration of directors.

19) Appointment, powers, duties remuneration, etc of auditors.
20) Appointment, powers, duties, qualifications, remuneration etc of the managing director, manager and secretary, if any.
21) Lien on shares.
22) Capitalization of profits.
23) Board meeting and their proceedings
24) Rules as t resolutions.
25) Winding up of the company.

ALTERATION OF ARTICLES

According to Sec. 31, the Articles of a company can be altered by a special resolution. A copy of the special resolution which authorized the alteration of Articles must be sent to the Registrar together with the copy of the altered Articles within 30 days of passing of the resolution.

Procedure of Alteration

1. **Where the form of company remain unchanged:** The following procedure is required to be followed for effective alteration of the articles :
   a. Approval of the Board
   b. Special resolution
   c. Filing resolution with the Registrar
2. **Where a private company is converted in to a public company**

1. The Board shall approve the draft resolution
2. Special resolution
3. To get the approval of the Central Government to the alteration.
4. File with the Registrar a printed copy of the altered articles. It shall be filled within one month from date of receipt of the order of approval.

Limitations of freedom to alter the Articles

(i) Alteration must not exceed the scope of or conflict with the Memorandum.
(ii) The alteration must not be inconsistent with the provisions of the Companies Act or any other law.
(iii) The Articles cannot be made to include anything which is in itself unlawful or opposed to public policy.
(iv) The alteration must not seek to undo the alteration made by the CLB or Tribunal in the documents of the company.
(v) The alteration must be bona fide and for the benefit of the company as a whole.
(vi) The alteration must not amount to a fraud by majority on the minority.
(vii) The alteration cannot be done to break a contract with a third party.
(viii) An alteration would not be complete unless it is followed by the approval of the Central Government wherever necessary.

Distinction between Memorandum and Articles

The memorandum and articles are two important documents for incorporation and governance of a company. The two may, however, be distinguished on the basis of the following points :

(i) The memorandum contains the basic conditions associated with the incorporation of the company. This includes the name, the maximum capital and the total area of activity of the company etc. The articles however, are the rules governing the internal functioning of the company.
(ii) The memorandum is a supreme document sub-ordinate to the Companies Act only. The articles is the document sub-ordinate to the memorandum and cannot override it.
(iii) A memorandum has to be compulsorily registered. The articles may not be registered.

(iv) The memorandum defines the relationship between the company and the outside world. The articles determine the relationship between the company and the members.
(v) The alteration in memorandum requires a somewhat difficult procedure. The articles will require a simple procedure for alteration.
(vi) The acts of the company which are ultra vires the memorandum cannot be made valid through their ratification by the company. However, the acts ultra vires the articles can be made valid through their ratification if they are intra vires the memorandum.

PROSPECTUS

After having obtained the certificate of incorporation the promoters of a public company will have to take steps to raise the necessary capital for the company. A public company may invite the public to subscribe to its shares or debentures. For this purpose a document known as Prospectus has to be issued.

Meaning of Prospectus

A document containing detailed information about the company and an invitation to the public for subscribing to the share capital and debentures issued is called prospectus.

According to section 2(36) of the Companies Act, "Prospectus means any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body Corporate". Any document to be called a prospectus must have the following ingredients;

(a) there must be an invitation offering to the public;
(b) the invitation must be made by or on behalf of the company or in relation to an intended company;
(c) the invitation must be to subscribe or purchase;
(d) the invitation must relate to shares or debentures.

[Parmatha Nath Sanyal vs. Kali Kumar Dutt AIR 1925 Calcutta 714]
Meaning of the word 'issued': The rules as to prospectus apply only where a prospectus is 'issued'. 'Issued' here means issued to the public. Whether the prospectus has been issued is a matter of fact.

Nash vs. Lynde (1929)

[South of England Natural Gas & Petroleum Company Ltd. (1900) 1. Ch. 513]

Offer to the Public

Section 67(1) of the Act States that public includes "any section of the public whether elected as members or debenture holders, or as clients of the person issuing the prospectus or in any other manner." But an offer is not to be treated as made to the public where the offer can in all the circumstances be properly regarded as a domestic concern of the persons making and receiving it.

Abridged Prospectus

It is no longer necessary to furnish a copy of the prospectus along with every application form which the company may issue while inviting the public to purchase or subscribe for its shares or debentures. In future, application form is to be accompanied only by a gist of material formation. This is referred to as 'abridged prospectus'.

SHELF-PROSPECTUS

Companies (Amendment) Act, 2000, has introduced the concept of 'shelf prospectus'. It was noticed that public financial institutions sometimes access the capital market more than once during a year.

Under the Act, a company was required to issue a full-fledged prospectus each time it wanted to access the capital market. To do away with this time consuming process and to reduce the cost burden on the company, the concept of shelf prospectus from the date of opening of the first issue of securities under that prospectus has been introduced. The validity period of self prospectus is one year.

Information Memorandum or Red-herring Prospectus

Companies (Amendment) Act, 2000 has inserted a new section 60B whereby the issue of securities through "book building" concept has been recognized. As per SEBI guidelines, book building is a pre-issue exercise whereby the issuer company collects order from investment bankers and large investors based on an indicative price range. Thus, the issue price and the exact number of securities to be issued is not decided in advance (and is not disclosed in the draft prospectus) but is fixed on the basis of bids received from potential investors.

The term 'Information memorandum' has been defined in section 2(19B) of the Act to mean a process undertaken prior to filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of issue for such securities is assessed by means of a notice, circular, advertisement or document. An information memorandum can be issued by a public company which is already listed or which is already listed or which intends to be listed after the issue. Recently, Maruti Udyog Limited has invited applications by issuing information memorandum.

'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 through such document. In other words, a red-herring prospectus lacks price and quantity of the securities offered.

WHEN PROSPECTUS IS NOT REQUIRED TO BE ISSUED

The issue of a prospectus containing the details as required by section 56(1) is not necessary in the following cases:

1. Where an offer is made in connection with bonafide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures. [Clause (a) of proviso 2 to Sec. 56 (3)]
2. Where the shares or debentures are not offered to the public. [Clause (b) of proviso 2 to Sec. 56(3)]
3. Where the shares or debentures are offered to the existing members or debenture holders of the company. [Sec.56(5)(a)]
4. Where the shares or debentures offered are uniform in all respects with shares or debentures previously issued and dealt in or quoted on a recognized stock exchange. [Sec. 5(b)]
5. Where any prospectus is published as a newspaper advertisement, it is not necessary to specify the contents of the Memorandum or the signatories thereto, or the number of shares subscribed for them. [Sec. 66]

STATEMENT IN LIEU OF PROSPECTUS

All public companies either issue a prospectus or file a statement in lieu of prospectus. A private company is prohibited from inviting monetary participation of the public. But the promoters of a public company need not necessarily go to the public for money. The promoters may be confident of obtaining the required capital, through private sources.

In such a case no prospectus need be issued to the public, but promoters must prepare a document, akin to the prospectus known as 'Statement in lieu of prospectus.' This document must be in the form set out in Schedule III of the Act and must contain practically the same information as is required in the prospectus.

Deemed Prospectus
Provisions relating to the prospectus are most stringent and duty of preparing and filling it in accordance with law is extremely onerous. So, a company may instead of offering its sharers or debentures for sale to the public allot its shares or debentures to an intermediary called 'issuing house'. Thereafter the 'issuing house' offers them for sale to the public by advertisement or circular of its own. The document by which the offer is made to the public by the issuing house is deemed for all purposes to be a 'prospectus' issued by the company.

CONTENTS OF PROSPECTUS

Section 55 provides that a prospectus issued by or on behalf of a company, or in relation to an intended company shall be dated, and that date must, unless contrary is proved, be taken as the date of the publication of the prospectus.

Section 56 provides that a prospectus must (i) contain the matters specified in Part I Schedule II and set out the reports specified in Part II of Schedule II of the Companies Act, 1956. The third part of the schedule is explanatory of Part I and II.

The government has revised the format of prospectus given in Schedule II of the Companies Act, 1956. The revised format will be effective from 1.11.1991.

SHARE CAPITAL

Equity shares capital means all share capital which is not preference share capital. In other words, a share or share capital which does not give the definition of preference shares or preference share capital, is equity share capital.
Equity shareholders receive dividend out of profits as recommended by the Board of directors and as declared by the shareholders in an annual general meeting but after preference shares have been paid their fixed dividend.
Moreover, equity shareholders have a right to vote on every resolution placed in the meeting and the voting right shall be in proportion to the paid up equity capital. Unless a company issue equity shares with differential rights.

Preference Shares
Preferences shares with reference to any company limited by shares are those which carry:
(a) A right to be paid a fixed amount of dividend or the amount of dividend, calculated at a fixed rate, e.g., 10% nominal value of shares and also.
(b) A right to be paid the amount of capital paid up as such shares in the event of winding up of the company.

The articles share capital is the sum of total of preference shares.

Those of Preference Shares
These may be of the following types:

1. **Cumulative Preference Shares:** These share are entitled to dividend at a fixed rate whether there are profits or not. The company pays dividend if it has sufficient profits. In case the company does not have sufficient profits, dividend on cumulative preference shares will go on accumulating till it is fully paid off, such arrears are carried forward to the next year and are actually paid out of the subsequent years' profits. In the case of winding up of the company, the arrears of dividend on these shares are payable only if the article of association contains express provision in this respect. It may be noted, that all preference shares are presumed to be cumulative unless expressly stated in the articles to be non-cumulative.
2. **Non-cumulative Preference Shares:** Non-cumulative preference shares are those shares on which the arrears of dividend do not accumulate. If in a particular year there are no profits are inadequate, the shareholders shall not get anything or receive a partial dividend and they

cannot claim the arrears of dividends in the subsequent year. In simple words, on such shares the unpaid dividends do not accumulate but lapse, i.e., the shareholders lose them forever.

3. **Participating Preference Shares:** The holders of such shares are entitled to receive dividend at a fixed rate and, in addition, they have a right to participate in the surplus profits along with equity shareholders after dividend at a certain rate has been paid to equity shareholders, there are surplus assets, then the holders of such shares shall be entitled to share in the surplus assets as well. Such shares can be issued only if there is a clear provision in the memorandum or articles of association or the terms of issue.
4. **Non-participating Preference Shares:** The holders of such shares are entitled to only a fixed rate of dividend and do not participate further in the surplus profits. If the articles are silent, all preference shares are deemed to be non-participating.
5. **Convertible Preferences Shares:** the holder of such shares have a right to convert these shares into equity shares within a certain period.
6. **Non-convertible Preference Shares:** The preference shares, where the holders have no right to convert their shares into equity shares are known as non-convertible preferences shares. Unless otherwise stated preference shares are assumed to be non-convertible.
7. **Redeemable Preference Shares:** ordinarily, the amounts received by the company on shares is not returned except on the winding up of the company. A company limited by shares, if authorised by its articles, may issue preference shares which are to be redeemed or repaid after a certain fixed period. Thus, the amounts received on such shares can be returned during the life-time of the company. Such shares are termed as redeemable preferences shares.

CLASSES OF CAPITAL

In view of the stages involved in collecting the money on shares, the shares capital of a company may be classified as follow:

(1) **Authorised Capital:** It is the capital which is stated in company's memorandum of association with which the company intends to be registered. It is called the nominal or registered capital. It is the maximum amount of shares capital which a company is authorised to raise by issuing the shares.

(2) **Issue Capital:** It is that part of the authorised capital which is actually offered (issued) to the public for subscription. Therefore, the issued capital can never be more than the authorised capital. It can at the most be equal to the nominal capital. The balance of nominal capital remaining to be issued is called 'unissued capital'.

(3) **Subscribed Capital:** It is that part of the issued capital which has been actually subscribed by the public. In other words, it is that part of issued capital for which the applications have been received from the public and shares allotted to them.

(4) **Called-up Capital:** It is that part of nominal value of issued capital which has been called-up or demanded on the shares by the company. Normally, a company does not collect the full amount of shares it has allotted.

(5) **Paid-up Capital:** It is that part of the called-up capital which has actually been received from the shareholders.

(6) **Reserve Capital:** It is that part of the uncalled capital which cannot be called by the company except in the event of its winding up.

ISSUE OF SHARES AT PREMIUM

The term 'Securities' has been defined under Section 2(45AA) inserted by Companies (Amendment) Act, 2000. The premium is an amount in excess of par value or nominal value or face value of the securities (shares). Where a company issues securities at a premium whether for cash or for a consideration other than cash, a sum equal to aggregate amount of premiums on these securities shall be transferred to Securities Premium Account. The Securities Premium Account may be applied by the company:

(a) in paying up unissued shares of the company to be issued to the members of the company as fully paid bonus shares:
(b) in writing off the preliminary expenses of the company;
(c) in writing off the expenses of or commission paid or discount allowed on any issue of shares or debentures of the company.
(d) In providing for the premium payable on the redemption of any redeemable preference shares or any debentures of the company.
(i) A company may issue shares at a premium, i.e, at a value greater than its face value. Premium so received shall be credited to a separate account called **Securities Premium Account.**

ISSUE OF SHARES AT A DISCOUNT

Discount means a price which is less than nominal value or face value of a share. If share of Rs. 10 is issued at Rs. 8, then, 10-8, i.e., the amount of Rs.2 is discount.
When shares are issued at a price which is lower than market price but not below the face value of the shares, such an issue is not an issue at a discount.

1. A company shall not issue shares at discount except in the Company of a class already issued, if the following conditions are fulfilled, namely:
   (i) The issue of the shares at a discount is authorised by a resolution passed by the company in general meeting and sanctioned by the company in general meeting and sanctioned by the Company Law Boards;
   (ii) The resolution specifies the maximum rate of discount at which the share are to be issued;
   (iii) Not less than one year has at the date of issue elapsed since the date on which the company was entitled to commence business; and
   (iv) The shares to be issued at discount are issued within two moths after the date on which the issue is sanctioned by the Company Law Board or within such extend time as the Company Law Board May allow.
2. Where a company has passed a resolution authorizing the issue of shares at a discount, it may apply to the Company Law Board for an order sanctioning the issue, on such application the Board may make an order if it thinks proper to do so, sanctioning the issue on such terms and conditions as it thinks fit.
3. Every prospectus relating to the issue of shares shall contain particulars of the discount allowed on the issue of shares.

TRANSFER & TRANSMISSION OF SHARES

MEANING OF TRANSFER OF SHARES:

Transfer of shares means a transfer by sale or otherwise by the registered holder of the shares. It does not include any involuntary or forced sale such as a court auction – sale or sale of forfeited shares for non payment of calls.
Every shareholder of a company is entitled to transfer his shares subject to certain restrictions. The restrictions can be classified into two heads:

a. Restriction under the companies act or statutory restrictions
b. Restrictions under the company's articles.

TRANSMISSION OF SHARES:

When the shares of a member are transferred to another person by operation of law, it is said to be the transmission of shares. Generally the transmission of shares taken place in the following cases:

a. On the death of member, the shares are transmitted to his nominee or executor or successor.
b. On the insolvency of a member, the shares are transferred to the official receiver/assignee/liquidator.
c. On the lunacy of a member, the shares are transferred to the administrator appointed by the court or to his legal representative or guardian.

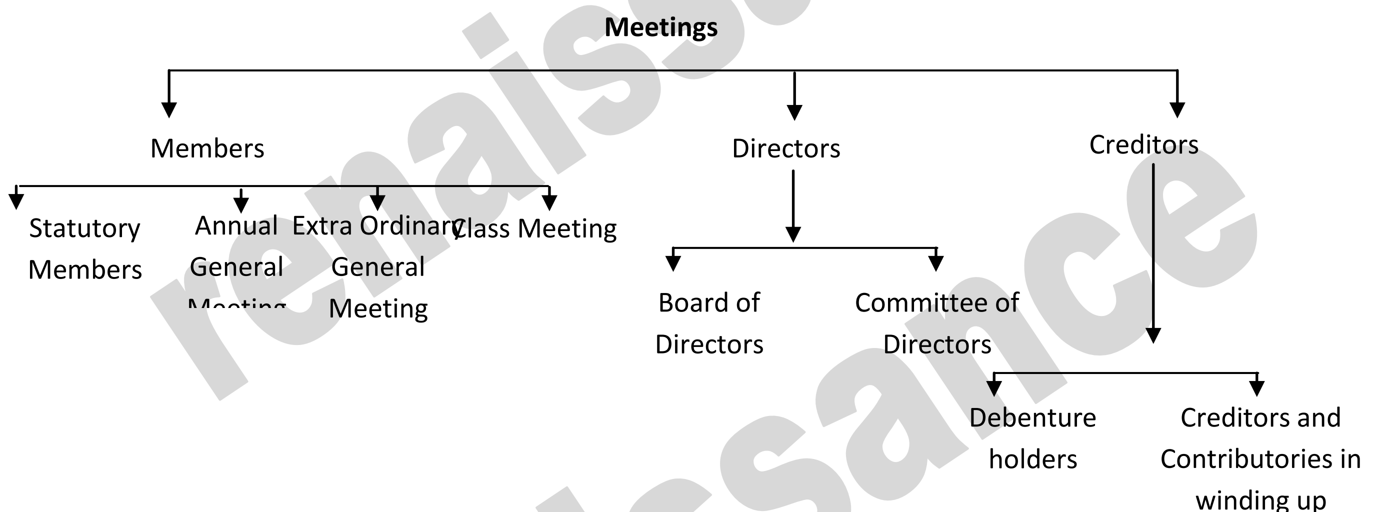
MEETINGS & RESOLUTIONS

A meeting may be generally defined as a gathering or assembly or getting together of a number of persons for transacting any lawful business. For proper working of the company, it is necessary that the shareholders meet as often as possible and discuss matters of mutual interest and take important decision, there must be at least two persons to constitute a meeting.

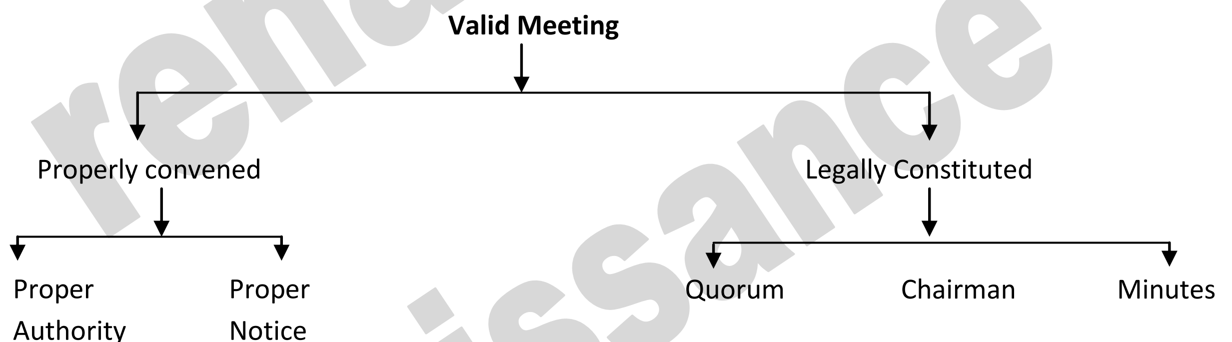
But every assembly or gathering do not constitute a meeting. Company meetings must be convened and held in perfect compliance with the various provisions of the Companies Act, 1956, and the rules framed there under.

KINDS OF MEETINGS

Company meetings are different kinds. The following chart depicts the various categories of meetings.



Requsisites of Valid Meeting: A meeting to be held valid, must satisfy the provisions laid down in the Act. Any irregularities in the procedure followed for convening and conducting the meeting will make the meeting invalid. So meeting must be properly convened and legally constituted.



(1) Meeting must be properly convened:
   (a) Proper authority must convene the meeting
   (b) Proper notice must be served in the prescribed manner to all the persons entitled to receive the notice.
(2) Meeting must be legally constituted
   (a) A quorum must be present
   (b) Proper Person must be in the chair
   (c) Minutes of the meeting shall be kept in prescribed manner.

Proper Authority

Proper authorities to call meeting are:

(a) **Board of Directors:** The articles of association of a company normally empower the Board of Directors to convene general meetings and they have this power at common law even if not conferred expressly on them.
(b) **Members:** If the directors do not call the meeting, then requisitionists (member) u/s 169 are eligible to call EGM.
(c) **Central Government:** An AGM can be called by Central Government u/s 167.
(d) **National Company Law Tribunal (NCLT).** An EGM can be called by NCLT u/s 186.

PROPER NOTICE

'Notice' means an advance intimation of the meeting so as to enable the person concerned to prepare himself for it. The notice must be clear and should state the purpose for which the meeting is called and the notice must be in writing.
It must be given at least 21 clear days before the date of the meeting. In case notice is sent by post, service of notice shall be deemed to have been effected at the expiry of 48 hours after it is posted.

(f) **Contents of Notice:** Every notice must specify the date, day, place, hour of the meeting. In case, the particulars provided in the section 172 are not specified in the notice, the meeting will be held invalid.

(i) Place of Meeting :

- In case of AGM: at registered office of the company or at some other place within the same town, city, village, in which registered office of the company is situated.
- In case of any other meeting : not subject to aforesaid restriction.

(ii) Day of Meeting:

- In case of AGM: any day which is not a public holiday.
- In case of any other meeting : not subject to aforesaid restriction.

(iii) Time of Meeting:

In case of AGM: during business hours, but it may continue beyond usual hours.

(iv) Type of business:

- Ordinary Business
- Special Business

QUORUM

Quorum is the minimum number of members who are personally present and their presence is necessary to constitute meeting and to validates the transactions and resolutions passed in the meeting.

(a) Requisite Quorum:

- Public Companies : 5 members personally present.
- Other Companies : 2 members personally present.

Articles may provide higher number to constitute a valid quorum but, when all members of the company are present in person, the quorum is present even if quorum required by articles is more than the number of members.

CHAIRMAN OF THE MEETING

The chairman of the meeting is a person who presides the meeting. The chairman can be explained as "the umpire of debate, the judge of admissibility and the upholder of the decorum."

(a) Appointment of Chairman: Section 175(1) states that unless the articles otherwise provide, the members present in person at a meeting shall elect on a show of hands one of their members to be the chairman. In this context Regulations 50, 51 and 52 of Table A are relevant.

(b) **Election of Chairman**: If the articles of association of a company do not contain any provision for the appointment of a chairman, such appointment shall be made in accordance with the provisions of section 175, which states that:

   (a) Members personally present shall elect one of themselves to be the chairman.
   (b) Election of chairman shall be made by voting on a show of hands.
   (c) If a poll is demanded on the election of a chairman, it shall be taken forthwith.
   (d) If some other person is elected chairman as a result of the poll, he shall be chairman for the rest of the meeting.

(c) Casting Vote: the chairman, if the articles provide for it in the case of equality of votes may have a casting vote (Second Vote). If the articles do not make any such provision, the chairman does not have a second or casting vote.

PROXIES

The term 'Proxy' is used both for the person who is authorised to act and vote for another at a meeting of the company and the instrument through which such as person is named and authorised to attend the meeting :

(a) Appointment of Proxy: Section 176 gives every shareholder, who is entitled to attend and vote, a statutory right to appoint another person as his Proxy to attend and vote for him. But the proxy so appointed has no right of audience, i.e, he cannot speak. The proxy may demand or join demanding a poll but (unless the articles otherwise provide) may vote only on a poll.

MINUTES

Minutes may be defined as the written record of the business transacted at a meeting. Section 193 imposes a statutory obligation on every company to cause minutes to all proceedings of General meetings, Board meetings and meeting of the Committee of the Board to be recorded.

(a) Writing of minutes: For this purpose, every company is required to make entries of the proceedings of its meetings in books kept for the purpose within 30 days of the conclusion thereof. Minutes have to be written by hand and typed minutes cannot be posted in the Minute Books.

(b) Signing of minutes: Every page of the book, with pages consecutively numbered, should be initialed or singed and the last page shall be dated and singed: (i) in the cases of Board or Committee minutes, by the Chairman of the meeting or the Chairman of the succeeding meeting; (ii) in the case of minutes of general meeting, by the Chairman o the meeting within the aforesaid period of 30 days of the conclusion of the meeting or in the event of death or inability of the Chairman, by the Director duly authorised for the purpose.

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COMPANY MANAGEMENT

DIRECTOR

1. Section 2(12). "Director includes any person verifying the position of director, by whatever name called." This is not satisfactory definition. It does not clear the meaning or the nature of the world director.

Provision Regarding Number of Directors

1. **Minimum Number of Directors (Section 252).** Every public company must have a minimum of 3 directors and every private company must have a minimum of 2 directors.
2. **Maximum Number of Directors (Section 258).** The companies Act does not specify any maximum number for the directors of a company.
3. **Increase in the Number of Directors (Section 259).** The number of directors of a public company or a private company subsidiary of a public company, cannot be increased without the approval of central government.

APPOINTMENT OF DIRECTORS

1. **Appointment of First Directors (Section 254).** The first directors of a company are appointed by its promoters. Their names and addresses are disclosed in the articles of association, otherwise the subscribers to memorandum of association of the company shall be deemed to be the first directors of the company.
2. **Appointment of Subsequent Directors.**
   (i) Section 255. The shareholders must appointment the directors for the company at the first annual general meeting and then at every subsequent annual general meeting of the company.
   (ii) Section 256. The minimum of the two-thirds of the total number of directors must retire by rotation every year in case of a public company and a private company which is a subsidiary of any public company.
   (iii) Section 257. A new person must inform the company, at least 14 days before, when he wants to be elected as a director.
   (iv) Section 263. Every director has to be appointed through a separate resolution and the resolution must be passed by a simple majority.
3. **Appointment of Additional Directors (Section 260).** If the articles of association of a company have a provision, that the board of directors can also appoint additional directors subject to the maximum number of directors fixed by the articles.
4. **Alternate Directors (Section 313).** The board of directors may appoint an alternate director only if a director remains absent from the state in which the meetings of the board are ordinarily held for a period of more than three months.
5. **Appointment of Directors in Case of Causal Vacancies (Section 262).** If the office of a director falls vacant due to the death or resignation of a director before the expiry of his term, the board of directors may fill up such vacancies.
6. **Appointment of Directors by the Central Government (Section 408).** On the application of minimum one hundred members of the company or on the application of members holding 10% voting rights or on its own motion the central government can appoint such number of directors in company as it may deem necessary, in case of mismanagement of the company. Such directors can be appointed for a period of not more than 3 years.
7. **Appointment of Directors by other parties.** If the articles of association of a company have a provision, other parties may also appoint the directors for the company. These include the bank, financial institution or debenture-holders etc.

DISQUALIFICATION OF DIRECTORS (SECTION 274).

The following persons can not be appointed as a director or an additional director or an alternate director:

(i) Declared to be of unsound mind.
(ii) An undercharged insolvent.
(iii) Adjudicated insolvent.
(iv) Convicted by a Court of Law and sentenced to at least 6 months of imprisonment for an offence and a period of not less than 5 years has not lapsed from the date of expiry of such sentence.
(v) Failed to pay call on his shares for the last six months.
(vi) Has been disqualified by the Court of Law for fraudulent activities in the promotion or management of the company.
(vii) A private company may add any other disqualifications in its article of association for appointment of a director.

Minimum and Maximum Limit of Remuneration

1. **Section 198.** The total managerial remuneration payable to directors, managing director, manager and whole-time director should not exceed 11 per cent of the net profits of the company in a financial years.
2. **Section 309 (3).** Under the above limits, a full time director cannot be paid any remuneration exceeding 5 per cent of the net profits of the company for a particular financial year. If the number of full time directors is two or more than two, they all cannot be paid the total remuneration exceeding 10 per cent of the net profits of the company.
3. **Section 309 (4).** If the company has no full time director or manager, the remuneration of such part time director can be increased upto 3 per cent of the net profits of the company.
4. A company will not pay remuneration free of tax to any officer or employee.

POWERS OF DIRECTORS

(I) **General Powers.** According to section n291 of the Indian Companies Act, the directors of a company is authorised to do, subject to the articles of association of the company and of the provision of the Indian Companies Act.

(II) **Special Powers.**
1. To fill up the causal vacancies.
2. to make unpaid calls.
3. To issue debentures.
4. To borrow money in any, other form.
5. To invest the funds of the company
6. To lend the money.
7. To enter into contract for the company.
8. To appointment the managing director.
9. A public company with share capital of not less than 5 crores of rupees is required to constitute an "audit committee of the Board of Directors."

Restrictions on the Powers of Board of Directors

1 (i) To sell, lease or otherwise dispose off the whole or a part of the undertaking of the company.
(ii) To write off or allow more time for the payment of any debt due by a director.
(iii) To borrow the money more than the aggregate of the paid up share capital of the company and its free reserves.
(iv) To invest the money received in respect of compulsory acquisition of any fixed assets of the company, in the securities other than the trust securities.
(v) To contribute an amount exceeding Rs. 50,000 or 5 per cent of the average net profit for the last three financial years, whichever is greater, to any charitable fund which is not directly related with the business of company or with the welfare of the employee of the company.

2. Restrictions upon the Appointment of Sole Selling Agent. (i) Section 294 (2). The board of directors of a company cannot appoint any sole selling agent.
3. Restrictions upon Grating the Loans to Directors
   (i) Any of its directors.
   (ii) Any of the directors of its subsidiary company.
   (iii) Any partner or relative of such directors.
   (iv) Any firm in which any of such directors or his relative is a partner.
   (v) Any private company in which any of such directors is a director or a member.
   (vi) Any incorporated body whose board of directors or managing director or manager is in a position to be controlled by the orders of directors or board of director of the company granting such loan.

DUTIES OF DIRECTORS

(I) Duties Under Indian Companies Act.

1. To disclose Personal Interest.
2. To disclose the Post Held and Resigned.
3. To disclose the Shares Held by Him.
4. Other duties.
   (i) **Section 56.** To verify the true of a prospectus to be issued by the company.
   (ii) **Section 149.** Not to start the business of the company until the amount of minimum subsection is collected and the amount on the shares taken by directors has been collected in the same proportion as others have paid.
   (iii) **Section 165.** To call a statutory meeting within a period of minimum one month and maximum 6 months form the date of certificate of commencement of business.
   (iv) **Section 166.** To call an annual general meeting of the company within 18 months of the incorporation of the company and then every years.
   (v) **Section 169.** To call the extraordinary meeting of the company if it is demanded by the members having a minimum of 10 per cent voting right.
   (vi) **Section 209.** To maintain the accounts and the books of accounts of the company in proper way.
   (vii) **Section 210.** To present the Profit and Loss Account and the Balance street of the company in its annual general meetings.

(II) Duties Under Articles of Association

A company may have some provisions in its Articles of Association regarding the duties of its directors. If it is so, the directors must follow them also.

LIABILITIES OF DIRECTORS

(I) Liabilities to the Outsiders

(1) If the enter into any contract with any outsider in their personal name, they will be held personally responsible to complete the contract.
(2) In Case of Mis-statement in the Prospectus. If the prospectus of the company contains any misstatement and the investors suffer any loss because of that misstatement, the directors who have signed the prospectus will be held personally responsible for such loss.
(3) In Case of Irregular Allotment. Allotment made not in accordance with Section 69 and 70 of the Companies Act, is called an irregular allotment. If the directors have made irregular allotment of the shares they will be held responsible to refund the money paid by the applicants along with the interest.

(II) Liabilities to the Company

1. **Liability for Ultra Vires Act.** If the directors have entered into any contract ultra vires the memorandum or ultra vires the articles or ultra vires their powers, and the company suffers

any loss because of such contract, they be held responsible to make good the loss of the company.

2. **Liability for Breach of Trust.** If the directors make any secret profit or use the funds of the company for their personal use and the company suffers any loss, they will be held liable to compensate the company.
3. **Liability for Breach of Duties.** If the directors do not discharge their duties, they will be held liable to compensate the loss caused to the company because of the fault at their part.
4. **Liability for Negligence.** If the directors are held responsible for the negligence in the performance of then duties, they will have to make good the loss to the company caused because of such negligence.
5. **Liability for Fraudulent Acts.** If any director has done any act in a fraudulent manner and the company suffers any loss because of such acts, the concerned director will be held personally liable to compensate the loss of the company.
6. **Liability for the Acts of Co-Directors.** If a director habitually absent himself from the meeting of the board of directors and the company suffers an loss by the acts of his co-directors, he will be held liable to compensate such loss.

(III) **Liability for the Criminal Acts**

1. If the Prospectus Contains an untrue Statement (Section 63).
2. If the Application Money on Shares is not deposited in a Scheduled Bank (Section 69)
3. If the Statement in lieu of Prospectus in not Submitted with the Registrar (Section 70).
4. If the return of Allotment is not filed with the Registrar (Section 75).
5. If the Re-Organisation of Share Capital or the Conversion of Share Capital into Stock is not informed to the Registrar (Section 95).
6. If the List of Members is not maintained (Section 151)
7. If the Statutory Meeting is not called within Specified Time (Section 165).
8. If the General Meeting is not called within Specified time (Section 166 and 167).
9. If the Profit and Loss Account and the Balance sheet are not presented in the Annual General Meeting (Section 210).

REMOVAL OF DIRECTORS

1. **Removal by the Shareholders (Section 284).** The directors of a company may be removed by its shareholders if it is proved that they are performing their duties in unsatisfactory manner or in any other manner undesirable.
   Exceptions to this Rule. The shareholders cannot remove the following types of directors:
   (i) If the director was appointed by the Central Government under Section 408.
   (ii) Director of a private company holding office for life as on Ist April 1952.
   (iii) If the director represent the interests of a particular class.
   (iv) If the director was elected by the proportionate representation under Section 265.
2. **Removal by Central Government (Section 388 E).** If any High Court has given any judgment, on a reference made by the government for the detection of fraud, misfeasance, negligence, or breach of trust, existing in carrying out his duties, the central Government may order for the removal of such director.
3. **Removal by the Court.** If an application is moved to the court for the prevention of mismanagement of a company, the court has the power to remove the director of the company under Section 397 and 398 of the Companies Act.

VACATION (DISQUALIFICATION) OF OFFICE BY DIRECTORS

1. If he does not purchase the qualification shares, if any, within a period of two months of his appointment.
2. If he is declared insolvent.
3. If he is declared a person of unsound mind by any court.

4. If he is removed by the shareholders by passing an ordinary resolution in the annual general meeting of the company.
5. If he moves an application in any court for being declared insolvent.
6. If he is declared disqualified to work as a director by any court.
7. If he does not disclose his interest in any contract entered into with the company.
8. If he was appointed the director because of being the employee of the company or because of any post held by him in the company and he is removed from his service or from his post.
9. If the absents himself from three consecutive meetings of the board of director or from all the meeting of the board of directors for a period of three months, whichever is longer without obtaining the leave of absence from the board .

MANAGING DIRECTORS

A managing director means a director who is entrusted with substantial powers of management.

Characteristics:

1. Must be director of the company.
2. Entrusted with substantial powers of management
3. Chief executive officer
4. Eligible for reappointment
5. Can be more than one managing directors.
6. Subordinates to the Board of Directors
7. Conferred upon powers by agreement, resolution or provision of MOA

WHOLE TIME DIRECTORS

Meaning:-

A whole time directors employed to devote the whole of his time and attention in carrying on such of the affairs of the company as may be assigned to him by the board of or the managing directors. He is generally known as executive director. He is an employee director. Like M.D. he occupies dual capacity that of director and of an employee.

Appointment: - The appointment of W.T. Director is governed by the provision 269 which incorporates the provision regarding the appointment of M.D. also. Besides this it requires the sanction of shareholders by means of a special resolution. A company is free to appoint a whole-time Director along with a managing director or a manager.

Distinction between M.D. and W.T.D.

1. M.D. entrusted with substantial powers of management. W.T.D. is an employee of the company entrusted with powers as per terms of employment.
2. '197-A' Prohibits M.D. and Manager. But a W.T.D. may be appointed with manager/ M.D.
3. M.D.- not more than 5 yrs. No restriction WTD.
4. A person can be M.D. of two or more companies. A Person can't be W.T.O. of more than one company.
5. Appoint of M.D. not require cones of shareholder. W.T. D. – special resolution necessary.

Provision Regarding Appointment of Managing, Whole Time Directors or Manager

1. Compulsory appointment
2. Appointment in accordance with condition of schedule XIII
3. Approval of central government
4. Application for approval
5. Number of managing directorship
6. M.D. in more than two companies only with the permission of central Govt.
7. Disqualification for appointment
8. Remuneration

Conditions for appointment as a Managing or Whole – Time Director or a Manager

1. Must not had been sentenced to imprisonment or to a fine exceeding 1000Rs.
2. Must had not been detained
3. Must be of specified age
4. Ceiling on remuneration
5. Must be Resident in India
6. Approval in general meeting
7. Certificate of compliance

WINDING UP OF A COMPANY

Winding up of a company is defined as a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors. An administrator, called the liquidator, is appointed and he takes control of the company, collects its assets, pays debts and finally distributes any surplus among the members in accordance with their rights. At the end of winding up, the company will have no assets or liabilities. When the affairs of a company are completely wound up, the dissolution of the company takes place. On dissolution, the company's name is struck off the register of the companies and its legal personality as a corporation comes to an end.
The procedure for winding up differs depending upon whether the company is registered or unregistered. A company formed by registration under the Companies Act, 1956 is known as a registered company. It also includes an existing company, which had been formed and registered under any of the earlier Companies Acts.

Difference between dissolution and winding up

1. Winding Up is first stage where assets/liabilities are realised/paid-off; Dissolution is final stage where company ceases to exist.
2. Winding up is carried on by liquidator appointed by company/court; Order for dissolution is given by court only.
3. Liquidator can represent company during winding up till dissolution; After dissolution liquidator don't represent co.
4. Creditors can prove their debts in winding up but not on dissolution 5. Winding up always don't lead to dissolution

Winding up a Registered Company

The Companies Act provides for two modes of winding up a registered company:
A . Winding up by the Tribunal
B. Voluntary Winding Up

A. <u>Winding up by the Tribunal or Grounds for Compulsory Winding Up</u>

The petition for winding up to the Tribunal may be made by:-

- The company, in case of passing a special resolution for winding up.
- A creditor, in case of a company's inability to pay debts.
- A contributory or contributories, in case of a failure to hold a statutory meeting or to file a statutory report or in case of reduction of members below the statutory minimum.
- The Registrar, on any ground provided prior approval of the Central Government has been obtained.
- A person authorized by the Central Government, in case of investigation into the business of the company where it appears from the report of the inspector that the affairs of the company have been conducted with intent to defraud its creditors, members or any other person.
- The Central or State Government, if the company has acted against the sovereignty, integrity or security of India or against public order, decency, morality, etc.

The following circumstances for the winding up of accompany by the court:

a) If the company has, by a Special Resolution, resolved that the company be wound up by the Tribunal.
b) If default is made in delivering the statutory report to the Registrar or in holding the statutory meeting. A petition on this ground may be filed by the Registrar or a contributory before the expiry of 14 days after the last day on which the meeting ought to have been held. The Tribunal may instead of winding up, order the holding of statutory meeting or the delivery of statutory report.
c) If the company fails to commence its business within one year of its incorporation, or suspends its business for a whole year. The winding up on this ground is ordered only if there is no intention to carry on the business and the Tribunal's power in this situation is discretionary.
d) If the number of members is reduced below the statutory minimum i.e. below seven in case of a public company and two in the case of a private company.
e) If the company is unable to pay its debts.
f) If the tribunal is of the opinion that it is just and equitable that the company should be wound up.
g) Tribunal may inquire into the revival and rehabilitation of sick units. It its revival is unlikely, the tribunal can order its winding up.
h) If the company has made a default in filing with the Registrar its balance sheet and profit and loss account or annual return for any five consecutive financial years
i) If the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.

B. Voluntary Winding Up of a Registered Company

When a company is wound up by the members or the creditors without the intervention of Tribunal, it is called as voluntary winding up. It may take place by:-

- By passing an ordinary resolution in the general meeting if: -
  (i) the period fixed for the duration of the company by the articles has expired; or
  (ii) Some event on the happening of which company is to be dissolved, has happened.
- By passing a special resolution to wind up voluntarily for any reason whatsoever.

Within 14 days of passing the resolution, whether ordinary or special, it must be advertised in the Official Gazette and also in some important newspaper circulating in the district of the registered office of the company.

The Act provides two methods for voluntary winding up:-

1. Members' voluntary winding up
2. Creditor's voluntary winding up

1. Members' voluntary winding up

It is possible in the case of solvent companies which are capable of paying their liabilities in full. There are two conditions for such winding up:-

a) A declaration of solvency must be made by a majority of directors, or all of them if they are two in number. It will state that the company will be able to pay its debts in full in a specified period not exceeding three years from commencement of winding up. It shall be made five weeks preceding the date of resolution for winding up and filed with the Registrar. It shall be accompanied by a copy of the report of auditors on Profit & Loss Account and Balance Sheet, and also a statement of assets and liabilities upto the latest practicable date; and

b) Shareholders must pass an ordinary or special resolution for winding up of the company.

The provisions applicable to members' voluntary winding up are as follows:-

a) Appointment of liquidator and fixation of his remuneration by the General Meeting.
b) Cessation of Board's power on appointment of liquidator except so far as may have been sanctioned by the General Meeting, or the liquidator.

c) Filling up of vacancy caused by death, resignation or otherwise in the office of liquidator by the general meeting subject to an arrangement with the creditors.
d) Sending the notice of appointment of liquidator to the Registrar.
e) Power of liquidator to accept shares or like interest as a consideration for the sale of business of the company provided special resolution has been passed to this effect.
f) Duty of liquidator to call creditors' meeting in case of insolvency of the company and place a statement of assets and liabilities before them.
g) Liquidator's duty to convene a General Meeting at the end of each year.
h) Liquidator's duty to make an account of winding up and lay the same before the final meeting.

2. Creditor's voluntary winding up

It is possible in the case of insolvent companies. It requires the holding of meetings of creditors besides those of the members right from the beginning of the process of voluntary winding up. It is the creditors who get the right to appoint liquidator and hence, the winding up proceedings are dominated by the creditors.

The provisions applicable to creditors' voluntary winding up are as follows:-

- The Board of Directors shall convene a meeting of creditors on the same day or the next day after the meeting at which winding up resolution is to be proposed.
- A statement of position of the company and a list of creditors along with list of their claims shall be placed before the meeting of creditors.
- A copy of resolution passed at creditors' meeting shall be filed with Registrar within 30 days of its passing.
- It shall be done at respective meetings of members and creditors. In case of difference, the nominee of creditors shall be the liquidator.
- A five-member Committee of Inspection is appointed by creditors to supervise the work of liquidator.
- Fixation of remuneration of liquidator by creditors or committee of inspection.
- Cessation of board's powers on appointment of liquidator.

As soon as the affairs of the company are wound up, the liquidator shall call a final meeting of the company as well as that of the creditors through an advertisement in local newspapers as well as in the Official Gazette at least one month before the meeting and place the accounts before it. Within one week of meeting, liquidator shall send to Registrar a copy of accounts and a return of resolutions.

Winding up an Unregistered Company

According to the Companies Act, an unregistered company includes any partnership, association, or company consisting of more than seven persons at the time when petition for winding up is presented. But it will not cover the following:-

- A railway company incorporated by an Act of Parliament or other Indian law or any Act of the British Parliament;
- A company registered under the Companies Act, 1956;
- A company registered under any previous company laws.
- An illegal association formed against the provisions of the Act.

However, a foreign company carrying on business in India can be wound up as an unregistered company even if it has been dissolved or has ceased to exist under the laws of the country of its incorporation.

The provisions relating to winding up of a unregistered company:-

- Such a company can be wound up by the Tribunal but never voluntarily.
- Circumstances in which unregistered company may be wound up are as follows:-
    - If the company has been dissolved or has ceased to carry on business or is carrying on business only for the purpose of winding up its affairs.

- If the company is unable to pay its debts.
- If the Tribunal regards it as just and equitable to wind up the company.

- Contributory means a person who is liable to contribute to the assets of a company in the event of its being wound up. Every person shall be considered a contributory if he is liable to pay any of the following amounts:-
  - Any debt or liability of the company;
  - Any sum for adjustment of rights of members among themselves;
  - Any cost, charges and expenses of winding up;
- On the making of winding up order, any legal proceeding can be filed only with the leave of the Tribunal.

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UNIT-II
NEGOTIABLE INSTRUMENTS ACT, 1881

The Negotiable Instruments Act was enacted, in India, in 1881 and it came into force on 1st March, 1881. Prior to its enactment, the provision of the English Negotiable Instrument Act were applicable in India, and the present Act is also based on the English Act with certain modifications. It extends to the whole of India except the State of Jammu and Kashmir. The Act operates subject to the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934

Definition
A "negotiable instrument" means a promissory note, bill of exchange or cheque payable either to order or to bearer.

Explanation (i) - A promissory note, bill of exchange or cheque is payable to order which is expressed to be so payable or which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable.
Explanation (ii) - A promissory note, bill of exchange or cheque is payable to bearer which is expressed to be so payable or on which the only or last endorsement is an indorsement in blank.
Explanation (iii) - Where a promissory note, bill of exchange or cheque, either originally or by endorsement, is expressed to be payable to the order of a specified person, and not to him or his order, it is nevertheless payable to him or his order at his option.
(2) A negotiable instrument may be made payable to two or more payees jointly, or it may be made payable in the alternative to one of two, or one or some of several payees. The word negotiable means 'transferable by delivery,' and the word instrument means 'a written document by which a right is created in favour of some person.' Thus, the term "negotiable instrument" literally means 'a written document which creates a right in favour of somebody and is freely transferable by delivery.'
A negotiable instrument is a piece of paper which entitles a person to a certain sum of money and which is transferable from one to another person by a delivery or by endorsement and delivery.
"According to **Blackburn J**, a negotiable instrument has two characteristics namely
1. It is transferable, like cash, by delivery (which assumes it is in a deliverable state) so that the transferee can enforce the rights embodied in it in his own name.
2. The transferee being a bonafide holder for value can acquire a better title to it than that of his transferor."
Negotiable Instrument is moreover a document of title which clearly explains the rights towards the payment of money or a security for money which is transferable by delivery either by custom or by legislation. The use of negotiable Instrument is mainly to facilitate payment for exports and imports of trade. The rapid growth of technology has revolutionized the world with computer, which is used in every field of profession. This has reduced the use of negotiable instrument and in future it may decline more. Even though the electronic revolution has got more advantages it may be considered as the next step because the world needs time to get used to it. But, the negotiable instrument are still in use.

Characteristics of Negotiable Instruments
1. Free transferability or easy negotiability
Negotiable instrument is freely transferable from one person to another without any formality. The property (right of ownership) in these instruments passes by either endorsement and delivery (in case it is payable to order) or by delivery merely (in case it is payable to bearer) and no further evidence of transfer is needed.

2. Title of holder is free from all defects

A person who takes negotiable instrument bona-fide and for value gets the instrument free from all defects in the title. The holder in due course is not affected by defective title of the transferor or of any other party.

3. Transferee can sue in his own name without giving notice to the debtor:

A bill, promissory note or a cheque represents a debt, i.e., an "actionable claim" and implies the right of the creditor to recover something from the debtor.

The creditor can either recover this amount himself or can transfer his right to another person.

In case he transfers his right, the transferee of a negotiable instrument is entitled to sue on the instrument in his own name in case of dishonour, without giving notice to the debtor of the fact that he has become holder.

In case of transfer or assignment of an ordinary "actionable claim" i.e., a book debt evidenced by an entry by the creditor in his account book, under the transfer of property act, notice to the debtor is necessary in order to make the transferee entitled to sue in his own name.

4. Presumptions:

Certain presumptions apply to negotiable instruments. Section 118, 119 and 139 lay down the following presumptions:

(a) For consideration : that every negotiable instrument, was made, drawn, accepted, endorsed or transferred for consideration.

(b) As to date : that every negotiable instrument bearing a date was made or drawn on such date.

(c) As to time of acceptance : that every bill of exchange was accepted within a reasonable time after its date and before its maturity.

(d) As to transfer: that every transfer of a negotiable instrument was made before its maturity

(e) As to time of endorsements : that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.

(f) As to stamps : that a lost promissory-note, bill of exchange or cheque was duly stamped.

(g) As to a holder in due course: that every holder of a negotiable instrument is holder in due course (this presumption would not arise where it is proved that the holder has obtained the instrument from its lawful owner, or from any person in lawful custody thereof, by means of an offence, fraud or for unlawful consideration and in such a case the holder has to prove that he is a holder in due course

(h) As to dishonour: that the instrument was dishonoured, in case a suit upon a dishonoured instrument is filed with the court and the fact of protest is proved.

Section 139 - Presumption in favour of holde:

It shall be presumed, unless the contrary is proved, that the holder of a cheque received the cheque of the nature referred to in section 138 for the discharge, in whole or in part, of any debt or other liability. "The effect of these presumptions is to place the evidential burden on the accused of proving that the cheque was not received by the complainant towards the discharge of any liability. Because both sections 138 and 139 require that the court shall presume the liability of the drawer of the cheques for the amounts for which the cheques are drawn…it is obligatory on the courts to raise this presumption in every case where the factual basis for the raising of this presumption had been established. It introduced an exception to the general rule as to the burden of proof in criminal cases and shifts the onus on to the accused."

Types of Negotiable Instruments

There are two types of Negotiable instruments:-

Negotiable Instruments recognized by statutes: The Negotiable Instruments Act mentions only three kinds of negotiable instruments **(Section 13)**.

These are: **1. Promissory Notes**
2. Bills of Exchange, and
3. Cheques

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Negotiable instruments recognized by usage or customs of trade: There are certain other instruments which have acquired the characteristic of negotiability by the usage or custom of trade.
For example: Exchequer bills, Bank notes, Share warrants, Circular notes, Bearer debentures, Dividend warrants, Share certificates with blank transfer deeds, etc.

Promissory Note

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

Parties to a Promissory Note

There are primarily two parties involved in a promissory note. They are:
(i) The Maker or Drawer: The person who makes the note and promises to pay the amount stated therein.
(ii) The Payee – The person to whom the amount is payable i.e. to whom the payment is to be made is called a payee.

In course of transfer of a promissory note by payee and others, the parties involved may be –
(a) The Endorser – the person who endorses the note in favour of another person.
(b) The Endorsee – the person in whose favour the note is negotiated by endorsement.

Characteristics of Promissory Note

1. It must be in writing:

A promissory note has to be in writing
An oral promise to pay does not become a promissory note
The writing may be on any paper or book
Illustrations: A signs the instruments in the following terms:
"I promise to pay B or order Rs.500/-"
"I acknowledge myself to be indebted to B in Rs.1,000/- to be paid on demand, for value received"
Both the above instruments are valid promissory notes.

2. It must contain a promise or undertaking to pay:

There must be a promise or an undertaking to pay
The undertaking to pay may be gathered either from express words or by necessary implication.
A mere acknowledgement of indebtedness is not a promissory note, although it is valid as an agreement and may be sued upon as such
Illustrations: A signs the instruments in the following terms:
"Mr. B I owe you Rs.1,000"
"I am liable to pay to B Rs.500"
The above instruments are not promissory notes as there is no undertaking or promise to pay. There is only an acknowledgement of indebtedness.
Where A signs the instrument in the following terms:
"I acknowledge myself to be indebted to B in Rs.1,000, to be paid on demand, for value received," there is a valid promissory note

3. The promise to pay must be unconditional:

A promissory note must contain an unconditional promise to pay
The promise to pay must not depend upon the happening of some uncertain event, i.e., a contingency or the fulfillment of a condition
Illustrations: A signs the instruments in the following terms:
"I promise to pay B Rs. 500 seven days after my marriage with C"

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"I promise to pay B Rs. 500 as soon as I can"
The above instruments are not valid promissory notes as the payment is made depending upon the happening of an uncertain event which may never happen and as a result the sum may never become payable

4. It must be signed by the maker: It is imperative that the promissory note should be duly authenticated by the 'signature' of the maker
'Signature' means the writing or otherwise affixing a person's name or a mark to represent his name, by himself or by his authority with the intention of authenticating a document.
5. The maker must be a certain person:
The instrument must itself indicate with certainty who is the person or are the persons engaging himself or themselves to pay
Alternative promisors are not permitted in law because of the general rule that "where liability lies no ambiguity must lie"

6. The payee must be certain:
Like the maker the payee of a pronote must also be certain on the face of the instrument
A note in favour of fictitious person is illegal and void
A pronote made payable to the maker himself is a nullity, the reason being the same person is both the promisor and the promisee

7. The undertaking must be to pay a certain and definite sum of money only.
For a valid pronote it is also essential that the sum of money promised to be payable must be certain and definite
The amount payable must not be capable of contingent additions or subtractions
Illustrations: A signs the instruments in the following terms:
"I promise to pay B Rs.500 and all other sums which shall be due to him"
"I promise to pay B Rs.500, first deducting thereout any money which he may owe me"
The above instruments are invalid as promissory notes because the exact amount to be paid by A is not certain

8. The amount payable must be in legal tender money of India:
A document containing a promise to pay a certain amount of foreign money or to deliver a certain quantity of goods is not a pronote. The payment must be in a legal money of the country.
9. Revenue stamps or requisite value under the stamp Act of the country should be affixed.
10. Other matters of form like number, date, place etc, are usually found given in notes, but they are not essentials in law.
11. A bank note or a currency note is not a promissory note within the meaning of this section.
12. A promissory note cannot be made payable to bearer on demand.

Bill of Exchange

Definition: Section 5 of the Negotiable Instruments Act defines a Bill of Exchange as follows:
"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." It is also called a Draft.
Illustration:
Mr. X purchases goods from Mr. Y for Rs.1000/-
Mr. Y buys goods from Mr. S for Rs.1000/-
Then Mr. Y may order Mr. X to pay Rs.1000/- Mr. S which will be nothing but a bill of exchange.

Parties to a Bill of Exchange

There are three parties involved in a bill of exchange
(i) The Drawer – The person who makes the order for making payment.
(ii) The Drawee – The person to whom the order to pay is made. He is generally a debtor of the drawer. The person directed to pay the money by the drawer is called the drawee.
(iii) The Payee – The person to whom the payment is to be made. The person named in the instrument, to whom or to whose order the money are directed to be paid by the instruments are called the payee.

The drawer can also draw a bill in his own name thereby he himself becomes the payee. Here the words in the bill would be Pay to us or order.
In a bill where a time period is mentioned, is called a Time Bill.
But a bill may be made payable on demand also. This is called a Demand Bill.

Essentials of a Bill of Exchange

1. **It must be in writing**
2. **It must contain an order to pay. A mere request to pay on account, will not amount to an order**
3. **The order to pay must be unconditional**
4. **It must be signed by the drawer**

   The drawer, drawee and payee must be certain. A bill cannot be drawn on two or more drawees but may be made payable in the alternative to one of two or more payees
5. **The sum payable must be certain**
6. **The bill must contain an order to pay money only**
7. **It must comply with the formalities as regards date, consideration, stamps, etc**

Cheque

Definition: A cheque is 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. (Sec. 6, NIA)
Explanation I - For the purposes of this section, the expressions-
(a) 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 signature) and asymmetric crypto system;
(b) 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 II - For the purposes of this section, the expression 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.

A cheque is a kind of bill of exchange but it has additional qualification namely-

1. **It is always drawn on a specified banker and**
2. **It is always payable on demand without any days of grace.**

Parties to a cheque
Drawer: Drawer is the person who draws or makes the cheque.
Drawee: Drawee is the drawer's banker on whom the cheque has been drawn.
Payee: Payee is the person who is entitled to receive the payment of a cheque.

Crossing of Cheques

A Crossed Cheque is one which bears across its face two parallel transverse lines with or without certain words. Such lines are usually drawn on the left side top corner of the face of the Cheque. However, such lines can be drawn anywhere on the face of the Cheque.
Crossing of Cheque is a direction to the drawee bank to pay the amount of the Cheque to a bank or to a particular bank. Therefore, a crossed Cheque is not payable to the payee or holder at the counter of the bank. In order to get the payment of the Cheque, it is required to be deposited in an account with a bank. The bank, in turn, presents the Cheque to the drawee bank and gets payment on behalf of the payee or indorsee of the Cheque.
The objects of crossing of a Cheque are as follows:
To direct the drawee bank to pay the amount of the Cheque only to a bank or a particular bank;
To prevent the payment of the Cheque to an unauthorized or wrong person.

KINDS OF CROSSING
Crossing of Cheque is basically of two kinds:-

1. **General crossing, and**
2. **Special crossing.**

These basic kinds of crossing may take several forms. Some of them are:

3. **Restrictive crossing.**
4. **Not negotiable crossing.**

1. General crossing: A Cheque is deemed to be generally crossed in any of the following cases:

a. When it bears across its face two parallel transverse lines without any words.
b. When it bears across its face an addition of the words "and company" or any abbreviation thereof between two parallel transverse lines. It may also be with or without the words 'Not negotiable'.

Effects of general crossing
The Cheque is not payable at the counter of the bank.
The drawee bank shall pay the amount of the Cheque only to a banker. Therefore, the holder will have to deposit the Cheque in an account with any banker. [Sec. 126 Para 1]

2. Special crossing: A Cheque is said to be specially crossed when the name of a banker is added across the face of the Cheque, either with or without words, not negotiable. Usually, two parallel transverse lines are used in special crossing but they are required not by law.

Effects of special crossing:
In the case of a Cheque especially crossed, the payment can be obtained only through the particular banker whose name appears across the face of the Cheque or his agent for collection.[Sec. 126, para2]

3. Restrictive crossing: Restrictive crossing has not been described anywhere in the Negotiable Instrument Act. It is a type of crossing which has evolved out of business and banking usage and now recognized by the law. Every Cheque crossed wither generally or specially may be crossed restrictively credit the proceeds of the Cheque only to the account of the payee.
4. Not negotiable crossing: Sometimes, a Cheque crossed generally or specially contains the words 'not negotiable' A crossing with such words is said to be 'not negotiable' crossing.
The words 'not negotiable' on a crossed Cheque destroy the negotiable character of the Cheque but not the transferability of the Cheque. Therefore, any person taking a crossed Cheque bearing the words 'not negotiable' shall not have and shall not be capable of giving a better title to the Cheque than the title of the person from whom he took it. [Sec. 130]

Parties to a Negotiable Instrument:

Holder and Holder in due course

Holder (Sec. 8, NIA)

Holder means any person entitled in his own name to the possession a promissory note bill of exchange or cheque and to recover or receive the amount due thereon from the parties thereon. A holder must therefore have the possession of the instrument and also the right to recover the money in his own name.

Therefore, **holder of a negotiable instrument is the person:**

1. **Who is entitled in his own name to the possession of the instrument, and**
2. **Who has the right to receive or recover the amount due thereon from the parties thereto.**

Characteristics:

a) **Entitled to possession of an instrument**
b) **Entitled to receive or recover the amount**
c) **Holder of lost or destroyed instrument**

Who can be a Holder?

i. **Payee**
ii. **Indoresee**
iii. **Bearer**
iv. **Legal representative or heir**

Who is Not a Holder?

i. **Agent**
ii. **Servant**
iii. **Beneficial**
iv. **Thief or finder**
v. **Forged indorsee**

Powers of Holder

I. **He is entitled in his own name to the possession of the instrument.**
II. **He can receive or recover the amount due on the instrument.**
III. **If necessary, he can sue the parties in order to recover the money due on the instrument.**
IV. **He can validly discharge the instrument on payment of the instrument.**
V. **He may indorse the instrument to any other person**

"Holder in due course" (Sec. 9, NIA)

Holder in due course means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to the bearer or the payee or indrosee thereof, if payable to the order before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from who he derived his title'

Thus, a person is a holder in due course if he satisfies the following conditions:

a) **He must be a holder (possessor) of a negotiable instrument.**
b) **He must have become holder (possessor) of the instrument for consideration.**
c) **He must have become holder before maturity of the instrument.**
d) **He must have obtained the instrument in good faith.**
e) **He must have received the instrument complete and regular on the face of it.**

RIGHTS AND PRIVILEGES OF HOLDER IN DUE COURSE

A holder in due course enjoys certain rights and privileges. They are available in the following particular cases:

In case of an inchoate instrument: Sometimes a person signs a stamped but otherwise incomplete (inchoate) instrument and delivers it to another person. In such a case, it implies that the holder may fill in any amount for which authority has been given by the maker.
In case of a fictitious bill: Sometimes the name of the drawer or the payee or both is fictitious in a bill. Such a bill is called a fictitious bill. The acceptor of such a fictitious bill is not liable to the holder of the bill. But if the same bill is passed on to a holder in due course, he will have a privilege to claim money on it from the acceptor. [Sec.42]
In case of the liability of prior parties: A holder in due course has a privilege to hold every prior party to a negotiable instrument liable on it until the instrument is duly satisfied. [Sec.36]
In case of instrument without consideration: Sometimes an instrument is made, drawn, accepted, indorsed or transferred without consideration. But, if the same instrument comes into the hands of a holder in due course, he has a privilege to recover the amount from any party thereto [Sec.43]
In case of transfer of title to a subsequent holder: A holder in due course has a privilege to transfer the title to an instrument free from all defects to subsequent holder. Therefore, any holder of a negotiable instrument who derives title to a negotiable instrument from a holder in due course enjoys all the rights and privileges of that holder in due course.
In case of an instrument obtained by unlawful means or for unlawful consideration: Sometimes, a person gets a lost instrument or obtains an instrument by means of an offence (i.e. by stealing or defrauding). In such a case, the holder cannot claim any right against the party liable on it. But if the same instrument is negotiated to a holder in due course, he will get good title to it.

DISTINCTION BETWEEN HOLDER AND HOLDER IN DUE COURSE

Basis of Distinction	Holder	Holder in Due Course
1. Definition	Holder is a person who is entitled in his own name to the possession of the instrument and to receive the amount due on it.	Holder in due course is a person who becomes the possessor of the instrument for consideration before its maturity and in good faith. [Sec. 9]
2. Consideration	A holder need not necessarily acquire the instrument for consideration. For instance, a holder may get the instrument by way of gift.	A holder in due course can acquire the instrument for consideration only.
3. Before maturity	A holder may obtain possession before or after the maturity of the instrument.	A holder in due course must obtain the possession before maturity of the instrument.
4. Good faith	A holder need not necessarily acquire possession of the instrument in good faith.	A holder in due course must always acquire possession of the instrument in good faith.
5. Inchoate instrument	A holder can claim only the amount which signer of the inchoate instrument intended to pay.	A holder in due course can claim any amount filled in the inchoate instrument provided it is covered by the stamp affixed on it. [Sec. 20]
6. Right against prior parties	A holder does not have rights against all the prior parties. He has rights against the original parties and his immediate indorser.	A holder in due course has rights against every prior party to the instrument. He can hold them liable jointly and severally.[Sec. 36]
7. Title better than the transferor	A holder can never get a better title than that of the transferor.	A holder in due course can acquire a better title than that of the transferor. In other words he gets the instrument cleansed of all prior defects.

Negotiation

One of the essential features of a negotiable instrument is its transferability. A negotiable instrument may be transferred from one person to another in either of the followings way-

1. **By negotiation**
2. **By assignment**

1) By negotiation - The transfer of an instrument by one party to another so as to constitute the transferee a holder is called Negotiation. Negotiation means as the process by which a third party is constituted the holder of the instrument so as to entitle him to the possession of the same and to receive the amount due thereon in his own name.
According to section 14 of the Act, "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." The main purpose and essence of negotiation is to make the transferee of a promissory note, a bill of exchange or a cheque the holder there of.

Modes of negotiation (Sec. 47 and 48, NIA)
1. Negotiation by delivery (Sec. 47): Where a promissory note or a bill of exchange or a cheque is payable to a bearer, it may be negotiated by delivery thereof.
Example: A the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep it for B. The instrument has been negotiated.

2. Negotiation by delivery (Sec. 48):
A promissory note, a cheque or a bill of exchange payable to order can be negotiated only be endorsement and delivery. Unless the holder signs his endorsement on the instrument and delivers it, the transferee does not become a holder. If there are more payees than one, all must endorse it.

2) By Assignment –
When a holder of a bill, promissory note or cheque transfers the same to another, he in fact gives his right to receive the payment of the instrument to the transferee.

Difference between Assignment & Negotiation:-

1) Mode of transfer- The transfer by negotiation requires only delivery with or without endorsement of a bearer or order instrument. Whereas the transfer by assignment requires a separate written document such as transfer deed signed by the transferor.
2) Notice of transfer-Not require in negotiation
3) Consideration-consideration must be proved in assignee.
4) Title
5) Right to sue

Endorsement

The word "endorsement" in its literal sense means, writing on the back of an instrument. But under the Negotiable Instruments Act, it means, the writing of one's name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein. Thus, endorsement is signing a negotiable instrument for the purpose of negotiation. The person who effects an endorsement is called an "endorser", and the person to whom negotiable instrument is transferred by endorsement is called the "endorsee". Who may Endorse / Negotiate [Section 51]: Every Sole maker, drawer, payee or endorsee, or all of several joint makers, drawers, payees or endorsees of a negotiable instrument may endorse and negotiate the same if the negotiability of such instrument has not been restricted or excluded as mentioned in Section 50.

When the maker or holder of a negotiable instrument signs the instrument (otherwise than as maker) for the purpose of its negotiation, it is said to be the Endorsement of the instrument. **[Section 15]**

Essentials of a Valid Endorsement: Following are the essentials of a valid endorsement:
1. Indorsers must be holder: For a valid Endorsement, the indorser must be holder of the instrument. In other words, indorser must be entitled in his own name to the possession of the instrument and recover or receive the amount due thereon. Therefore, a person who steals or finds a lost instrument cannot indorse the instrument because he is not a holder.
2. On the instrument: Endorsement must be on the face or back of the instrument or on a piece of paper annexed to the instrument.
3. Signature: Endorsement must be signed by the indorser for the purpose of negotiation of the instrument. It may be signed by the maker or holder of the instrument but the maker must not sign the Endorsement in the capacity of the maker.
4. Additional words and form of words: Indorser may sign the Endorsement with a without additional words or statement.
5. Endorsement by joint holders: An Endorsement is valid only when all joint holders (i.e. all makers, drawers, indorsees or payees) join in Endorsement unless any one of them has the authority to indorse for the others.
6. Endorsement of entire instrument: Endorsement must be of the entire instrument. An Endorsement which purports to transfer only a part of the amount of the instrument is not a valid Endorsement.
7. Delivery: In order to make a complete and effective Endorsement, the instrument must be delivered by the indorser to the indorsee.

8. It must be made by the holder of the instrument.
9. It must be completed by the delivery of the instrument.
10.It must be signed by the endorser. It must be on the back or face of instrument or on a slip of paper annexed thereto.

Persons Entitled to Indorse:

1. **Payee**
2. **Maker, drawer or holder**
3. **Indorsee**
4. **Joint makers, drawers etc.**

Kinds of Endorsements

1. Blank or general Endorsement: When the indorser signs his name only on the instrument for the purpose of its negotiation, it is called the blank or general Endorsement. Illustration: Anta has a Cheque payable to 'Anta or order' Anta merely signs on the instrument. It constitutes a blank Endorsement.
2. Full or special Endorsement: When an indorser signs his name and adds a direction to pay the amount mentioned in the instrument to or to the order of a specified person, it is called the Endorsement in full. Illustration: Anita is a holder of a Cheque. He writes 'Pay Banta or Order or Pay Banta only' and signs the Cheque. It is a full or special Endorsement.
3. Restrictive Endorsement: Illustration: (a) 'Pay the contents to Banta only'. (b) 'Pay Banta for my use'.
4. Partial Endorsement: Sometimes, an Endorsement purports to transfer only a part of the amount of the instrument. Such an Endorsement is called as partial Endorsement. It is not a valid Endorsement for the purpose of negotiation.
5. Conditional or qualified Endorsement: When an indorser inserts a condition in his Endorsement, it is called a conditional Endorsement. Sometimes, an indorser by express words in the Endorsement may exclude his liability on the instrument makes the right of the indorsee to receive the amount due

thereon on the happening of a specified event or on the implement of some condition. In such a case, the Endorsement is said to be conditional.

Effects of Endorsement:

1. An unconditional Endorsement of a negotiable instrument followed by an unconditional delivery of the instrument has the following effects:
2. The property in the instrument stands transferred to the indorsee.
3. The indorsee gets the right of further negotiation of the instrument [Sec. 50]
4. The indorsee is entitled to sue all parties, whose names appear on it.

Discharge of a negotiable instrument

"**Discharge means release from obligation**." Discharge can take place-

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 Negotiable Instruments Act, 1881 4.5 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 up to the party primarily liable.

4) **By Cancellation:** Where an instrument is intentionally cancelled by the holder or his agent and the cancellation is apparent 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 innovation or rescission or by expiry of period of limitation.

Dishonour of a negotiable instrument

An instrument is said to be dishonored when the acceptance and/or payment is refused on a duly presented instrument. Thus, a negotiable instrument may be dishonored in two ways:

1. **by non acceptance, and**
2. **by non payment**

Dishonor by Non-acceptance:

Only a bill may be dishonored by non acceptance. A bill is deemed to be dishonored by non acceptance in any of the following cases:

a. **Refused to accept**
b. **Not signed by all the drawees**
c. **Not accepted by any partner**
d. **Bill not accepted within forty eight hours.**
e. **Drawee could not be found**

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Dishonour by Non-payment:

a. **Default in payment**
b. **When excused from presentment**

On the dishonour of a cheque, one can file a suit for recovery of the cheque amount along with the cost & interest under order XXXVII of Code of Civil Procedure 1908 (which is a summary procedure and) can also file a Criminal Complaint u/s 138 of Negotiable Instrument Act for punishment to the signatory of the cheque for haring committed an offence. However, before filing the said complaint a statutory notice is liable to be given to the other party.

NOTICE OF DISHONOUR

When a negotiable instrument is dishonored by non acceptance (bill) or by non-payment, the holder may sue against the parties liable for the same. But he can do so only when he has served a formal notice to the effect.

The notice of dishonor is necessary for two reasons:

a. **To warn the party about his liability.**
b. **To secure rights of the holder**

Notice by Whom?

The notice of dishonor may be given by any of the following:

i. **By the holder.**
ii. **By any party receiving the notice of dishonor. He may do so if he wants to hold any prior party liable to himself.**
iii. **By an agent of the holder**

Notice to Whom?

i. **To all prior parties.**
ii. **To some one of the several parties.**
iii. **To an agent of the person.**
iv. **To the legal representative, in case the party liable is dead.**
v. **To the official assignee, in case the party liable has been declared insolvent.**

Time and Place of Notice:

i. The notice must be given within a reasonable time after dishonour.
ii. The notice must be given at the place of business. In case the party has no place of business, it must be given at the residence of the party.

Dishonour of certain cheques for insufficiency of funds

Provided that nothing contained in this section shall apply unless-

(a) the cheque has been presented to the bank within a period of three months from the date on which it is drawn or within the period of its validity, whichever is earlier;

(b) the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice in writing, to the drawer of the cheque within thirty days of the receipt of information by him from the bank regarding the return of the cheque as unpaid; and

(c) the drawer of such cheque fails to make the payment of the said amount of money to the payee or as the case may be, to the holder in due course of the cheque within 15 days of the receipt of the said notice.

Explanation - For the purposes of this section, debt or other liability means a legally enforceable debt or other liability.

Ingredients of the offence under Section 138, NIA: It is manifest that to constitute an offence under Section 138 of NIA, the following ingredients are required to be fulfilled:

1. a person must have drawn a cheque on an account maintained by him in a bank for payment of a certain 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; that cheque has been presented to bank within a period of three months from the date on which it is drawn or within the period of its validity whichever is earlier;
2. that cheque is returned by the bank unpaid, either because of the amount of money standing to the credit of the account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with the bank;
3. the payee or the holder in due course of the cheque makes a demand for the payment of the said amount of money by giving a notice in writing, to the drawer of the cheque, within 30 days of the receipt of information by him from the bank regarding the return of the cheque as unpaid;
4. The drawer of such cheque fails to make payment of the said amount of money to the payee or the holder in due course of the cheque within 15 days of the receipt of the said notice.

Section 139 - Presumption in favour of holder

It shall be presumed, unless the contrary is proved, that the holder of a cheque received the cheque of the nature referred to in section 138 for the discharge, in whole or in part, of any debt or other liability. The effect of these presumptions is to place the evidential burden on the accused of proving that the cheque was not received by the complainant towards the discharge of any liability. Because both sections 138 and 139 require that the court shall presume the liability of the drawer of the cheques for the amounts for which the cheques are drawn…it is obligatory on the courts to raise this presumption in every case where the factual basis for the raising of this presumption had been established. It introduced an exception to the general rule as to the burden of proof in criminal cases and shifts the onus on to the accused.

NOTING

Meaning – Noting is the process of recording the fact and reasons of dishonor of negotiable instrument by the notary public upon the dishonored instrument. In other words, noting consists of recording and authenticating the fact and reasons of dishonor of a negotiable instrument by the notary public.

Need – Noting is not compulsory in the case of an inland bill or note. But noting serves as an authentic and official proof of dishonor of an instrument by non acceptance or non-payment. It serves as an evidence of dishonor of a negotiable instrument in the legal proceedings before the Court.

Procedure of Noting – When a promissory note or a bill of exchange is dishonoured, the holder may request within a reasonable time after its dishonor to a notary public for its noting. On receipt of the request, the notary public takes following steps:
The notary public makes a formal demand upon the acceptor or maker for acceptance or payment. It may be noted that such demand may be made either by the notary public personally or by his clerk. If authorized by agreement or usage, the demand may be made by a registered letter.
When it is not then accepted or paid, the notary public records the fact of dishonor upon the instrument, or upon a paper attached thereto or party upon each.

Such a note must specify the following things:

a) The fact of dishonour.
b) The date of dishonor of the instrument.
c) The reasons, if any, assigned for such dishonor.
d) If the instrument has not been expressly dishonored, the reasons why the holder treats it as dishonored.
e) The notary's charges. [Sec. 99]

In addition, the notary public also makes a reference of his register and puts signature with seal on the instrument.

PROTEST

Protest is a certificate issued by a notary public attesting the fact of dishonor of a negotiable instrument recorded upon the dishonored instrument.

Contents of protest

1. The instrument itself or a literal transcript of it which must contain everything written or printed thereon.
2. The name of the person for whom and against whom the instrument has been protested.
3. A statement that payment or acceptance, or better security (as the case may be) has been demanded of such person by the notary public; and the terms of his answer, if any
4. If the person gave no answer, or that he could not be found a statement to that effect.
5. The date, place and time of dishonor of the instrument. If better security has been refused; the place and time of refusal.

Distinction between Noting and Protest

The notice is different from protest on the following grounds:

Nature - Noting consists of recording the fact and reasons of dishonor of a negotiable instrument upon the instrument. Protest is a certificate as to fact and reasons that an instrument has been dishonored or the acceptor has refused to give a better security for the bill.

Contents - The contents of noting are limited to the date and reasons (express or implied) of dishonor. But contents of protest are more detailed as specified under Section 101.

Scope - Noting can be done even without protest but protest is issued only after the noting has been done.

Requirement - Noting is optional in case of inland bill or note. But a foreign bill must be protested if it is required by the law of the place where they are drawn.

Conclusion

Negotiable Instruments plays a major role in the trade world. We can also see the use of negotiable instruments in the international trade. We can assume that the international trade is also developing with the negotiable instrument. The nature of negotiable instrument is an area of law which has major influence on any person in his professional field. Negotiable instrument plays a major role in different part of the world in raising the economy. The negotiable instrument is of contractual in nature and it characterizes the fact that it is negotiable.